Treaty Application for Companies in a Group

Verdragstoepassing voor vennootschappen in een groep

Thesis

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Louisa Cornelia van Hulten
born in Waalwijk

Erasmus University Rotterdam

Doctoral Committee:

Promotors:	Prof.dr. P. Kavelaars
	Prof.mr.dr. M.F. de Wilde
Other members:	Prof.dr. I.J.J. Burgers
	Prof.dr. S.J.C. Hemels
	Prof.dr. A.J.A. Stevens

PREFACE

In January 2018, I decided it was time to pursue my research ambitions. While brainstorming about potential interesting topics, I soon realised that a tax treaty related topic would be perfect for me. I began to wonder why we attach so much importance to an entity's legal form for domestic and tax treaty purposes. The entire process required enthusiasm and persistence, but most of all I learned a lot.

Writing a book also requires the help from people around you. In this preface I would like to thank some of them especially. Firstly, my promotors prof.dr. P. Kavelaars and prof.mr.dr. M.F. de Wilde. Peter has contributed tremendously to my career so far. He supervised the first article I ever wrote (as part of the Deloitte Professorendiner in 2012). Also, I was part of his team at Deloitte for several years and am still part of the department he leads at the Erasmus University Rotterdam. I would like to thank him for his valuable comments. Maarten, thank you very much for the helicopter view you kept throughout this research to prevent me from losing sight of the bigger picture. Your comments certainly improved the structure and storyline a lot.

I would sincerely like to thank the assessment committee of this research, consisting of prof.dr. I.J.J. Burgers, prof.dr. S.J.C. Hemels and prof.dr. A.J.A. Stevens. Thank you so much for the time you put into reading the manuscript and providing feedback. From relatively small points to overarching feedback: it has helped me enormously. Also, many thanks to the members of the plenary doctoral committee for their willingness to discuss the findings on 20 October 2022: prof.mr.dr. P.G.H. Albert, prof.dr. L. De Broe and prof.dr. S. van Weeghel.

Furthermore, a word of thanks for my colleagues at the Dutch Institute for Taxation and Economics (FEI BV) of the Erasmus University Rotterdam: thank you for asking updates and for taking over part of my teaching and thesis supervising tasks so I would have more time for my research activities. Thanks for the support (special thanks to Ymke and Chantal)!

Thank you Deloitte for allowing me all the space I needed to conduct my research, and to support my research activities financially when university funding ended. Various of my Deloitte colleagues should be mentioned specifically here. It is great to be part of the Netherlands Knowledge Management team! A small team, in which everyone is very supportive of each other. My colleagues Mariëlle and René helped me out with translating and editing (especially Mariëlle, who enthusiastically read every word of this manuscript!), which I appreciate very much. Aart, thanks a lot for your continuous support and for giving me the time to fully focus on my PhD in the summer of 2021. Jasper, thank you for always making time to discuss my PhD (and non-PhD) issues. Debby, it is always great to arrive at the office and find the kiwi you saved me from the Deloitte fruit stash. Also, thanks Corina, Richard, Eddo, Reinier, Susan, Albert: I am glad that you are my team members.

Next to that, I would like to thank my paranymphs Anne and Megan. Anne, you were my friend since my first day as a student at Maastricht University. I think it is wonderful that years later our daughters are playing together while we are drinking tea. Megan, you have always positively influenced me with your ambitious mindset since we were both board members of the fiscal study association FIRST Maastricht.

A special word of thanks should go to my parents Kees and Marjo. Their door was always open, literally: a big part of this manuscript has been written in their home while tea and fruit were brought to my desk. I already had to promise them to continue scheduling those 'writing weeks' for writing articles. My brother Mart has also helped me a lot throughout the process by sharing his own PhD experiences. Being able to discuss my questions and doubts with him was of great value. Of course, my other brothers Niek and Luuk should be mentioned here as well: thanks for the welcome distractions and our great annual snowboarding trip to Fügen.

And last, but certainly not least: Jeroen and our daughter Noor, you are both great! Sorry Noor, that my PhD defence is on your 3rd birthday. I promise you that we will celebrate your birthday as well.

Loes van Hulten, 4 May 2022

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CHAPTER 1

Introduction and problem statement

1.1 Grounds for the research

Legal entities are usually not fully autonomous but are often part of a larger economic unit. There is often a certain connection with other legal entities, for instance if a legal entity holds all or part of the shares in another legal entity. The question arises under which conditions or circumstances such affiliation should lead to the conclusion that there is a group. Subsequently, the question arises whether the fact that a legal entity is part of a group has or should have consequences for the way in which this legal entity is taxed.

In many countries, a corporation is considered an independent legal entity for the purpose of levying profit tax on entities. In principle, such a legal entity is therefore taxed separately from any shareholders.[1] But various provisions of national corporate tax law do not always consider companies to be stand-alone entities. The underlying reasoning for this is, in essence, that following the legal reality would not be appropriate in today's internationally oriented world. It would lead to double taxation and would create opportunities for tax avoidance. For the purposes of taxation, we try to solve this issue with all kinds of ad hoc rules to still reflect the group situation as much as possible. This is the case, for instance, with Controlled Foreign Company (CFC) legislation, taxing low-taxed profits of a controlled foreign subsidiary once again at the level of its parent company. What's more, a group regime may apply which enables intra-group loss relief under certain conditions. The participation exemption is yet another example of a provision in the national legislation of many countries, which takes into account the existence of a certain connection between companies.

How does the above work out for international group situations involving cross-border income? For tax treaties based on the Model Tax Convention on Income and on Capital 2017 (OECD MTC) of the Organisation for Economic Co-operation and Development (OECD), the starting point is that each individual legal entity must be considered for the application of the treaty.[2] This is confirmed, inter alia, in art. 5, par. 7, OECD MTC, which states that the fact that a group company has control over another group company does not mean that the subsidiary is automatically a permanent establishment of the parent company. Such a subsidiary thus constitutes an independent legal entity for tax purposes. From this provision and the related Commentary by the OECD,[3] it can be concluded that a subsidiary is a legally independent entity for the application of tax treaties.

In treaty relations, deviation from the principle that entities in a group should be treated as separate entities is exceptional. An example is art. 9 OECD MTC, which states that affiliated entities must act as if they were independent parties. Another clear provision, which takes into account the potential existence of a group, is art. 10, par. 2, OECD MTC. This article provides that a parent company which holds at least 25% of the shares in a subsidiary is eligible for a reduction of withholding tax on dividend payments.

Is it logical to adopt a separate entity approach for the application of tax treaties? In many cases, the legal approach does not reflect the economic reality that an entity is usually part of a bigger enterprise with a shared profit motive.[4] Today, most multinational enterprises include hundreds of affiliated companies, often involving complex group structures. From an economic perspective, there may be a single company. This is reflected, for instance, in the consolidation rules that apply for accounting purposes. Also, in areas other than tax law, the group is sometimes taken into account rather than the individual group entities.[5]

It was stated some time ago that the separate entity approach underlying tax treaties is no longer appropriate in a globalising society.[6] As different tax regimes are applied to different types of income, taxpayers can for example recharacterize income[7] or can structure transactions to get the best tax result. The fact that there are various situations within group relationships in which the separate entity approach may lead to inconsistencies in

4 I.e., the more substantive reality, which is influenced by the economic relations between two or more parties.

5 For instance, competition law within the European Union is based on an enterprise approach, whereas for labour law the entity approach seems to prevail (K.E. Sørensen, 'Groups of Companies in the Case Law of the Court of Justice of the European Union', *European Business Law Review* 2016, vol. 27, no. 3).

6 R.J. Vann, 'A Model Tax Treaty for the Asian-Pacific Region?', *Legal Studies Research Paper* 2010, no. 10/122. According to Gurría the effects of globalization in general call for a re-examination of the international tax principles on which the OECD MTC is based (A. Gurría, 'Conference on the 50th Anniversary of the OECD Model Tax Convention, remarks by Angel Gurría', 2008, available at https://www.oecd.org/ctp/conferenceonthe50thanniversaryoftheoecdmodeltaxconvention-remarksbyangelgurria.htm, accessed 4 May 2022). Other well-known difficulties of existing tax treaties are in short: the bilateral nature of tax treaties (which leads to triangular cases and provides treaty shopping opportunities), the limited scope of tax treaties (as they generally only deal with income taxes), reciprocity (generally the same provisions will apply to residents of both states. However, as domestic tax systems differ, different rules for each country would be required), standardization (which makes it more difficult to justify specific provisions), and the relieving nature of tax treaties (which can lead to double non-taxation) (J. Sasseville, 'The Role of Tax Treaties in the 21st Century', par. 3, appendix to B. Arnold, J. Sasseville & E. Zolt, 'Summary of the Proceedings of an Invitational Seminar on Tax Treaties in the 21st Century', *Bulletin for International Taxation* 2002, vol. 56, no. 6). A more practical problem of the tax treaty network is that it is very difficult to update them. Taylor even compares treaties with Neanderthals: *'successful for a long period; adapted well to conditions that prevailed at a particular time; but not able to respond sufficiently quickly to changing circumstances.'* (C.J. Taylor, 'Twilight of the Neanderthals, or are Bilateral Double Taxation Treaty Networks Sustainable?', *Melbourne University Law Review* 2010, vol. 34, no. 1, p. 307).

7 Vann describes the possibility to transfer a patent in exchange for shares (producing dividend income), the possibility to transfer a patent and leave the purchase price outstanding as a loan (producing interest income) and the possibility to license a patent in exchange for a royalty (R.J. Vann, 'A Model Tax Treaty for the Asian-Pacific Region?', *Legal Studies Research Paper* 2010, no. 10/122, p. 10).

the application of treaties can be illustrated best by means of examples. Some stylised examples are given below.

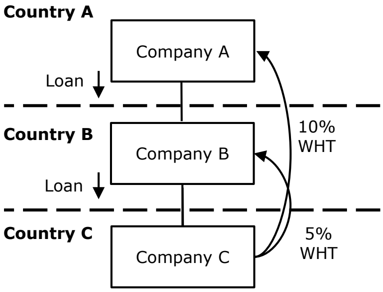

Figure 1.1

A multinational enterprise consists of three companies in three different countries: country A, country B and country C (see figure 1.1). Company A holds all the shares in company B, which in turn holds all the shares in company C. Under national law, only country C has the possibility to withhold tax on interest payments.[8] All three countries have concluded tax treaties with each other. Company C is in need of financing and company A can meet this need. The A-C tax treaty limits the possibility to withhold tax on interest payments to 10%.[9] The B-C tax treaty limits the withholding tax on interest payments to 5%. Hence, a direct financing by company A to company C is more unattractive in terms of withholding tax than a financing through company B, assuming that company B can be seen as the beneficial owner of the interest payment from C to B.[10] This form of treaty shopping is relatively simple within a multinational group and follows from the fact that a separate entity approach is applied.[11] In fact, tax avoidance is facilitated in this example. The loan through intermediary company B has no economic reality. Under a partial group approach, it could be argued that the reduced withholding tax rate of the B-C tax treaty should not be granted. However, it could also be argued that the possibility of withholding taxes in

8 Withholding taxes that are applied to payments to non-residents are often justified by referring to administrative issues with respect to the determination and collection of tax. Withholding at the time of payment seems the only realistic approach for the source country to collect its tax (H.J. Ault & J. Sasseville, 'Taxation and Non-Discrimination: A Reconsideration', *World Tax Journal* 2010, vol. 2, no. 2, par. 2.4.2).

9 In conformity with art. 11, par. 2, OECD MTC.

10 In country B, an arm's length spread should be taken into account in connection with the incoming and outgoing loan.

11 Of course, similar treaty shopping situations can arise in the context of dividends and royalties. E.g., for dividends, withholding taxes could be lowered by interposing a conduit company (S. Hebous, 'Chapter 4: Global Firms, National Corporate Taxes: An Evolution of Incompatibility', p. 49, in R.A. de Mooij, A. Klemm & V. Perry (eds.), *Corporate Income Taxes Under Pressure: Why Reform Is Needed and How It Could Be Designed*, Washington, DC: International Monetary Fund 2021). Another example of a tax avoidance structure involving loans is given in R. Offermanns & B. Baldewsing, 'Chapter 4: Anti-Base-Erosion Measures for Intra-Group Debt Financing', par. 4.2.1, in M. Cotrudt (ed.), *International Tax Structures in the BEPS Era: An Analysis of Anti-Abuse Measures*, Amsterdam: IBFD 2015. In that example the loan is granted via a low taxed financing company.

such group relationships should be fully restricted, as under a full group approach the internal loans would not be visible as such. Additionally, the example could lead to residual juridical double taxation. Such double taxation would be the result of the operation of the double tax relief in treaties: the withholding tax is levied as a percentage of the gross amount,[12] whereas the net amount is taken into consideration for determining the credit for taxes paid abroad.[13]

A second example shows that a separate entity approach may lead to double taxation. The structure remains unchanged. In this example, for dividend payments a maximum withholding tax of 10% applies under both the A-B and B-C tax treaties. Under national law, both country B and country C withhold tax on dividend payments. Company C pays a dividend of 100 to its shareholder. Withholding tax at a rate of 10% is deducted. Company B then pays the dividend to its shareholder and 10% withholding tax is deducted once again. On top of that, the dividend payment may be subject to profit tax at the level of both company B and company A. The double tax relief article in both tax treaties in principle provides for the elimination of double taxation for the concurrence of withholding tax and profit tax.[14] The fact that income tax has already been paid at the level of company C is irrelevant in this context. So, in this situation, the same dividend distribution is taxed multiple times. This double taxation is caused by the separate entity approach, while the very aim of tax treaties is to prevent double taxation. From an economic perspective, the amount of profit tax on dividend payments should not depend on the number of legal intermediaries. The double profit tax is levied on different entities, which results in economic double taxation. Tax treaties mainly aim at the avoidance of juridical double taxation. Nonetheless, the OECD Commentary explicitly states that economic double taxation of dividends is a major impediment to international investment.[15]

The OECD's Base Erosion and Profit Shifting (BEPS) project also implies that – according to the OECD – the separate entity approach is not sufficient in all cases. This is evident, for instance, from the reports on the adjustment of the permanent establishment rules.[16] According to the OECD, in certain cases the activities of group companies should be taken into account in determining whether there is a permanent establishment.[17] Without such a group approach, the existence of a permanent establishment could easily be circumvented.

12 Without taking into account the costs incurred for acquiring the respective income.

13 Commentary on art. 23 A and 23 B OECD MTC, par. 63 and E. Reimer et al., *Klaus Vogel on Double Taxation Conventions,* Alphen aan den Rijn: Kluwer Law International 2022, p. 937. This is also evident from the wording of the allocation rules in the treaties. The source state may withhold tax on '*the gross amount*' (e.g., art. 10, par. 2, OECD MTC), whereas the description of the taxing rights of the residence state does not include the term *gross*.

14 As discussed above, the withholding tax is levied as a percentage of the gross amount, whereas the credit for tax paid abroad is based on the net amount. Moreover, if the participation exemption is applied to the dividends, it is possible that no credit is available at all. This would mean that both corporate income taxes (at the level of company C) and withholding taxes would be levied.

15 Commentary on art. 23 A and 23 B OECD MTC, par. 49.

16 OECD, *Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 - 2015 Final Report*, Paris: OECD Publishing 2015.

17 See in this context, inter alia, the anti-fragmentation rule of art. 5, par. 4.1, OECD MTC. This provision relates to the activities of a taxpayer in connection with closely related enterprises.

However, the BEPS project solely closes loopholes instead of re-examining the rules.[18] Via the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) countries had the possibility to quickly and efficiently amend their tax treaties to combat tax avoidance in line with the OECD recommendations, without the need for renegotiation.

1.2 Problem statement

The issues outlined above raise the question of whether, in view of the objectives of the OECD MTC, the OECD MTC should have more regard to the fact that companies can be part of a group. Therefore, the problem definition of this research is:

> *From the perspective of the aim and purpose of the OECD MTC, should the separate entity approach for the application of treaty rules in the OECD MTC be replaced by a group approach? If so, what would this mean for the treaty rules?*

The central question of this research is, therefore, whether a change to the OECD MTC is desirable, from the perspective of the aim and purpose of the OECD MTC, and if so, what this would mean for the treaty rules.

The term *separate entity approach* refers to the legal approach that is the current foundation of the OECD MTC, i.e., to purely regard legal entities as separate entities for the purposes of tax treaties. The term *group approach* refers to a more substantive approach, in which facts and circumstances within the group to which a taxpayer belongs can affect the application of the treaty rules in the OECD MTC.[19] A group approach abstracts from the legal form of a corporate structure and follows the economic situation. As a result, tax treaties would reflect the economic reality – i.e., the economic relations – of multinational groups as closely as possible.

If the current treaty rules of the OECD MTC for entities that are part of a group turn out to be in line with the aim and purpose of the OECD MTC, the relevance of this research is that it shows that the current time frame does not require any changes. However, should changing the OECD MTC appear to be desirable, recommendations will be made to shape such a change. To do so, it should first of all be determined how the group concept should be defined. Furthermore, in view of the objectives of the OECD MTC it is important to examine which group problems should fall within the scope of tax treaties.

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18 M. Devereux & J. Vella, 'Are We Heading towards a Corporate Tax System Fit for the 21st Century?', *Fiscal Studies* 2014, vol. 35, no. 4, par. 1.

19 I.e., tax consequences for the entity depend on other taxable entities (International Fiscal Association, *Cahiers de Droit Fiscal International – Group approach and separate entity approach in domestic and international tax law (vol. 106a)*, Rotterdam: International Fiscal Association (IFA) 2022, p. 20).

Changed treaty rules in the OECD MTC do not automatically imply that the taxing rights can actually be effectuated on a national level.[20] After all, a tax treaty does not create taxing rights, it merely allocates them.[21] Thus, next to the recommendations provided to shape the OECD MTC, attention will also be paid to the principles on which the national taxing rights of countries should be based.

1.3 Assessment framework

To assess whether the current treaty rules of the OECD MTC for group entities are in line with the object and purpose of tax treaties, or whether changes are required, this research assesses the objectives of tax treaties as contained in the OECD MTC.[22] From the title and preamble of the OECD MTC it follows that the objectives of the Convention are to eliminate double taxation with respect to taxes on income and capital, without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance. The context of these purposes is the desire of the Contracting States to further develop their economic relationship and to enhance co-operation in tax matters. Double taxation can increase the overall tax burden of companies and can therefore negatively impact capital investments. The motivation to enter into a tax treaty is thus to promote and reduce barriers to international trade and investment.[23]

The OECD MTC focuses on eliminating international juridical double taxation.[24] The OECD defines international juridical double taxation as the imposition of comparable taxes in

20 States are free to choose the manner in which treaty obligations are adhered to in their domestic law. There are two main possibilities: monism (the treaty has direct legal effect) or dualism (the treaty should be implemented in domestic legislation). See in this regard, e.g., S. Sachdeva, 'Tax Treaty Overrides: A Comparative Study of the Monist and the Dualist Approaches', *Intertax* 2013, vol. 41, no. 1, par. 1.

21 Tax treaties restrict the application of domestic law. A country can thus apply its domestic law, unless it is prohibited by a tax treaty to do so. For some thoughts on whether it could be the other way around see P. Kavelaars, 'Bouwstenen en het internationale fiscale recht', *Tijdschrift voor Fiscaal Ondernemingsrecht* 2021/173.6, par. 2.1. See also par. 6.3.8.5.

22 See, e.g., Introduction OECD MTC, par. 1 and 2.

23 Next to removing trade barriers, another important objective that was key to international taxation as it was conceived in the 1920s is that the national sovereignty of states should be preserved (S. Wilkie, 'New Rules of Engagement? Corporate Personality and the Allocation of "International Income" and Taxing Rights', p. 353, in B.J. Arnold (ed.), *Tax Treaties After the BEPS Project: A Tribute to Jacques Sasseville*, Toronto: Canadian Tax Foundation 2018).

24 Introduction OECD MTC, par. 1. The rules in the OECD MTC/the OECD Commentary do not provide details on how the exemption or credit to prevent double taxation should be computed (Commentary on art. 23 A and 23 B OECD MTC, par. 32). Apart from preventing juridical double taxation, economic double taxation with respect to the application of art. 9 OECD MTC is mitigated via a common understanding of the arm's length principle (additionally, art. 25 OECD MTC provides a framework to resolve economic double taxation after application of art. 9 OECD MTC, see Commentary on art. 25 OECD MTC, par. 10). After applying the OECD MTC, economic double taxation with respect to distributed dividends remains. Economic double taxation occurs if two different taxpayers are taxed by two (or more) states for one tax object. Is double taxation as such a problem? It can be said that it is solely unjust when '*one taxpayer is assessed twice while another in substantially the same class is assessed but once.*' (E.R.A. Seligman, *Essays in Taxation*, New York: Macmillan and Co. 1925, p. 99). From this point of view it is logical that tax treaties are mainly focused on the elimination of juridical double taxation (F. De Lillo, 'Chapter 1: In Search of Single Taxation', par. 1.2.4.2, in J.C. Wheeler (ed.), *Single Taxation?*, Amsterdam: IBFD 2018).

two or more states on the same taxpayer in respect of the same subject matter and for identical periods.[25] The importance of avoiding double taxation is justified by the OECD by pointing out the obstacles it creates to international trade.[26] The primary focus is thus on the development of the economic relationship of treaty states as a result of unhindered cross-border movements of trades, capital and people.[27] According to the OECD member countries, it is desirable to clarify, standardize and confirm the tax situation of taxpayers, who carry out commercial, industrial, financial or other activities in other countries. Therefore, there should be common solutions for identical cases to eliminate double taxation.[28] Through the use of tax treaties, Contracting States aim to prevent cross-border services, trade and investment from being hampered by the risk of double taxation due to the concurrence of two tax systems.[29] By stimulating cross-border trade and investment, the OECD MTC can contribute to the overall goal of the OECD: '*shape policies that foster prosperity, equality, opportunity and well-being for all.*'[30] The underlying presumption seems to be that tax treaties stimulate job creation and positively influence economic growth.[31]

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25 Introduction OECD MTC, par. 1. There are three main variants of juridical double taxation: residence-residence, source-source and source-residence (S. Leduc & G. Michielse, 'Chapter 8: Are Tax Treaties Worth It for Developing Economies?', p. 140, in R.A. de Mooij, A. Klemm & V. Perry (eds.), *Corporate Income Taxes Under Pressure: Why Reform Is Needed and How It Could Be Designed,* Washington, DC: International Monetary Fund 2021). Most countries apply worldwide taxation for residents. If both Contracting States view the taxpayer as a resident in their jurisdiction, residence-residence double taxation is the result. The tiebreaker rules as included in art. 4 OECD MTC aim to address these cases. Source-source double taxation arises if two countries apply different sourcing rules. A single payment may then be simultaneously sourced in two countries. In principle, for interest and royalties this dual sourcing-issue is solved in tax treaties. The last variant, source-residence double taxation, is the result of one state taxing on the basis of residency, while the other state taxes income on the basis of its domestic source. This is dealt with in the distributive provisions of tax treaties. For completeness, application of the nationality principle can also lead to double taxation.

26 Additionally, tax treaties could promote trade and investments by reducing source-country taxation (via lowering the applicable withholding tax rates). Lower withholding tax rates could increase investments: the pre-tax rate of return required to make a project viable on an after-tax basis will be lowered. However, there is no unambiguous empirical evidence in this respect (S. Leduc & G. Michielse, 'Chapter 8: Are Tax Treaties Worth It for Developing Economies?', p. 140, in R.A. de Mooij, A. Klemm & V. Perry (eds.), *Corporate Income Taxes Under Pressure: Why Reform Is Needed and How It Could Be Designed,* Washington, DC: International Monetary Fund 2021).

27 J. Gooijer, *Tax Treaty Residence of Entities*, Deventer: Wolters Kluwer 2019, par. 4.2.

28 Introduction OECD MTC, par. 2.

29 Introduction OECD MTC, par. 15.2. '*Tax treaties provide for relief to be granted by the residence state and the right to tax by the source state*' (P.F. Kaka, 'From the Avoidance of Double Taxation to the Avoidance of Double Non-Taxation: The Changing Objectives of Tax Treaties', *Bulletin for International Taxation* 2021, vol 75, no. 11/12, par. 1.).

30 OECD, 'Who we are', available at https://www.oecd.org/about/, accessed 4 May 2022). Perez-Navarro stated that the objective of tax treaties is to '*maximize global wealth by ensuring an efficient allocation of resources*' (G. Perez-Navarro, 'The Purpose of Tax Treaties and the Role of the OECD in their Development', *Workshop on Double Taxation in the European Union* 2011, available at https://www.europarl.europa.eu/RegData/etudes/workshop/join/2011/464460/IPOL-ECON_AT(2011)464460_EN.pdf, accessed 4 May 2022).

31 J. Gooijer, *Tax Treaty Residence of Entities*, Deventer: Wolters Kluwer 2019, par. 4.2.

As indicated, the second[32] objective that states pursue through the agreement of tax treaties is to make sure no opportunities for non-taxation or reduced taxation are created through tax evasion[33] or tax avoidance.[34] This second objective is explicitly included in the title and preamble of the OECD MTC since 2017.[35] The adjustment is a result of the OECD's BEPS project.[36] More specifically, the adjustment to the title and preamble follows from the report on Action 6, aimed at preventing the granting of treaty benefits in inappropriate circumstances.[37] Taxpayers can take advantage of the international tax treaty network and can structure their business operations to benefit from, e.g., a lower withholding tax rate (treaty shopping).[38] Moreover, persons can, inter alia, seek to circumvent treaty limitations.[39] This can lead to the granting of tax treaty benefits in inappropriate circumstances. Additionally, although tax treaties were originally designed to prevent double taxation, they

32 If the prevention of tax avoidance is viewed as a separate objective (alongside the prevention of tax evasion), there are three stated purposes (S. van Weeghel, 'A Deconstruction of the Principal Purposes Test', *World Tax Journal* 2019, vol. 11, no. 1, par. 4).

33 Tax evasion can be defined as: '*escape taxation which is legally due. On the one hand, there are cases of taxpayers who deliberately defy the law and resort to concealment; on the other hand, there are the individuals who, owing to carelessness, forgetfulness or negligence, do not carry out their obligations in the matter of taxation, on who, where (owing to the obscurity of the law) doubts exist as to its interpretation, take the benefit of the doubt in their own favour.*' (Double Taxation and Tax Evasion, Report and Resolutions submitted by the Technical Experts to the Financial Committee, Document F.212 (Geneva, February 1925), p. 34). Tax evasion is also described as illegal tax avoidance (D. Shaviro, 'The Two Faces of the Single Tax Principle', *Brooklyn Journal of International Law* 2016, vol. 41, no. 3, p. 1293). To combat tax evasion, there are, inter alia, various treaty provisions aimed at administrative cooperation between states. For instance, there are treaty provisions that regulate the exchange of information as well as treaty provisions that provide for assistance in collecting taxes.

34 Tax avoidance includes treaty shopping arrangements aimed at relief for the indirect benefit of residents of third states (preamble OECD MTC).

35 It could be argued that according to the preamble, there is essentially one objective, which is '*the elimination of double taxation … without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance.*' (S. van Weeghel, 'A Deconstruction of the Principal Purposes Test', *World Tax Journal* 2019, vol. 11, no. 1, par. 4).

36 OECD, *Action Plan on Base Erosion and Profit Shifting*, Paris: OECD Publishing 2013.

37 OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 - 2015 Final Report*, Paris: OECD Publishing 2015.

38 A restructuring should not necessarily lead to the conclusion that there is an abusive situation. Taxpayers are allowed to structure their business in the most cost-effective manner. If there is no economic substance underlying the restructuring, it can be seen as abusive (S. Leduc & G. Michielse, 'Chapter 8: Are Tax Treaties Worth It for Developing Economies?', p. 163, in R.A. de Mooij, A. Klemm & V. Perry (eds.), *Corporate Income Taxes Under Pressure: Why Reform Is Needed and How It Could Be Designed,* Washington, DC: International Monetary Fund 2021).

39 E.g., transactions that circumvent the application of art. 13, par. 4, OECD MTC.

can also result in double non-taxation.[40] The reason for this is that tax treaties restrict the application of domestic law. If a Contracting State relinquishes its taxing power in full or partially to the other Contracting State through a tax treaty, this is usually based on the assumption that the other state will tax the component of the income. If this is not the case, situations of double non-taxation may arise. This is especially the case under the application of an exemption system.[41]

There is a difference between the terms double non-taxation and non-taxation. However, the OECD seems to use them interchangeably.[42] Non-taxation as such involves the perspective of only one state, while double non-taxation refers to the result of a given event that is not taxed by both states involved in a cross-border situation. The terms are related: double non-taxation requires the existence of non-taxation.[43] Sovereignty exercised by different states can lead to non-taxation domestically, and subsequently to double non-taxation across borders.[44] The OECD MTC preamble solely refers to non-taxation and not to double non-taxation. The underlying objective of the amendment to the preamble was to clarify that tax treaties are not intended to be used to generate double non-taxation.[45] Additionally, as the OECD MTC entails a cross-border perspective, it seems logical to interpret the objective as preventing both non-taxation and double non-taxation in cases of tax avoidance, where double non-taxation seems the main issue.[46] In this regard, a distinction can be made between intended and unintended double non-taxation. Double non-taxation can

40 In the 2013 OECD BEPS report (OECD, *Action Plan on Base Erosion and Profit Shifting*, Paris: OECD Publishing 2013, p. 13) it is stated that tax treaties often fail to prevent double non-taxation. It is rather strange that the BEPS Action Plan sees this as a failure as this was not the purpose of tax treaties (E. Gil García, 'The Single Tax Principle: Fiction or Reality in a Non-Comprehensive International Tax Regime?', *World Tax Journal* 2019, vol. 11, no. 3, par. 3.2.1.2). In fact, the report states that work will be done to *clarify* that treaties are not intended to be used to generate double non-taxation (p. 19). This statement reflects the view that preventing double non-taxation has always been central to the interpretation of the OECD MTC (H.J. Ault, 'The Partnership Report Revisited: BEPS the Multilateral Convention, and the 2017 OECD Model Convention', p. 20, in B.J. Arnold (ed.), *Tax Treaties After the BEPS Project: A Tribute to Jacques Sasseville*, Toronto: Canadian Tax Foundation 2018).

41 J. Sasseville, 'The Role of Tax Treaties in the 21st Century', par. 3, appendix to B. Arnold, J. Sasseville & E. Zolt, 'Summary of the Proceedings of an Invitational Seminar on Tax Treaties in the 21st Century', *Bulletin for International Taxation* 2002, vol. 56, no. 6.

42 See also A.L. Kennedy, 'The Effect of Article 6 MLI on Covered Tax Agreements: Fata Morgana or New Reality?', *Intertax* 2022, vol. 50, no. 4, par. 4.6.

43 B. Ferreira Liotti, 'Limits of International Cooperation: The Concept of "Jurisdiction Not to Tax" from the BEPS Project to GloBE', *Bulletin for International Taxation* 2022, vol. 76, no. 2, par. 3.2.

44 F.D. Martínez Laguna, 'Abuse and Aggressive Tax Planning: Between OECD and EU Initiatives – The Dividing Line Between Intended and Unintended Double Non-Taxation', *World Tax Journal* 2017, vol. 9, no. 2, par. 2.3.

45 OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 - 2015 Final Report*, Paris: OECD Publishing 2015, p. 91.

46 In literature this point of view also seems to prevail, even though it is not explicitly mentioned that the OECD preamble solely refers to non-taxation (see, e.g., L. De Broe, 'Role of the Preamble for the Interpretation of Old and New Tax Treaties and on the Policy of the Prevention of Treaty Abuse', *Bulletin for International Taxation* 2020, vol 74, no. 4/5, par. 5 and P.F. Kaka, 'From the Avoidance of Double Taxation to the Avoidance of Double Non-Taxation: The Changing Objectives of Tax Treaties', *Bulletin for International Taxation* 2021, vol 75, no. 11/12).

be the result of the tax policy of one or both of the Contracting States.[47] In that situation the outcome is intended: there is no abuse.[48]

The question arises whether equal weight should be given to both objectives. It is clear that the original purpose of the OECD MTC was the prevention of double taxation, to which the prevention of tax evasion and tax avoidance was added later. The OECD writes in the introduction to the OECD MTC that '*these are the main purposes*', which seems to imply that equal value is given to both purposes. In contrast, the OECD also writes:[49]

> *'The principal purpose of double taxation conventions is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons. As confirmed in the preamble of the Convention, it is also a part of the purposes of tax conventions to prevent tax avoidance and evasion.'*

From the foregoing it seems that the OECD attaches the most importance to the prevention of double taxation.[50] Does this mean that, in situations where there is concurrence between the two, in the eyes of the OECD the prevention of double taxation is more important than the prevention of tax evasion and tax avoidance? If so, it could be claimed that if there is double taxation due to the application of a treaty rule that aims at combatting tax evasion and tax avoidance, the elimination of double taxation should still be provided for. What would this mean in practice? This can best be explained by a simple example. If a dividend payment is made to an entity that is not the beneficial owner of that dividend, it would be in line with the goal to combat tax avoidance to not grant a lowered withholding tax rate nor grant a credit at the level of the recipient. This would of course lead to double taxation.[51] Avoiding this double taxation could be done by granting a lowered withholding tax rate and a credit at the level of the recipient in line with the regular rules of the tax treaty. However, such a solution would make the anti-avoidance rule useless. This simple example indicates that it is not possible in each situation to pursue both objectives. The only logical conclusion is that in tax avoidance situations, the weight of the principal purpose of the treaty (avoiding double taxation) needs to be reduced in favour of the ancillary purpose (preventing tax evasion and tax avoidance).[52] In case the anti-avoidance rule leads to a situation in which there is no longer double non-taxation (i.e., single taxation), there is no conflict between the two objectives.

47 Such a tax policy can aim to attract investments, but the reason can also be that income is already coming from, e.g., other means of taxation (L.E. Schoueri & G. Galdino, 'Chapter 3: Single Taxation as a Policy Goal: Controversial Meaning, Lack of Justification and Unfeasibility', par. 3.2.1, in J.C. Wheeler (ed.), *Single Taxation?*, Amsterdam: IBFD 2018). Tax policy measures to attract investments are, e.g., tax sparing and matching credit clauses (F.D. Martínez Laguna, 'Abuse and Aggressive Tax Planning: Between OECD and EU Initiatives – The Dividing Line Between Intended and Unintended Double Non-Taxation', *World Tax Journal* 2017, vol. 9, no. 2, par. 2.3).

48 J. Gooijer, *Tax Treaty Residence of Entities*, Deventer: Wolters Kluwer 2019, par. 7.3.

49 Commentary on art. 1 OECD MTC, par. 54.

50 The latter objectives can be seen as additional objectives (S. van Weeghel, 'A Deconstruction of the Principal Purposes Test', *World Tax Journal* 2019, vol. 11, no. 1, par. 4).

51 If the beneficial owner also sees itself as a recipient, this may cause additional double taxation.

52 See also Van Weeghel who comes to a similar conclusion specifically with regard to the application of the Principal Purpose Test (S. van Weeghel, 'A Deconstruction of the Principal Purposes Test', *World Tax Journal* 2019, vol. 11, no. 1, par. 4).