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FEATURED PERSPECTIVE

Update on BEPS Action 6: No Land in Sight

by Oliver R. Hoor and Keith O'Donnell

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Action 6 of the OECD's action plan on base erosion and profit shifting targets the prevention of tax treaty abuse. In a draft report released in September 2014, the OECD made recommendations regarding the design of tax treaty provisions and domestic tax rules that should prevent the abuse of tax treaties. This article provides a critical overview of the proposals made in the 2014 draft report and analyzes restrictions from an EU law perspective.

Bilateral tax treaties are an important and well-established feature of the international tax system. Their main purpose is the promotion of cross-border trade and investment through the allocation of taxing rights between two contracting states and the determination of mechanisms for the elimination of double taxation. There are more than 3,000 tax treaties in force around the globe.

Though every tax treaty is subject to negotiations between the two contracting states, most tax treaties are fairly similar. This is because the treaty negotiations between the contracting states are generally based on the OECD model tax convention and are then tailored to the particular economic interest of each contracting state. The development of the OECD model was arguably one of the most important contributions of the OECD to promote international trade and cross-border investment activities.

The abuse of tax treaties — and in particular, treaty shopping — has been identified as one of the most important sources of base erosion and profit-shifting concerns. In order to address those concerns, the 2014 OECD draft report proposes a limitation on benefits provision, a principal purpose test (PPT), and a series of specific antiabuse rules (SAAR), which would come in addition to existing rules such as the beneficial ownership concept. Regarding the adoption of these rules, the OECD recommended the following three options to countries:

- including both the PPT and the LOB provision in tax treaties;
- including a PPT only; and
- including an LOB only and supplementing it with the introduction of domestic anti-conduit rules.

Further, the OECD recommended that the title and the preamble of tax treaties should clarify that they are not intended to generate double nontaxation and that the contracting states intend to prevent tax evasion and tax avoidance.

However, the proposals are still works in progress, and the more than 750 pages of public comments received regarding the second discussion draft released in November 2014, as well as the comments made during the public consultation of January 25, 2015 (which the authors participated in), suggest that the 2014 draft report is still far from being a consensus document.

I. The LOB Provision

A. Overview

The LOB provision proposed by the OECD is almost identical to the one in the 2006 U.S. model income tax convention, and it contains both ownership and activity elements. It denies treaty benefits to a legal entity by default and is essentially designed to prevent a company from accessing tax treaties if the entity is owned or financed from abroad or from where its shares are traded on a foreign stock exchange. In other words, it would no longer be sufficient to be a resident of a contracting state to benefit from treaty protection.

Instead, treaty benefits will be applicable only when a resident of a contracting state is classified as a ''qualified person'' within the meaning of the LOB provision. Thus, a company that is a resident of a contracting state must satisfy at least one of the tests of the LOB provision in order to be eligible for treaty benefits. This would reverse the general principle that companies should be able to enjoy the benefits of tax treaties concluded by their state of residence to the extent they perform genuine economic activities.

B. Publicly Traded Test

The first test requires that the principal class of shares[1] of the company claiming the benefits of the treaty be traded regularly and primarily on one or more recognized stock exchanges located in the contracting state in which the company or trust is resident (publicly traded test). Alternatively, the shares of the company may be quoted and regularly traded on another recognized stock exchange as long as the company has its primary place of management and control in its state of residence.

According to the proposed commentary to the LOB provision, a company's primary place of management and control will be situated in its state of residence only if the executive officers and senior management employees exercise day-to-day responsibility for more of the strategic, financial, and operational policy decision-making for the company in the country concerned than in any other state, and the staff that supports the management in making the decisions is also based in that state.

It follows that the concept of primary place of management and control is much more difficult to satisfy than the concept of place of effective management. In practice, it will be difficult for companies resident in smaller countries to satisfy this test because senior management may spend more time outside the boundaries of the country than the senior management of a company based in a large economy.

At the same time, companies resident in smaller countries may wish to be listed and raise capital on stock exchanges in major international markets such as the United States. In order to prevent distortions between small countries and large countries, the management time test should be removed from the proposed LOB provision. Emphasis should instead be on substantive policy decisions that are normally made at the head office.

The LOB provision further includes an indirect publicly traded test under which a company would be classified as a qualified person if five or fewer publicly traded companies resident in contracting states owned at least 50 percent of the aggregate vote and value of its shares (including at least 50 percent of any disproportionate shares). The problem with this test is that all the intermediary companies should also be qualified persons, which would significantly reduce the scope of application of this rule.

C. Nonprofit Organizations and Pension Funds

According to the proposed LOB provision, some nonprofit organizations and pension funds qualifying as a resident of a contracting state may be entitled to treaty benefits. However, for a resident pension fund to be classified as a qualified person, at least 50 percent of the beneficial interests in its pensions must be owned by individuals resident in either contracting state. Fund of funds of pensions may also qualify for treaty benefits.[2]

D. Ownership and Base Erosion Test

Under the ownership and base erosion test, a company that is a resident of a contracting state is eligible for treaty benefits if:

- at least 50 percent of the aggregate voting power and value is owned, directly or indirectly, by residents of the same contracting state who are themselves entitled to the benefits of the tax treaty (ownership test); and
- less than 50 percent of the company's gross income is paid to persons that are not resident in either of the contracting states, giving rise to a right of deduction for the company paying that income (base erosion test).

The latter test is designed to verify whether a company is ultimately owned and financed from its country of residence and meeting it should be relatively straightforward for companies operating in large economies given that such companies are generally owned and financed domestically. In contrast, companies established in small countries will frequently not satisfy this test because their capital, and therefore ownership and financing, will often come from outside those countries. Hence, this test disproportionately disadvantages companies resident in smaller countries.

E. Active Business Test

A company that is a resident of a contracting state but is not considered a qualified resident under the aforementioned clauses of the LOB provision will be entitled to treaty benefits if:

- it carries on an active business (other than portfolio investments unless these activities involve banking, insurance, or securities activities carried on by a bank or financial institution); and

[1]The term ''principal class of shares'' refers to the ordinary or common shares of a company if these shares represent a majority of the voting rights and the value of the company.

[2]This clause may present a restriction on the free movement of capital as far as EU member states are concerned.

- the income derived from the other contracting state is derived in connection with, or incidental to, that business (active business test).

The proposed LOB provision further states that when income is derived from a related party, the active business test will be satisfied only if the business activity carried on in the state of residence is substantial relative to the business activities carried on in the other state. This is determined based on all facts and circumstances. Practical experience gained with tax treaties concluded by the United States (that include an LOB provision) has shown that this test is often failed by companies with economic substance and substantial functions.

For companies resident in smaller countries, it will frequently be difficult to satisfy this substantiality requirement. Evidently, the proposed LOB provision would exclude most, if not all, holding and headquarters companies that serve legitimate business purposes from treaty benefits. It makes little sense that a company that has operational substance in its state of residence should be obliged to satisfy such an exaggerated standard for enjoying treaty benefits.

Many commentators to the public discussion drafts released in March and November 2014 emphasized that holding, financing, intellectual property (IP) management, investment, and business support activities are all legitimate business activities, and suggested that the LOB provision take into account the substance and purpose of a company performing such activities.

F. Collective Investment Vehicles

Under the proposed LOB provision, the making or managing of investments by a collective investment vehicle (CIV)[3] (or a holding company controlled by a CIV) will be deemed not to satisfy the active business test under the LOB provision (unless carried on by a bank, insurance company, or securities dealer) and therefore will be deemed not to be entitled to treaty benefits. This would, however, be in contradiction to the 2010 CIV report (''The Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles''), which concludes that it is entirely appropriate that CIVs should be granted treaty benefits (on their own behalf).[4]

Following the receipt of public comments on the first discussion draft on BEPS action 6, released in March 2014, the LOB provision in the 2014 draft report has been amended and now foresees the inclusion of CIVs in the definition of a qualified person, although a specific clause still must be drafted.

The 2010 CIV report recognizes that CIVs can take different legal forms in different countries and are therefore subject to different tax treatments (regarding the CIV and its investors). Given these differences, the 2010 CIV report states that there is no single preferred approach that should be adopted. In order to avoid any unintended damages to the fund industry, CIVs should per se be treated as ''qualified residents,'' without any further requirements.

The 2010 CIV report did not deal with treaty entitlement issues regarding non-CIV funds. Non-CIV funds include the following categories of funds:

- Real estate funds are funds that invest in a diversified portfolio of real estate assets in accordance with a defined investment strategy (target jurisdictions, type of property, and so forth). Real estate funds are important to the real economy since they ensure the quality and availability of business infrastructure and residential property. Also, they allow small investors and institutional investors alike to earn a stable return from investments in real estate.
- Private equity funds typically make medium- to long-term investments in private companies that are generally not listed on the stock exchange. These investments are characterized by active ownership, the contribution of management expertise, and the provision of additional funding where needed to grow business activities. A common private equity strategy involves the acquisition of troubled companies with a view to saving them through corporate renewal and the development of a strategic plan to increase performance and competitiveness.
- Venture capital is a subsegment of private equity focused on start-up companies. Venture capital funds help entrepreneurs with innovative ideas for a product or service with the investment of capital and give them strategic advice in growing their businesses.
- Debt funds typically invest in existing loan portfolios or originate loans and are an important source of funding since banks have significantly reduced their lending activities (for example, the financing of real estate and infrastructure projects) following the recent financial crises.
- Pension funds play a vital role in the funding of the retirement of individual wage earners and typically benefit from a favorable tax regime in their state of residence. In order to spread their risk, pension funds often invest internationally in different asset classes, including real estate, private equity, and debt funds. In recognition of this and to promote risk diversification, many tax treaties allow pension funds to have reduced or zero withholding tax rates on their investment income.

[3]CIVs are investment vehicles that are widely held, hold a diversified portfolio of securities, and are subject to investor protection regulation in the countries in which they are established.

[4]*See* OECD Committee on Fiscal Affairs, ''The Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles,'' No. 35 (adopted on Apr. 23, 2010).

- Sovereign wealth funds are state-owned investment funds investing globally in real estate, financial assets, and alternative investments and private equity funds. The purpose of sovereign wealth funds is to manage and invest budget surpluses (in most cases deriving from the exportation of commodities) to ensure economic prosperity for future generations.

The positive contribution of non-CIV funds to the real economy, the stability of capital markets, and economic growth has been recognized by several institutions. It is acknowledged that a precondition of long-term investment is a stable and predictable tax environment that provides tax neutrality toward different forms and structures of financing. Given the wording of the LOB provision, however, there is a real concern in the European fund industry that the recommendations of the OECD will have a detrimental impact on the ability of non-CIV funds (and companies owned by non-CIV funds) to claim the benefits of the tax treaties concluded by their states of residence.

It must be emphasized that non-CIV funds are not established for achieving double nontaxation or for treaty-shopping purposes. Investments are taxed both in the jurisdiction in which they are made and in the hands of the investors. Given that these funds raise and invest capital internationally, they are exposed to different tax systems and potentially to double and multiple taxation. Therefore, it is important to ensure a level playing field between direct investments and investments through non-CIV funds. In this regard, it would be crucial to include non-CIV funds in the definition of qualified resident.

G. Derivative Benefits Test

A company that is a resident of a contracting state but fails to be classified as a qualified resident under the LOB provision (because of its foreign shareholders) may nonetheless be entitled to treaty benefits if it is owned and financed by ''equivalent beneficiaries.'' An equivalent beneficiary is a person that is resident in a country with which the other contracting state also has a tax treaty (to the extent the person is entitled to the benefits thereof).

The derivative benefits test is satisfied if:

- at least 95 percent of the voting power and value of the shares of a company that is a resident of a contracting state (and at least 50 percent of any disproportionate class of shares) are owned by seven or fewer persons that are equivalent beneficiaries (share ownership test); and
- less than 50 percent of the gross income is paid or accrued to persons that are not equivalent beneficiaries and are non-arm's-length (base erosion test).

For indirect ownership, each intermediate owner must itself be an equivalent beneficiary. Moreover, for some items of income, a beneficial owner does not automatically qualify as an equivalent beneficiary simply because its country has a tax treaty with the other contracting state. For those items of income (that is, dividends, interest, and royalties), the third country's treaty must offer withholding rates at least as low as the rate available under the claimed treaty.

The availability of a broad-based derivative benefits test is of particular importance for companies resident in small countries, which are often owned and financed by nonresidents. The draft version of the derivative benefits provision is clearly too narrowly drawn to be of assistance to safeguard treaty benefits for situations in which there is no treaty abuse concern.

First, the definition of an equivalent beneficiary is relatively narrow, excluding private companies. Second, for indirect ownership, each intermediate company must be an equivalent beneficiary. This would significantly limit the potential application of the derivative benefits clause. Third, given the increasing commercial use of joint ventures, the 95 percent ownership requirement will deny treaty benefits in many commercial situations. Therefore, to prevent significant disadvantages to smaller economies compared with larger economies, a widely cast derivative benefits test is essential when a LOB provision is included in a tax treaty.

H. Discretionary Relief

When a company cannot satisfy any of the other LOB tests, it may as a last resort apply to the competent authority for relief (a competent authority agreement). Here, the company must demonstrate that the ''establishment, acquisition, or maintenance'' of the company ''and the conduct of its operations''[5] did not have as one of its principal purposes the obtaining of benefits under the treaty. Hence, tax reasons must clearly be secondary to other business reasons. In such cases, both competent authorities would consult even though the competent authority to which the request is made has the final decision.

However, in practice it may be difficult to persuade the competent authorities that no tax motives have been present. Given the importance of tax as a cost to businesses, it would arguably be irresponsible not to consider tax aspects before the implementation of investments and activities. Last, it should be clarified that discretionary relief is granted retroactively since taxpayers will rely on that relief only as a last resort, when they do not meet another test (for example, the active business test).

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[5] *See* the 2014 Report on BEPS Action 6, ''Preventing the Granting of Treaty Benefits in Inappropriate Circumstances,'' p. 64.

I. Checklist — LOB Provision

The figure below summarizes the operation of the LOB provision proposed by the OECD.

Overall, the mechanism of the LOB provision is inherently biased in favor of larger jurisdictions. In contrast, companies resident in jurisdictions with small economies that are more reliant on an international investor base and funding than companies in jurisdictions with larger economies will have more difficulties being a qualifying person under the LOB provision. This is because that clause automatically grants treaty access if most of the preferred investors are resident in the same country, whereas much more restrictive conditions are imposed on smaller economies that inevitably depend on foreign investment. The LOB provision is further problematic from an EU law perspective (see Section V).

II. The Principal Purpose Test

The discussion draft also contains a PPT. Even if the requirements of the LOB provision were satisfied, the PPT would deny a treaty benefit when it is reasonable to conclude that obtaining the treaty benefit was ''*one of* the main purposes'' (emphasis added) of any arrangement or transaction, unless the taxpayer is able to establish that granting the benefit would be ''in accordance with the object and purpose'' of the relevant treaty provisions.[6] However, is a prudent business manager not expected to consider tax aspects in each genuine business activity? The contradictory message of the PPT is therefore that treaty benefits are available to qualifying taxpayers unless they intend to gain from those benefits. In any case, the threshold to deny treaty benefits would be significantly reduced as compared with the existing guidance in the commentary to the OECD model.

While the LOB provision and the PPT are designed to address treaty shopping, there are fundamental differences between the two approaches. The LOB provision is technically complex but leaves limited room for subjective and arbitrary assessments. In stark contrast, the PPT opens the door for tax administrations to disqualify a taxpayer from treaty benefits when one of the main purposes of an arrangement or a transaction is considered to be a given treaty benefit.

Obviously, this injects a subjective element into every aspect of determining whether treaty benefits are available, and not much guidance is provided regarding when treaty benefits will be granted. Similar to the proposed LOB provision, the PPT imposes a significant burden on the taxpayer (''establish that the granting of tax benefit would be in accordance with the object and purpose of provision in the convention''), whereas the onus on the tax administration is low (''reasonable to conclude,'' ''one of the main purposes,'' and ''directly or indirectly'').

The PPT would create significant uncertainty for taxpayers (and their advisers) because of the extremely unpredictable outcomes and would produce serious concerns for bona fide businesses. Holding, financing, IP management, and other investment activities are all legitimate and genuine business activities that may fall within the scope of the PPT.

However, a PPT should be designed to tackle only clear cases of treaty abuse that are set up solely for the purpose of obtaining treaty benefits. Accordingly, it should be established that ''the main purpose'' instead of ''one of'' the main purposes was to obtain the tax benefit. Also, the commentary to the PPT should be revised to acknowledge that it is legitimate that one of the main purposes for choosing a jurisdiction is the existence of a tax treaty and the benefits it affords. The provision should further be applicable only if it is established that granting the benefit would be contrary to the objective of the provisions of the convention.

The proposed PPT is particularly problematic for businesses established in small countries. Small countries like Luxembourg are attractive for a number of valid commercial reasons, including the availability of a qualified labor force, a good infrastructure, political stability, a competitive tax environment (including the existence of tax treaties), and a flexible regulatory framework. Conversely, companies located in large countries can point to other obvious factors such as a large population, greater availability of capital and funding, and increased infrastructure when depicting the key reasons for choosing their location.

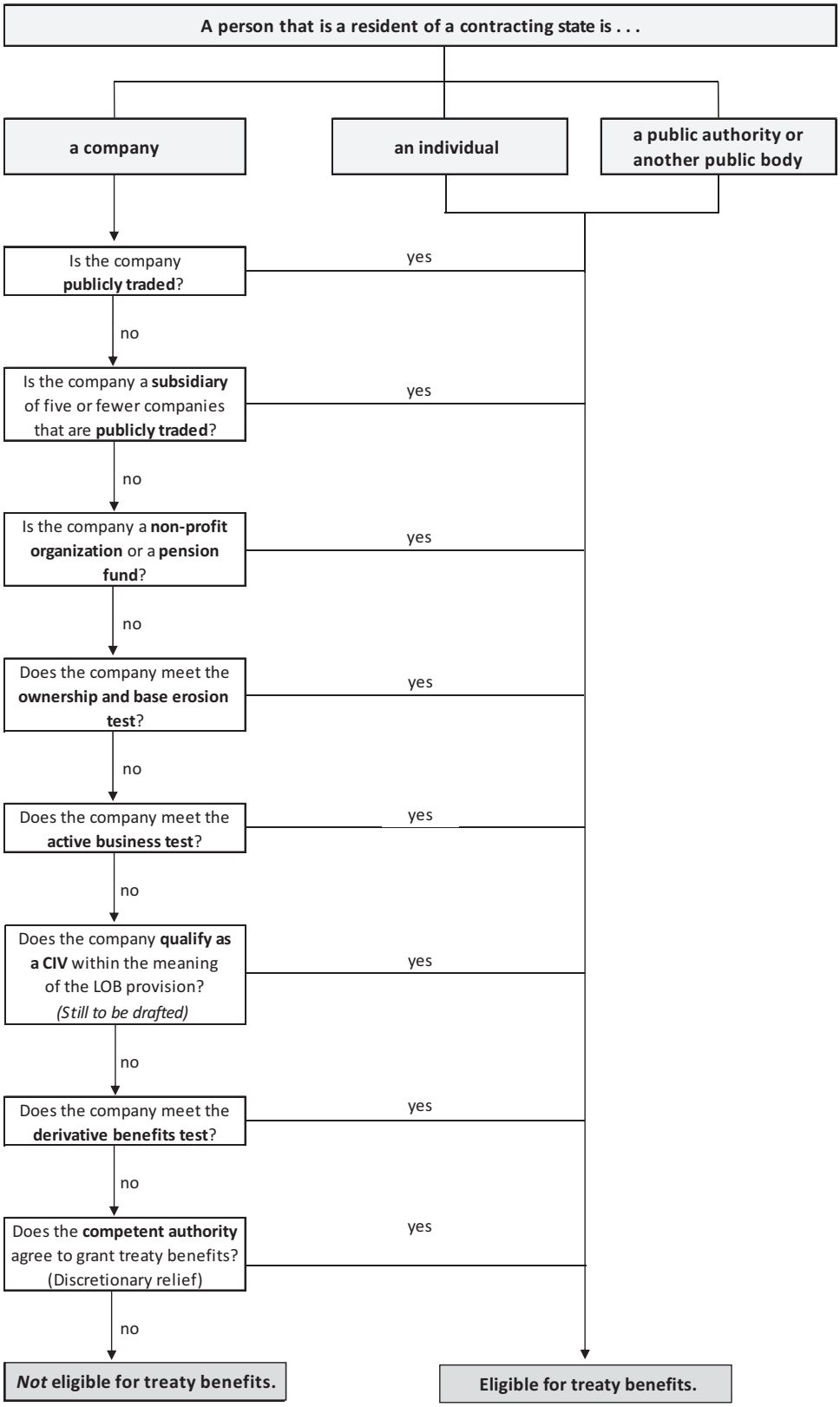
In practice, companies will find it much easier to demonstrate the self-evident advantages of establishing in a large economy (considering the market size of the economy and available infrastructure) than a company resident in a smaller economy. In the latter case, more weight would be attached to the taxpayer's status as a local tax resident, and the application of a tax treaty would be more easily identified as one of the main purposes for an arrangement or a transaction, even with the existence of equally valid business reasons.

Therefore, companies resident in a small country such as Luxembourg may find it fundamentally impossible to meet the criteria of the PPT, resulting in significant legal uncertainty and costs for those companies.

Moreover, it should be clarified that CIVs (and companies owned by CIVs) are excluded from the PPT since these investment vehicles serve, by definition, bona fide activities and are not established for the purpose of abusing tax treaties. Likewise, non-CIV funds (and companies owned by non-CIV funds) should be explicitly excluded from the PPT since co-investments, or the structuring of investments through non-CIV

[6] *See* 2014 Report on BEPS Action 6, ''Preventing the Granting of Treaty Benefits in Inappropriate Circumstances,'' p. 66.

Eligibility for Treaty Benefits Under the Proposed LOB Provision



funds, should not trigger additional tax costs for investors when compared with direct investment.

III. Title and Preamble

The 2014 draft report proposes that the title to the OECD model be replaced with the following wording:

> Convention between (State A) and (State B) for the elimination of double taxation with respect to taxes on income and on capital and the prevention of tax evasion and *tax avoidance*. [Emphasis added.]

The proposed preamble also states that the parties intend that the convention eliminate double taxation ''without creating opportunities for nontaxation or reduced taxation through tax evasion or avoidance.'' It is interesting that the proposed preamble devotes one line to referring to the prevention of double taxation and three lines to the prevention of abuse of the convention.

However, the main purpose of a tax treaty is to facilitate cross-border trade and investment through the elimination of double taxation, and the prevention of tax avoidance and evasion (in general) or treaty abuse (in particular) is not the main objective for entering into a tax treaty. While it is necessary to prevent treaty abuse, it is not the purpose of a treaty to do so.

It is only natural that countries should try in their treaty negotiations to design treaty provisions in a way that does not allow unintended nontaxation. However, although tax treaties are not intended to be used to generate double nontaxation, they are sometimes sought by the two contracting states in order to make foreign investments more attractive.

The proposed amendments may call into question unambiguous treaty terms and thereby add an unwarranted level of complexity to treaty analysis and contribute to uncertainty. A preamble should not be used for rulemaking. The proposed title could also be interpreted to undermine the fundamental principle that a tax treaty should only relieve, and not increase, the taxation imposed under the domestic tax laws of the two contracting states.

IV. Specific Antiabuse Provisions

The 2014 draft report also contains a new rule for dealing with dual residency and SAAR proposals that are targeted at specific situations of treaty abuse. In the current version of the OECD model, article 4(3) seeks to settle the issue of dual residence of companies. In many jurisdictions, companies are considered tax resident if either their seats or places of effective management are located in those states. Thus, cases of dual residence may occur if only one of the two criteria is fulfilled.

In these circumstances, the entity will be deemed to be a resident of the contracting state in which its place of effective management is situated (the ''corporate residence tiebreaker''). The main purposes of the tiebreaker rule are the determination of the state of residence of a company, which is essential for the application of a tax treaty, and the avoidance of a concurrent liability to tax the worldwide income in two contracting states.[7] Instances of dual residency usually occur for nontax reasons (for example, companies may want to change their places of effective management while keeping their corporate identity for commercial or employment reasons).

The 2014 draft report provides that the competent authorities of the contracting states shall endeavor to determine by mutual agreement the state of residence (without real guidelines or rules for them to apply). In the absence of such agreement, a dual resident company will not be entitled to any relief or exemption from tax provided by the relevant tax treaty except to the extent agreed upon by the competent authorities of the contracting states.

The amendment of the corporate tiebreaker rule would undermine legal certainty and the rule of law by placing the matter within the hands of the competent authorities. Indeed, the proposal starts from the wrong assumption — that the corporate tiebreaker rule is designed primarily to prevent abuse and not to resolve double taxation. It seems inappropriate to amend an established rule that provides reasonable and predictable results.[8]

Other, more targeted proposals provided in the 2014 draft report include:

- the split of construction contracts between related companies in order to circumvent the 12-month threshold required for the constitution of a permanent establishment in accordance with article 5(3) of the OECD model;
- amendments to article 13(4) of the OECD model that target transactions that circumvent the taxation of capital gains on the sale of shares in property companies deriving more than 50 percent of their value from immovable property; and
- a rule designed to disallow treaty benefits when participations, debt claims, and IP rights are allocated to a PE and the related income (that is, dividends, interest, and royalties) is taxable in neither the host state of the PE nor in the jurisdiction of the head office.

V. Considerations Regarding EU Law

Most OECD countries (that is, 21 of 34) are EU member states. Therefore, the question whether the

[7] *See* Oliver R. Hoor, *The OECD Model Tax Convention — A Comprehensive Technical Analysis*, Legitech, 2015, pp. 31, 65.

[8] Following the significant criticism received on this proposal, the current corporate tiebreaker rule has been included as an option in the 2014 draft report.

proposed antiabuse rules are in violation of EU law is important because EU member states may not follow any recommendation that is contrary to the principles of EU law, particularly regarding intra-Community dealings.

The principle of freedom of contract and Court of Justice of the European Union case law provide that a given structure may be disregarded only if it is proven to be a wholly artificial arrangement. A letterbox company may be such a purely artificial structure.[9] In *Cadbury Schweppes* (C-196/04), the CJEU acknowledged that a taxpayer is free to rely on its EU freedoms for tax planning purposes as long as the underlying contractual arrangements are not purely artificial.[10]

The right of a member state to protect its tax base against abusive arrangements is secondary. It follows that tax jurisdiction shopping is a legitimate activity in an internal market, even if the choice of jurisdiction is based solely on tax considerations. Why should a company choose a higher-tax jurisdiction? Nevertheless, EU member states are free to protect their tax bases by way of antiabuse rules, which are exclusively directed at wholly artificial arrangements.[11]

An abusive situation not only depends on the intention of the taxpayer to obtain tax advantages, but requires the existence of specific objective factors.[12] Among these objective elements, the CJEU emphasized the importance of the existence of an ''actual establishment'' in the host state (for example, premises, staff, facilities, and equipment) and a ''genuine economic activity'' performed by the foreign company.[13]

The notion of a genuine economic activity should be broadly understood and may include the mere exploitation of assets such as participations, receivables, and intangibles for the purpose of deriving passive income. The nature of the activity should not be compromised if that passive income is principally sourced outside the host state of the entity.[14]

Also, no specific ties or connections between the economic activity assigned to the foreign entity and the territory of the host state of that entity can be required by domestic antiabuse provisions. Therefore, as far as the internal market is concerned, the fact that an intermediary company is active in conducting the functions and assets allocated to it (rather than being a mere letterbox company) should suffice for it to be out of the scope of domestic antiabuse rules.[15]

Note that until now, national courts have not deviated from the wholly artificial arrangement doctrine laid down by the CJEU. While the CJEU does not seem to require an extensive level of substance, from a risk management perspective, it may nevertheless be wise to exceed the minimum standard of substance in order to limit foreign tax risks.

Both the proposed LOB provision and the PPT pose significant compatibility issues with EU law. In fact, each of the LOB clauses includes elements that are problematic from an EU law perspective because they would deny treaty benefits when a company is owned or financed from abroad or when its shares are traded on a foreign stock exchange. Likewise, the PPT would deny treaty benefits solely on the grounds that one of the main purposes was to obtain treaty benefits. Accordingly, even companies that have economic substance in their state of residence and perform bona fide business activities may not be entitled to treaty benefits.

In an EU context, such restrictions can be justified only by the need to prevent tax avoidance when a SAAR targets ''wholly artificial arrangements aimed solely at escaping national tax normally due.''[16] Considering that the proposed LOB provision and the PPT impose a lower abuse threshold than the standard set by the CJEU, serious doubts can be raised on the compatibility of the proposed provisions with EU law.[17]

The OECD's second discussion draft on BEPS action 6, released in November 2014, acknowledges these compatibility issues and considers the drafting of alternative provisions that are acceptable for EU countries. In our view, both rules would need to include the wholly artificial arrangement concept in order to be compliant with EU law requirements.

The requirements of the publicly traded test in the LOB provision that would favor listing in the state of residence — or expect a company's primary place of management and control to be situated in its state of residence when it is listed in another state — would discriminate against an EU company operating in another EU member state and would therefore be a clear breach of one or more of the fundamental freedoms.

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[9] *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd. v. Commissioners of Inland Revenue*; *see* Eric Robert and Driss Tof, ''The Substance Requirement and the Future of Domestic Anti-Abuse Rules Within the Internal Market,'' *Eur'n Tax'n*, Nov. 2011, p. 437; and Hoor and Georges Bock, ''The Importance of Substance and Arm's-Length Conditions in Luxembourg,'' *Tax Notes Int'l*, Feb. 4, 2013, p. 489.

[10] *See Cadbury Schweppes*, *supra* note 9, paras. 36, 37, 55.

[11] *See Cadbury Schweppes*, *supra* note 9, para. 51; Robert and Tof, *supra* note 9, at 438; and José Calejo Guerra, ''Limitation on Benefits Clauses and EU Law,'' *Eur'n Tax'n*, Feb./Mar. 2011, p. 93.

[12] *See Cadbury Schweppes*, *supra* note 9, para. 55.

[13] *See Cadbury Schweppes*, *supra* note 9, para. 54.

[14] The mere fact that a structure may also help to shift income from a high-tax to a low-tax jurisdiction does not alone suffice for a conclusion that the structure is abusive (even if the structure has innovative features); *see* Robert and Tof, *supra* note 9, at 438.

[15] *See* Robert and Tof, *supra* note 9, at 443.

[16] *See* Hoor and Bock, *supra* note 9.

[17] For example, an LOB provision without a derivative benefits clause would breach the fundamental freedom of establishment.

VI. Conclusion and Outlook

BEPS action 6 aims to prevent perceived abuses of tax treaties. These are best addressed through specific and targeted antiabuse provisions designed so that they have a minimum impact on genuine business operations. However, both the highly complex and restrictive LOB provision and the vague and subjective PPT fail in this respect, since they are too general in nature and not limited to clear cases of abuse.

It is evident that antiabuse provisions that have the effect of precluding treaty benefits regarding common business structures when no treaty-shopping concern is present would do more harm than good and should not be included in the OECD model. Instead, tax treaties should remain focused on the elimination of double taxation and the promotion of international trade and investment. The value of tax treaties will be significantly reduced if their applicability is less certain.

The proposals would be especially detrimental for companies that are resident in smaller countries with open economies (such as Luxembourg) and are predominantly owned by international investors. The LOB provision and the PPT are inherently biased in favor of larger countries and disregard whether a company has economic substance in its state of residence.

The proposed rules are also problematic from an EU law perspective. Under EU law as interpreted by the CJEU, a given structure may only be disregarded if it is proven to be a wholly artificial arrangement (for example, letterbox companies). However, the LOB and PPT clearly create discrimination against companies exercising their activities within more than one EU member state, a clear breach of fundamental EU freedoms.

Another issue concerns widely held CIVs, which are popular because they provide an efficient way for people to develop their savings. Undertakings for collective investment in transferable securities funds have become a favored investment vehicle because of efforts by EU policymakers to eliminate tax barriers. However, most widely held CIVs wouldn't satisfy an LOB provision's ownership thresholds.

There is great concern within the industry that these funds would become collateral damage within the BEPS project. In order to address this concern, a broadly structured clause regarding CIVs should be included in the LOB provision, and CIVs should be explicitly excluded from the scope of the PPT. Equally, non-CIV funds (pension funds, real estate funds, private equity funds, and so forth) are established for legitimate commercial purposes, contribute to the real economy in various ways, and should generally be eligible for treaty benefits.

Following the second discussion draft of November 2014 and a public consultation on January 25, 2015, a third discussion draft should be released in June 2015. Ultimately, we believe that the proposals still require significant amendments in order to strike an appropriate balance between preventing tax treaty abuse and allowing treaty benefits to be obtained without undue difficulty or uncertainty as far as genuine business activities are concerned. ◆