Treaty Abuse

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Abuse of treaties: the issues

- A State tries to abuse the treaty
  - Public international law issue
- A taxpayer tries to abuse the treaty
  - Public international law issue
  - Domestic tax law issue

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Abuse of treaties in public international law

- Doctrine of abuse of rights has been recognized in public international law:
  - M. Byers, *Abuse of Rights: An Old Principle, A New Age,* (2002) 47 McGill LJ., 389
- "Abuse of rights" is a principle of international law, not a rule of interpretation

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Abuse of treaties in public international law

- Article 26 *Vienna Convention on the Law of Treaties*:

  Every treaty in force is binding upon the parties to it and must be performed by them in good faith.
- Commentary

  "There is much authority in the jurisprudence of international tribunals for the proposition that in the present context the principle of good faith is a legal principle which forms an integral part of the rule *pacta sunt servanda."*

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Abuse of treaties in public international law

- Commentary

  *"…*Some members felt that there would be advantage in also stating that a party must abstain from acts calculated to frustrate the object and purpose of the treaty. The Commission, however, considered that this was clearly implicit in the obligation to perform the treaty in good faith and preferred to state the *pacta sunt servanda* rule in as simple a form as possible."

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Art. 300 United Nations Convention on the Law of the Sea

Good faith and abuse of rights

States Parties shall fulfil in good faith the obligations assumed under this Convention and shall exercise the rights, jurisdiction and freedoms recognized in this Convention in a manner which would not constitute an abuse of right.

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Appellate Body of the World Trade Organization ("WTO") 1998 *Shrimp-Turtle Case*

"The chapeau of Article XX is, in fact, but one expression of the principle of good faith. This principle, at once a general principle of law and a general principle of international law, controls the exercise of rights by states. One application of this general principle, the application widely known as the doctrine of *abus de droit,* prohibits the abusive exercise of a state's rights and enjoins that whenever the assertion of a right "impinges on the field covered by [a] treaty obligation, it must be exercised bona fide, that is to say, reasonably." An abusive exercise by a Member of its own treaty right thus results in a breach of the treaty rights of the other Members and, as well, a violation of the treaty obligation of the Member so acting."

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How does this apply to abuses by taxpayers?

- Taxpayers, when exercising rights under a treaty, do not have more rights than the countries that entered into the treaty
- If abuse of rights rule of international law is applicable to the Contracting States, it arguably applies to the taxpayers
- This link does not seem to have been made expressly

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How does this apply to abuses by taxpayers?

- A number of domestic court decisions dealing with the application of tax treaties to taxpayers have, however, recognized the application of the *Vienna Convention on the Law of Treaties*
- At a minimum, there is ample judicial precedent supporting the view that Art. 31 VCLT applies when interpreting tax treaties and Art. 31 includes the principle of "good faith"

  "A treaty shall be interpreted ***in good faith*** in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."

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How to address abuses by taxpayers?

- Principles of international law
- Specific anti-abuse provisions in tax treaties
  - Included in the articles of the OECD/UN models
  - Suggested or presented in the Commentary
- Domestic anti-abuse provisions
  - Specific anti-abuse rules
  - General anti-abuse rules and judicial doctrines
  - Interaction between treaties and domestic anti-abuse rules

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Specific anti-abuse provisions in Model

- “Beneficial owner" (in Articles 10, 11, and 12)
- “Special relationship” rule applicable to interest and royalties
- Rule on alienation of shares of immovable property companies (paragraph 4 of Article 13)
- Rule on alienation of shares of other companies (paragraph 5 of Article 13 of the UN Model) (?)
- Rule on “star-companies” (paragraph 2 of Article 17)
- Article 9 on transfer pricing (?)

Anti-abuse rules in Commentary

- Treaty shopping provisions in section on “Improper use of the Convention in Commentary on Art. 1
- Paragraphs 21 to 21.5 of that section include alternative provisions that may be included to deal with other forms of treaty abuses; these include:
  - provisions which are aimed at entities benefiting from preferential tax regimes;
  - provisions which are aimed at particular types of income that is subject to low or no tax under a preferential tax regime;
  - anti-abuse rules dealing with source taxation of specific types of income;
  - provisions which are aimed at preferential regimes introduced after the signature of the convention.

Anti-abuse rules in the Commentary

- Paragraphs 6.3 and 18 of the Commentary on Article 5 (to deal with attempts to abuse the 12-month rule applicable to construction sites);
- Paragraph 17 of the Commentary on Article 10 (to deal with attempts to abuse the preferential rate of source taxation on dividends from substantial shareholdings);
- Commentary on Articles 10, 11 and 12 (to avoid granting the benefits of Articles 10, 11 and 12 to non-resident-owned companies that enjoy preferential tax treatment);
- Paragraph 6 of the Commentary on Article 21 and paragraph 53 of the Commentary on Article 24 (to deal with cases where shares, loans or rights would be transferred to a permanent establishment in the other State to enjoy a preferential treatment and benefit from the exemption method);
- Paragraphs 31, 31.1 and 35 of the Commentary on Articles 23A and 23B (to deal with low or non-taxation situations arising from the exemption method)
- Paragraphs 8.1 to 8.28 of the Commentary on Art. 15 on definition of employer

Other specific treaty anti-abuse rules

- Provisions excluding certain entities (Luxembourg holding companies, Barbados IBCs, etc…)

Domestic anti-abuse approaches

- Domestic rules dealing with treaty abuses
  - 1962 Swiss Decree on treaty shopping
  - GAAR rules that apply to treaty abuses
- Domestic rules dealing domestic law abuses
  - Tax is imposed under domestic law, not under the treaty
  - Abuse of a tax treaty provision results in an abuse of domestic law

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Domestic anti-abuse approaches

- Examples of specific rules
  - Thin capitalisation rules
  - CFC; FIF rules
  - Conduit financing rules
  - Exit or departure taxes
  - Dividend stripping rules
  - Transfer pricing rules

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Domestic general anti-abuse rules

- General anti-avoidance rule
- Judicial doctrines
  - Step-transaction
  - Business purpose
  - Substance over form
  - Abuse of rights; *Fraus legis*
  - Economic substance
  - Others?

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Interaction between domestic law anti-abuse rules and treaties (1/2)

- In case of conflict between the provisions of tax treaties and those of domestic law, the provisions of tax treaties must prevail
- "*Pacta sunt servanda*"; Article 26 of the *Vienna Convention on the Law of Treaties*
- Do domestic law anti-abuse rules conflict with tax treaties?

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Interaction between domestic law anti-abuse rules and treaties (2/2)

- Para. 22 and 22.1 of the Commentary on Article 1 provide a general discussion of the interaction between tax treaties and domestic anti-abuse rules
- These paragraphs conclude that a conflict would not occur in the case of the application of certain domestic anti-abuse rules to a transaction that constitutes an abuse of the tax treaty (which is determined by reference to the guiding principle of para. 9.5)

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Guiding principle

9.5. A guiding principle is that the benefits of a double taxation convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions

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The world after BEPS

Action 6

Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. Work will also be done to clarify that tax treaties are not intended to be used to generate double non-taxation and to identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country. The work will be co-ordinated with the work on hybrids.

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Report Action 6: Treaty abuse

- Clear statement that treaties should avoid creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including treaty shopping
- A general treaty anti-abuse rule aimed at arrangements one of the principal purposes of which is to obtain treaty benefits
- A number of specific treaty anti-abuse rules
- Clarification of the interaction of tax treaties and domestic anti-abuse rules

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Report Action 6: Specific treaty anti-abuse rules

- Limitation-on-benefits (LOB) rule to address a large number of treaty shopping situations based on the legal nature, ownership in, and general activities of, residents of a Contracting State
- Minimum shareholding period to prevent dividend transfer transactions
- Changes to Article 13(4) to prevent transactions that circumvent the application of that rule dealing with capital gains on shares of immovable property companies
- Changes to the tie-breaker rule for determining the treaty residence of dual-resident entities
- Anti-abuse rule for permanent establishments situated in third States

Why so many different rules?

- Treaty abuse, like abuse of domestic law, is best addressed through a combination of
  - Specific anti-abuse rules, which provide greater certainty but can only deal with known abusive strategies that can be addressed through general objective criteria
  - More general anti-abuse rules or judicial doctrines, which are less certain but offer protection against abusive transactions that have not previously been identified or addressed or that require a more case-by-case analysis

Using specific anti-abuse rules

- Provide more certainty

BUT

- Can only be drafted once a particular avoidance strategy has been identified and treaties take a long time to amend or replace
- Can seriously weaken the case as regards the application of general anti-abuse rules or doctrines to other forms of treaty abuses

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A minimum standard to prevent treaty shopping

- A key outcome of the work on Action 6 is agreement on a minimum level of protection against treaty shopping
- At a minimum countries should agree to include in their tax treaties
  - An express statement that their common intention is to eliminate double taxation without creating opportunities for treaty shopping, and
  - Either
    - The general treaty anti-abuse rule
    - The LOB rule supplemented by a mechanism that would deal with conduit arrangements not already dealt with in tax treaties, or
    - Both the general treaty anti-abuse rule and the LOB rule

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Action 6: three areas of work

A. Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances
B. Clarify that tax treaties are not intended to be used to generate double non-taxation
C. Identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country

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C. Tax policy considerations that should be considered before entering into a tax treaty

- Paragraphs to be added to the introduction of the Model Tax Convention
- Will make it easier for countries to justify their decision not to enter into tax treaties with certain low- or no- tax jurisdictions
- Also relevant with respect to the question of whether a treaty previously concluded should be maintained, changed or terminated, especially after substantial changes to domestic law of a treaty partner
- Only deals with tax policy; other factors may be relevant to the decision of concluding, maintaining or terminating a tax treaty

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B. Clarify that tax treaties are not intended to be used to generate double non-taxation

- Title:

  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 avoidance Convention between (State A) and (State B) with respect to taxes on income and on capital[1]

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B. Clarify that tax treaties are not intended to be used to generate double non-taxation

- Preamble:

  Desiring to further develop their economic relationship and to enhance their cooperation in tax matters,

  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 through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States)

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Why bother?

- Article 31(1) of the *Vienna Convention on the Law of Treaties:* "[a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose"
- Expressly recognises that the purposes of the Convention are not limited to the elimination of double taxation
- Given BEPS concerns related to treaty-shopping arrangements, express reference to such arrangements as an example of tax avoidance that should not result from tax treaties (not restrictive: only an example of tax avoidance that the Contracting States intend to prevent)

A. Rules to prevent the granting of treaty benefits in inappropriate circumstances

"*Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances*"

- Report includes a number of rules to address various situations loosely referred to as "treaty abuse"

When is it inappropriate to grant treaty benefits?

1. When a person tries to circumvent the limitations provided by the treaty itself

2. When a person tries to abuse the provisions of domestic tax law using treaty benefits

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When a person tries to circumvent the limitations provided by the treaty itself

- These are cases where a person seeks to obtain treaty benefits that would otherwise be unavailable by trying to circumvent treaty provisions:
  - Treaty shopping arrangements
  - Dividend/share transfer transactions to get to reduced rate of 5% in Art. 10(2)*a)*
  - Hiring-out of labour cases, to obtain benefit of Art. 15(2)
  - Others

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Circumvent the limitations provided by the treaty

- Domestic law will not address these types of transactions if it is drafted without regard to treaties
- The Commentary already discusses some of these transactions and includes suggestions
- The Report includes a number of new anti-abuse provisions intended to address such cases
- Transactions aimed at circumventing the permanent establishment threshold: Action 7 (Prevent the artificial avoidance of PE status)

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New treaty anti-abuse rules

- Limitation-on-Benefits (LOB) rule
- Principal Purposes Test (PPT) rule
- New minimum holding period for lower rate on dividends
- New rule for denying the lower dividend rate to certain CIV distributions
- Revised immovable property company rule
- Revised residence tie-breaker rule
- New rule for permanent establishments in third States

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The PPT rule

Notwithstanding the other provisions of this Convention, a benefit under this Convention 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 that 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 this Convention.

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When a person tries to abuse the provisions of domestic tax law using treaty benefits

- Some tax avoidance strategies seek to circumvent domestic law through the use of treaties
- In these cases, it is not sufficient to address the treaty issues: changes to domestic law are also required

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Treaty Issues

- Many countries have domestic anti-abuse rules or judicial doctrines that address such examples
- Additional domestic rules may well result from the work on Action 2 (Neutralise the effects of hybrid mismatch arrangements), Action 3 (Strengthen CFC rules), Action 4 (Limit base erosion via interest deductions and other financial payments)
- ***Treaty issues: the compatibility of these domestic anti-abuse rules with tax treaties***

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Practical examples of these treaty issues

- Do the provisions of a tax treaty prevent the application of a domestic GAAR?
- Do Art. 24(4) and Art. 24(5) prevent the application of domestic thin-capitalisation rules?
- Does Art. 7 and/or Art. 10(5) prevent the application of CFC rules?
- Does Art. 13(5) prevents the application of exit or departure taxes?
- Does Art. 24(5) prevents the application of domestic rules that restrict tax consolidation to resident entities?
- Does Art. 13(5) prevents the application of dividend stripping rules?
- Does Art. 13(5) prevents the application of domestic assignment of income rules (such as grantor trust rules)?

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Conclusions of the Report on these issues

- The Report notes that the Commentary already addresses a number of these issues, for example
  - CFC rules in para. 23 of the Commentary on Article 1
  - Thin capitalisation rules in para. 3 of the Commentary on Article 9

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Conclusions of the Report on these issues

- The inclusion of the PPT rule (which is based in the guiding principle) will confirm that treaty provisions do not apply where transactions or arrangements are entered into in order to obtain the benefit of these provisions in inappropriate circumstances
- This new provision does not modify, however, the conclusions already reflected in the Commentary on Article 1 concerning the interaction between treaties and domestic anti-abuse rules

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Conclusions of the Report on these issues

- The conclusions already found in the Commentary remain applicable, in particular with respect to treaties that do not incorporate the new general anti-abuse rule
- This is clarified through the addition of new Commentary that discusses more specifically the interaction between treaties and
  - Specific legislative anti-abuse rules
  - General legislative anti-abuse rules
  - Judicial doctrines that are part of domestic law

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New LOB rule (1/5)

1 . Except as otherwise provided in this Article, a resident of a Contracting State shall not be entitled to a benefit that would otherwise be accorded by this Convention (other than a benefit under paragraph 3 of Article 4, paragraph 2 of Article 9 or Article 25), unless such resident is a "qualified person", as defined in paragraph 2, at the time that the benefit would be accorded.

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New LOB rule (2/5)

- Paragraph 2 defines "qualified person". The definition applies to:
  - Individuals
  - The States and their subdivisions and entities
  - Certain publicly-listed companies
  - Non-profit organisations and pension funds
  - Companies that are at least 50% owned by residents of the same State and satisfy the 50% base erosion test
  - [Certain collective investment vehicles]

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New LOB rule (3/5)

- Paragraph 3 is the active business exception which applies to entities that do not qualify for treaty benefits under paragraph 2: the entity may receive treaty benefits with respect to an item of income if it is engaged in the active conduct of a business and the income is derived in connection with, or is incidental to, that business.

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New LOB rule (4/5)

- Paragraph 4 is a possible derivative benefits provision which would grant treaty benefits if at least 95 per cent of the company is owned by not more than 7 equivalent beneficiaries entitled to similar treaty benefits and the entity meets the 50% base erosion test

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New LOB rule (5/5)

- Paragraph 5 is a discretionary relief provision that allows the competent authority of a Contracting State to grant treaty relief if it determines that the creation or operations of the taxpayer did not have as one of its principal purposes the obtaining of treaty benefits

- Paragraph 6 includes the definitions of various terms found in the LOB rule

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Revised residence tie-breaker rule

3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, ***the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States***.

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Permanent establishments in third States

Where

a) an enterprise of a Contracting State derives income from the other Contracting State and such income is attributable to a permanent establishment of the enterprise situated in a third jurisdiction, and

b) the profits attributable to that permanent establishment are exempt from tax in the first-mentioned State…

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Permanent establishments in third States

... the tax benefits that would otherwise apply under the other provisions of the Convention will not apply to any item of income on which the tax in the third jurisdiction is less than 60 per cent of the tax that would be imposed in the first-mentioned State if the income were earned or received in that State by the enterprise and were not attributable to the permanent establishment in the third jurisdiction. ...

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Permanent establishments in third States

In such a case

c) any dividends, interest, or royalties to which the provisions of this paragraph apply shall remain taxable according to the domestic law of the other State but the tax charged in that State shall not exceed [rate to be determined] per cent of the gross amount thereof, and

d) any other income to which the provisions of this paragraph apply shall remain taxable according to the domestic law of the other State, notwithstanding any other provision of the Convention. ...

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Permanent establishments in third States

The preceding provisions of this paragraph shall not apply if the income derived from the other State is

e) derived in connection with or is incidental to the active conduct of a business carried on through the permanent establishment (other than the business of making, managing or simply holding investments for the enterprise's own account, unless these activities are banking, insurance or securities activities carried on by a bank, insurance enterprise or registered securities dealer, respectively), or

f) royalties that are received as compensation for the use of, or the right to use, intangible property produced or developed by the enterprise through the permanent establishment.

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Treaty provisions that may affect a State's right to tax its own residents

- The Report also deals with two issues related to attempts to use tax treaties in a way that would restrict a Contracting State's right to tax its own residents:
  - The addition of a "saving clause"
  - The relationship between treaties and departure taxes

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The new "saving clause"

This Convention shall not affect the taxation, by a Contracting State, of its residents except with respect to the benefits granted under paragraph 3 of Article 7, paragraph 2 of Article 9 and Articles 19, 20, 23, 24 and 25 and 28

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Treaties and departure taxes

- The Report clarifies that treaties do not prevent "departure taxes" ("exit taxes"), which are triggered when a resident ceases to be a resident of a State:

  "To the extent that the liability to such a tax arises when a person is still a resident of the State that applies the tax and does not extend to income accruing after the cessation of residence, nothing in the Convention, and in particular in Articles 13 and 18, prevents the application of that form of taxation."

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Treaties and departure taxes

- The Report also discusses the risks of double taxation arising from such taxes where the relevant person becomes a resident of another State which seeks to tax the same income at a different time, *e.g.* when pension income is actually received or when assets are sold to third parties
  - Not a new issue: was examined in the context of the work on employee stock-options

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New minimum holding period for lower rate on dividends

a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 25 per cent of the capital of the company paying the dividends throughout a 365 day period that includes the day of the payment of the dividend (for the purpose of computing that period, no account shall be taken of changes of ownership that would directly result from a corporate reorganisation, such as a merger or divisive reorganisation, of the company that holds the shares or that pays the dividend);

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Immovable property company rule

4 . Gains derived by a resident of a Contracting State from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed in the other Contracting State if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from immovable property, as defined in Article 6, situated in that other State.

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Case studies

- *Johansson*
- *Mills*
- *Slovenský plynárenský priemysel*

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Johansson (United States - 5th Cir. 1964)

- Facts:
  - Johansson established Swiss corporation and claims to become resident of Switzerland
  - Fights Floyd Patterson for the heavyweight boxing championship of the world in US as employee
  - Swiss tax authorities say Johansson is resident in Switzerland
- Issue: is Johansson entitled to benefit of Art. 15?

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Johansson (United States - 5th Cir. 1964)

- Treaty with Switzerland

  "An individual resident of Switzerland shall be exempt from United States Tax upon compensation for labor or personal services performed in the United States …if he is temporarily present in the United States for a period or periods not exceeding a total of 183 days during the taxable year and …. (a) his compensation is received for such labor or personal services performed as an employee of, or under contract with, a resident or corporation or other entity of Switzerland …

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Johansson (United States - 5th Cir. 1964)

- Is Johansson Swiss resident?

  "Johansson contends that, because of its position within the phrase "an individual resident of Switzerland," the term "resident" must be defined according to Swiss law. As conclusive proof that he comes within the Swiss definition of "resident" for tax purposes, he relies upon a determination by the Swiss tax authorities that he became a resident of Switzerland on December 1, 1959. Although the evidence on this point is ambiguous, the determination by the Swiss tax authorities may well have been based primarily upon Johansson's own declaration as to his residence in that country. "

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Johansson (United States - 5th Cir. 1964)

- "Applying this standard to the facts of the present case, the district court concluded that Johansson was not a resident of Switzerland during the period in question. This conclusion is fully supported by the evidence"
- "Even if we were to find that the district court erred in determining that Johansson was not a resident of Switzerland, the tax exemption in the Swiss treaty does not apply unless Johansson received the income in question as an employee of or under contract with a Swiss entity"

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Johansson (United States - 5th Cir. 1964)

- "Although some treaty provisions are inevitably the results of political compromise, the dominant criterion for determining the appropriate taxing locus is economic impact. Thus, as a general rule, the income from services is taxable where the services are rendered. See Smith, The Functions of Tax Treaties, 12 Nat'l Tax J. 317, 320 (1959). Where, as here, services are performed in the United States and the compensation for them is drawn from the wealth of the United States, this is the country of primary economic impact and, consequently, the appropriate taxing locus"

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Johansson (United States - 5th Cir. 1964)

- "Thus, while Johansson may have brought himself within the words of the Swiss treaty by his "residence" in Switzerland and his "employment" by a "Swiss corporation," he has failed to establish any substantial reasons for deviating from the treaty's basic rule that income from services is taxable where the services were rendered. International trade will not be seriously encumbered by our refusal to grant special tax treatment to one only marginally, if at all, a Swiss resident and only technically, if at all, employed by a paper Swiss corporation"

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Mills v Commissioner of Taxation

- High Court of Australia, decision dated 14 November 2012
- Decision on the general anti-avoidance rule of Australia
- Domestic case but Articles 10 and 11 of the Australia-New Zealand treaty are relevant

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Facts

- PERLS V (Perpetual Exchangeable Resaleable Listed Securities V) publicly issued by the Commonwealth Bank of Australia
- These stapled securities include a preference share and a subordinated unsecured note issued by the New Zealand branch ("stapled" because conditions of issue generally prevent the shares and the notes being traded separately)

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Facts

- PERLS V are “Non-innovative Residual Tier 1 capital” for the bank, i.e. counts as capital providing “a permanent and unrestricted commitment of funds, be freely available to absorb losses, not impose any unavoidable servicing charge against earnings and rank behind the claims of depositors and other creditors in the event of winding up”

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Facts

- Holder entitled to quarterly distributions, including interest on the notes at a distribution rate to be calculated each quarter, non-cumulative and at the discretion of the Bank (but if not paid a “dividend stopper” restricting the Bank from paying dividends, interest or distributions or returning capital on ordinary shares and certain other securities would arise)

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Facts

- PERLS V issued in 2009, after bank management determined that bank "would face a substantial capital requirement over the ensuing year due to business growth, potential acquisitions and foreign exchange movements"
- Decision to issue $600 million; due to strong demand, Board agreed to increase the maximum size of the issue of PERLS V to $2.25 billion

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Facts

- Tax ruling was sought in Australia but was expected to be adverse; agreed that would be settled by courts
- Tax ruling was obtained in New Zealand on deductibility of interest

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Facts

- Mills acquires PERLS V
- Claims an “imputation credit” (dividend tax credit) for the return on PERLS V (Australia has an imputation system under which corporate tax is credited in the hands of shareholders who receive dividends)
- Note issued by the branch in New Zealand (mostly used for loan to a bank subsidiary)
- Australia exempts foreign PE income

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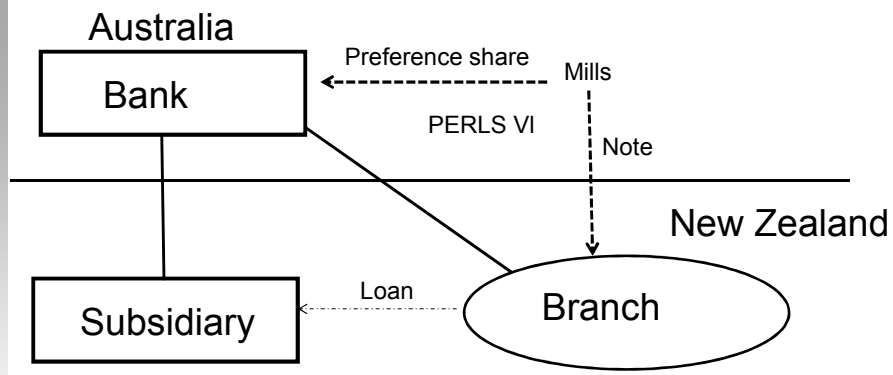
Facts



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Debt-equity distinction in Australia

- Under Australian law, the debt-equity distinction is more a matter of substance than of form
  - "equity interest can include not only an interest in a company as a member but also an interest that carries a right to a variable or fixed return from the company where the right itself or the amount of the return is either in substance or in effect contingent on the economic performance of the company ***or at the discretion of the company***"

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Part IVC of *Tax Assessment Act*

- General anti-abuse rule applies if

  "… having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme ***did so for a purpose*** (***whether or not the dominant purpose but not including an incidental purpose***) of enabling the relevant taxpayer to obtain an imputation benefit."

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Question

- Whether, having regard to the "relevant circumstances" of the arrangements for the issue of PERLS V, it would be concluded from the perspective of a reasonable person that the Bank entered into and carried out those arrangements "for a purpose (whether or not the dominant purpose but not including an incidental purpose) of enabling holders of PERLS V to obtain an imputation benefit"

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Decision

- Taxpayer wins
- "It would be concluded from the perspective of a reasonable person that the Bank entered into and carried out the arrangements for the issue of PERLS V for a purpose of enabling taxpayers who became holders of PERLS V to obtain franking credits."
- "It would also be concluded that the purpose was incidental to the Bank's purpose of raising Tier 1 capital."

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Discussion

- Hybrid mismatch arrangement
- BEPS concerns
  - Deduction in New Zealand
  - No taxation and dividend tax credit in Australia
  - Domestic law issue
- Treaty aspects
  - Article 7 and deduction of interest
  - Withholding tax aspects

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The cross-border aspects

- Hybrid mismatch arrangement
- BEPS concerns
  - Deduction in New Zealand
  - No taxation and dividend tax credit in Australia
  - Domestic law issue
- Treaty aspects
  - Article 7 and deduction of interest
  - Withholding tax aspects

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Australia-New Zealand Treaty

- Article 11 (Interest)

2. That interest may be taxed in the Contracting State in which it arises, and according to the law of that State, but the tax so charged shall not exceed 10 per cent of the gross amount of the interest.

3. The term "interest" in this Article includes … as well as all other income assimilated to income from money lent by the law, relating to tax, of the Contracting State in which the income arises, but does not include any income which is treated as a dividend under Article 10.

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Australia-New Zealand Treaty

- Article 10 (Dividends)

3. The term "dividends" in this Article means income from shares and other income assimilated to income from shares by the law, relating to tax, of the Contracting State of which the company making the payment is a resident for the purposes of its tax.

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Slovenský plynárenský priemysel

- Facts:
  - *Slovenský plynárenský priemysel (*SPP a.s.) is a Slovak gas company
  - Until 2003 its shares are owned
    - 51% by State
    - 24.5% by GDF Investissements s.a. (French resident)
    - 24.5% by Ruhrgas Mittel-und Osteuropa GmbH (German resident)
  - In March 2003, the French and German shareholders transfer their shares to Slovak Gas Holding B.V., a Dutch resident (SGH B.V.)

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Facts

- SGH B.V. :
  - No employees
  - Only assets are shares of SPP
  - No premises; registered office is in a building of GDF subsidiary in Zoetermeer, Netherlands
  - 4 directors: 2 from Rurhgas and 2 from GDF
  - Shareholders' agreement: important decisions required mutual agreement
  - 19 June 2003: a dividend of 3 719 907 231 SKK (around € 86 000 000) is paid to SGH B.B. by SPP a.s. for 2002; no withholding tax

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Facts

- SGH B.V.:
  - 25 June 2003; money invested in certificate of deposit expiring 1 August
  - 1 August 2003: makes a loan to Rurhgas and GDF for € 43 900 000 each (payable 30 November 2003)
  - Advanced dividend for 2003 declared by SGH on 28 November 2003 (year end is 31 December)
  - 5 December: difference between dividend and loans is paid to each shareholder (€ 172 791).

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Facts

- Slovak Republic joined the EU on 1 May 2004
- Czechoslovakia-Netherlands treaty (1974):

  "Notwithstanding the provisions of paragraph 2 the State of which the company is a resident shall not levy a tax on dividends paid by that company to a company the capital of which is wholly or partly divided into shares and which is a resident of the other State and holds directly at least 25% of the capital of the company paying the dividends."

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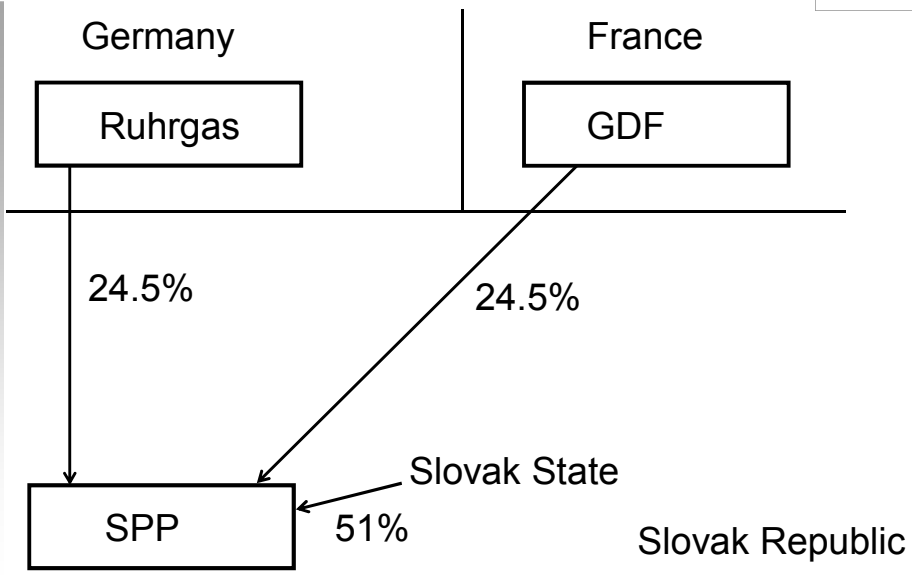
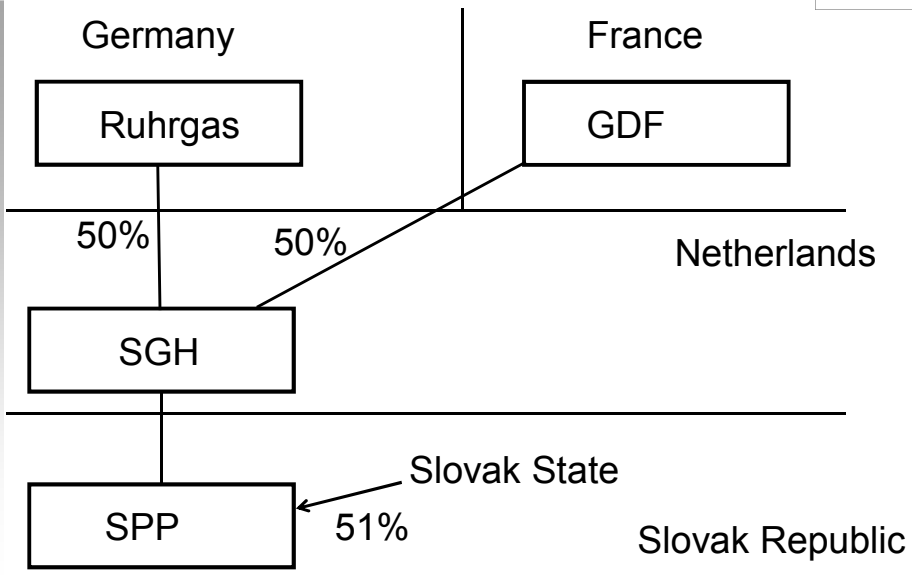
Facts



87

Facts



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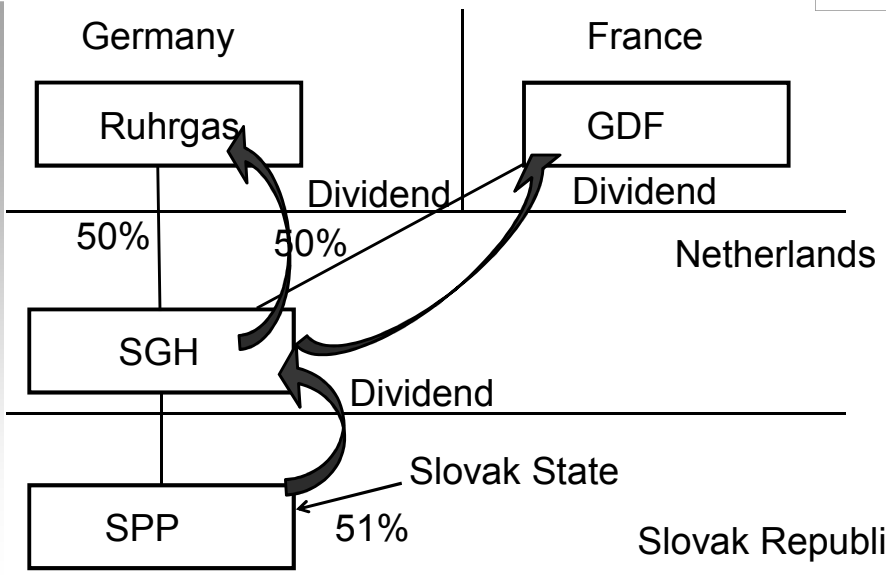
Facts


Germany
France
Ruhrgas
GDF
Dividend
Dividend
50%
50%
Netherlands
SGH
Dividend
Slovak State
SPP
51%
Slovak Republic

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