ABA Tax Section | 2015 Annual Meeting | Foreign Lawyers Forum

General Anti-Abuse Rules (GAAR) Rapidly Gaining Territory in Double Tax Treaties

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Agenda

- GAAR Background
- Action 6 (BEPS)
- Country-Specific Initiatives
  - Canada
  - China
  - India
  - Denmark
  - US
- Application & Resolution

GAAR Background

Level-set

- **Country tension in respect of attracting FDI, securing favorable reciprocal measures and protecting tax base**
  - Domestic law
  - Treaties
- **Laws may lag modern practices or fail to operate as originally envisaged**
  - Globalization / realignment of business
  - Mobility of capital
  - Novel business models / digital distribution
- **Fiscal pressure and budgetary considerations**
  - Political climate

Anti-abuse Measures

- **Specific vs. general measures**
  - *Specific* (SAAR) – bespoke rules targeting identified abuse areas
  - *General* (GAAR) – broad, non-specific rules targeting general "misuse" of law
- **Breadth**
  - SAARs – tend to be circumscribed
  - GAARS – more variable: anti-*avoidance* (broad) vs. anti-*abuse* (narrow)
- **Situs of rules – domestic law vs. treaty**
  - Location impact

Anti-abuse Measures – Overview

	Domestic Rules		Treaty Rules	
	SAAR	**GAAR**	**SAAR**	**GAAR**
Generally	VARIES		Arms-length Pricing LOB? Beneficial ownership	Main/principal purpose test?
United States	**SAAR** § 482 § 163(j) § 894(c) § 7701(*l*) (anti-conduit)	**GAAR** § 7701(o) (codified economic substance) Common law principles (step-transaction, SoF, etc.)	**SAAR** Arms-length Pricing LOB Beneficial ownership	**GAAR**

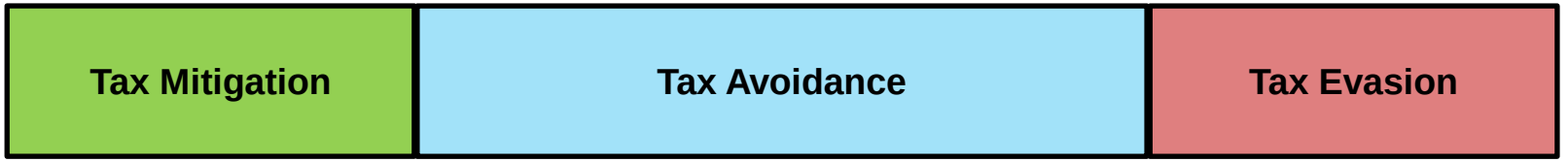
GAAR Trend

- **Increasing popularity**
  - GAARs have been around for a long time (*e.g.,* early 1900s)
  - Significant bodies have focused on GAAR proposals
    - European Commission (2012) – common GAAR in domestic laws
    - OECD BEPS Action 6
  - Anecdotal evidence suggests increasing GAAR enforcement
- **SAARs inadequate?**
  - Most countries interested in GAAR already have SAAR on books
  - A generalized response to cases (*e.g., Prevost , Velcro*)?
- **What happens if SAAR and GAAR intersect?**

GAAR Considerations

- **GAAR architecture**
  - Applicable test – narrow or broad?
    - *E.g.,* the main purpose vs. one of the main purposes
  - Certainty as to application
    - Extensive published guidance / examples vs. little / no guidance
  - Safeguards in application
    - Burden of proof – taxpayer vs. tax authority vs. both
    - Enforcement – unilateral by tax authority vs. advisory board concurrence
    - Review mechanisms
- **GAAR is inherently subjective; creating uncertainty for taxpayers**

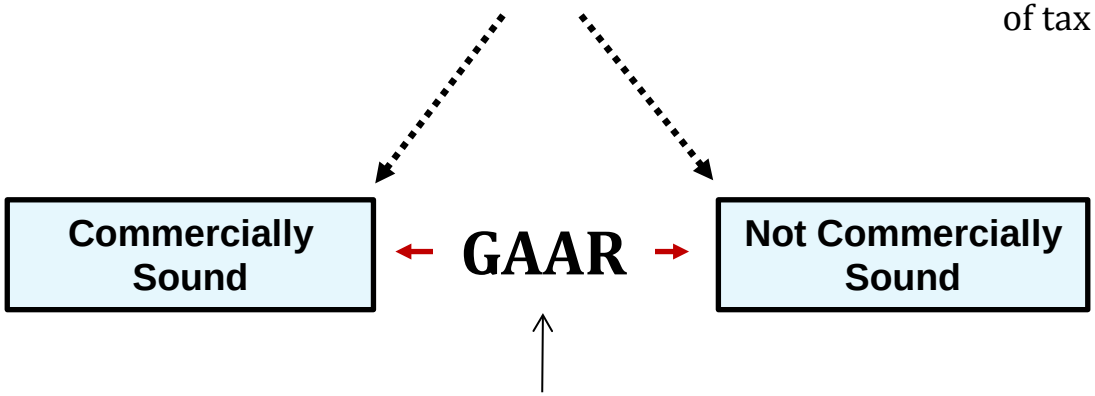
GAAR on the Planning Spectrum



- Utilizing gov't tax incentives

- Legal application of laws
- Economic or commercial soundness?

- Illegal activity
- Unjustifiable application of tax laws



Generally <u>subjective</u> assessments

Typically probes the <u>purpose</u> of a business structure / transaction

Additional GAAR Considerations

- **GAAR as provision of domestic law**
  - Treaty override?
  - MAP-ability?
- **Domestic GAAR used to interpret existing treaty**
  - Unilateral interpretation of treaty provisions (*e.g.,* via circular)?
- **GAAR explicitly addressed in treaty**
  - Specific substantive provision of treaty
  - Treaty explicitly permits application of domestic GAAR
- **Penalties / retroactivity**

BEPS Action 6

BEPS Action 6

- **The call to action**

> *Existing domestic and international tax rules should be modified in order to more closely align the allocation of income with the economic activity that generates that income: Treaty abuse is one of the most important sources of BEPS concerns…Tight treaty anti-abuse clauses coupled with the exercise of taxing rights under domestic laws will contribute to restore source taxation in a number of cases.*
>
> – BEPS Action Plan (2013)

- **The charge**

> *Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances*
>
> – BEPS Action 6 (2014)

Action 6 Timeline

- **14 March 2014 – Action 6 discussion draft released**
  - Proposal – *combined* treaty anti-abuse approach : LOB (SAAR) *plus* "main purpose test" (GAAR)
  - April 2014 – comments received / public consultation
  - US Treasury signals that it will "reserve" if MPT included in OECD model treaty
- **16 September 2014 – Action 6 report released**
  - Proposal – *fielder's choice* approach: "minimum standards" anti-abuse provisioning
- **21 November 2014 – Action 6 "additional work" discussion draft released**
  - Further work needed on – (1) LOB issues (*e.g.,* funds, EU law restrictions, active business provision), (2) PPT issues (*e.g.,* exclusion from arbitration, administrative resolution process), and (3) whether commentary should further clarify interaction of tax treaties and domestic GAAR
  - December 2015 – Action 14 (dispute resolution) discussion draft released
  - January 2015 – comments received / public consultation
- **May/June 2015 – Action 6 "additional work" report anticipated**

Evolution of Action 6

- **INITIAL APPROACH: Combined LOB + GAAR**

Modified US-style LOB

plus

"Main Purpose Test"

Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income ***if it is reasonable to conclude****, having regard to all relevant facts and circumstances, that obtaining that benefit was* ***one of the main 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*

- OECD Commentary (2003) to Article 1 already contained similar principles
- Significant opposition to MPT
- US Treasury to "reserve" / 1999 experience with Senate rejection of "main purpose"
- Others argued LOB is over/under-inclusive

Evolution of Action 6 (cont.)

- **REVISED: Minimum Standards**
  - All believe that anti-treaty abuse provisions should be included in tax treaties
  - Nonetheless, as long as countries have a *minimum level of protection* against treaty abuse, they can use the policy choices most appropriate to them. The selection menu at right should meet minimum standards
- **Follow-up work necessary**
  - Specifics of LOB rules (*e.g.,* EU compatibility)
  - PPT-related issues (*e.g.,* should application be excluded from arbitration provisions; should there be a form of administrative process)
  - Interaction of domestic GAARs and treaties

LOB + PPT*

or

"Principal Purpose Test"*

or

LOB + supplemental mechanism to deal w/ conduit situations

* Formerly called the "main purpose test" (MPT)

Country-Specific Initiatives

GAAR in Canada

Canada – Current Law

- **Canada has long had a general anti-avoidance rule ("GAAR") embedded in its domestic tax legislation**
  - Applies to deny a tax benefit realized in connection with an "avoidance transaction" that results in a misuse or abuse of the provisions of domestic legislation or a tax treaty
  - An avoidance transaction is a transaction (or part of a series) that gives rise to a tax benefit, unless the transaction was undertaken primarily for *bona fide* purposes other than to obtain the tax benefit
- **The GAAR was amended in 2005 to "clarify" [this was the Department of Finance's term, but many practitioners argue the amendment was a retroactive change in law] that the GAAR applies in respect of a transaction that results in a misuse or abuse of the provisions of a tax treaty**

Canada – Current Law (cont.)

- **A successful GAAR assessment in a treaty shopping context requires the Canada Revenue Agency ("CRA") to demonstrate that a particular transaction defeats the object, spirit and purpose of a particular provision of a treaty**
  - Crown has the burden of identifying a provision's object, spirit and purpose and showing that it has been misused or abused

Canada – Current Law (cont.)

- **CRA has not been successful in applying the GAAR in the treaty shopping context:**
  - In *MIL (Investments) S.A.*, 2007 DTC 5437, a Cayman Islands company (a jurisdiction without a tax treaty) continued into Luxembourg and sold shares of a Canadian company, the gain from which would, absent a treaty exemption, attract Canadian tax
  - MIL claimed an exemption from taxation in Canada under the terms of the *Canada-Luxembourg Tax Convention*, which exempted residents of Luxembourg from tax realized on the sale of shares of a company in which it held an interest of less than 10% of any class
  - The Federal Court of Appeal found in favor of the taxpayer – in a very brief oral decision, the court held that it could find no support for an abuse of the provisions of the Treaty or any underlying object or purpose that would justify a departure from the Treaty's plain words
  - See also commentary in *Antle v. R.* (2009)
- **CRA has not been successful in otherwise challenging international transactions on the basis of "beneficial ownership"**
  - See *Prevost Car Inc.,* 2009 DTC 5053
  - See *Velcro Canada Inc.*, 2012 DTC 1100

Canada – 2013 Government Consultation

- **In August 2013, the Department of Finance (Canada) launched a consultation paper on treaty shopping acknowledging that the decision in *MIL* was a particularly strong statement by the Federal Court of Appeal indicating that Canadian courts will require further legislative direction before finding that treaty shopping is an improper (and abusive) use of tax treaties**

Canada – Proposed Treaty Shopping Rule

- **In the 2014 federal budget (February 2014), the Department of Finance (Canada) set out four basic elements for a new domestic anti-treaty-shopping rule:**
  - Main Purpose Provision
  - Conduit Presumption
  - Safe Harbor Presumption
  - Relieving Provision

Canada – Proposed Treaty Shopping Rule (cont.)

1. Main Purpose Provision

- Treaty benefits will be denied if it is reasonable to conclude that *one of the main purposes* for undertaking a transaction (or a transaction that is part of a series of transactions or events) that results in the benefit was for the person to obtain the benefit.

Canada – Proposed Treaty Shopping Rule (cont.)

2. Conduit Presumption

- Presumed the main purpose condition is met if the relevant item of income is used primarily to pay, distribute or otherwise transfer, directly or indirectly, at any time or in any form, an amount to another person(s) that would not have been entitled to at least an equivalent benefit had the other person(s) received the relevant item of income directly

Canada – Proposed Treaty Shopping Rule (cont.)

3. Safe Harbor Presumption

- Subject to the conduit presumption, presumed that none of the main purposes of a transaction was to obtain a treaty benefit if one of the following exceptions is met:
  - Active Business Exception
  - Controlled Exception
  - Public Company Exception

Canada – Proposed Treaty Shopping Rule (cont.)

4. Relieving Provision

- If the main purpose provision applies in respect of a benefit under a tax treaty, the benefit is to be provided, in whole or in part, to the extent that it is reasonable having regard to all the circumstances

Canada – Proposed Treaty Shopping Rule (cont.)

- **On August 29, 2014, the Department of Finance issued the following News Release in connection with the issuance of draft legislation relating to other budget measures:**

  "After engaging in consultations on a proposed anti-treaty shopping measure, the Government will instead await further work by the Organisation for Economic Co-operation and Development and the Group of 20 (G-20) in relation to their Base Erosion and Profit Shifting initiative."

- **In its April 21, 2015 federal budget, the Department of Finance reiterated its commitment to wait on the conclusion of the BEPS Project following which it "will proceed in this area in a manner that balances tax integrity and fairness with the competitiveness of Canada's tax system."**

GAAR in China

China – Background

- **Enterprise Income Tax ("EIT") Law of PRC**
  Effective from January 1, 2008

  - **Article 47** – Other arrangements implemented by enterprises *without reasonable commercial purposes*, which result in reduction in taxable income, shall be subject to adjustments by the tax authority based on reasonable methods.

  - **Article 120 of the Detailed Implementation Rules of EIT Law** – "without reasonable commercial purposes" means *the main purpose* (of the arrangements) is to reduce, exempt from or defer tax payments.

China – 2009 Circular

- **Tax Administration – GAAR Investigation**
  Circular Guoshuifa [2009] No. 2 (国税发【2009】2号)
  - **Target**
    - Abuse of tax benefits
    - Abuse of double tax treaties
    - Abuse of corporate organizational structure
    - Use of tax heavens for tax avoidance
    - Other arrangements that are without reasonable commercial purposes
  - **Assessment**
    - Form and substance
    - Date of establishment and period of implementation
    - Mode of realization
    - Connectivity of each phase or component
    - Change in financial condition of parties concerned
    - Taxation result

China – 2009 Circular (cont.)

- **Tax Administration – GAAR Investigation**
  Circular Guoshuifa [2009] No. 2 (国税发【2009】2号)

  - The tax authority shall re-characterize the arrangements based on economic substance and reclaim the tax benefits derived by enterprises from implementation of the arrangements. For enterprises that are without economic substance, especially those established in tax heavens which result in tax avoidance by their related or non-related parties, their existence may be denied in terms of tax.

  - The tax authority may require the advisor or consultant of a tax avoidance scheme to provide the relevant documents.

  - GAAR investigation and adjustment must be approved by the State Administration of Taxation ("SAT").

China – GAAR Administrative Measures

- **GAAR Administrative Measures (Provisional)**
  《一般反避税管理办法(试行)》
  - Tax avoidance schemes adopted by enterprises without reasonable commercial purposes but for obtaining tax benefits shall be subject to special tax adjustments. A "tax avoidance scheme" has the following characteristics:
    - The sole or main purpose is to obtain tax benefits;
    - The tax benefits are obtained by using an arrangement where it complies with the tax law in form but is not consistent with its economic substance.
  - Special tax adjustments made by the tax authority shall be based on similar arrangements that have reasonable commercial purposes and economic substance and follow the principle of “substance-over-form”. The adjustment methods include:
    - Re-characterize part or all of the transactions involved in an arrangement;
    - Deny the existence of a transaction party, or regard the party and other transaction parties as on entity;
    - Re-characterize the relevant income, deductions, tax benefits, foreign tax credits, etc. or re-allocate among the transaction parties;
    - Other reasonable methods.

China – GAAR Administrative Measures (cont.)

- **GAAR Administrative Measures (Provisional)**
  《一般反避税管理办法(试行)》
  - Transfer pricing, cost-sharing, controlled foreign corporation ("CFC"), thin capitalization shall be regulated by the respective special tax adjustment rules; beneficial ownership, limitation on benefits ("LOB") shall be regulated by the respective rules for implementation of double tax treaties.
  - The tax authority utilizes the various source of information/data, e.g. EIT annual filing, tax assessment, contemporaneous documentation, equity transfer transaction, implementation of double tax treaty, etc. to search for cases pertaining to GAAR.
  - The tax authority should seek approval, level by level, from the SAT for commencing a GAAR investigation.

China – GAAR Administrative Measures (cont.)

- **GAAR Administrative Measures (Provisional)**
  《一般反避税管理办法(试行)》
  - Target enterprise should provide the following documents/information:
    - Background information of the arrangement;
    - Commercial purpose of the arrangement;
    - Internal decision and management documents, e.g. board resolution, memorandum, e-mail, etc.;
    - Other specific documents, e.g. contract, supplementary agreement, payment receipt, etc.;
    - Chain of communication between the parties concerned;
    - Other documents proving that the arrangement is not a tax avoidance scheme;
    - Other necessary documents requested by the tax authority.
  - The tax authority should formulate its initial view and report, level by level, to the SAT for review and approval in order to close the investigation.

China – Indirect Transfers

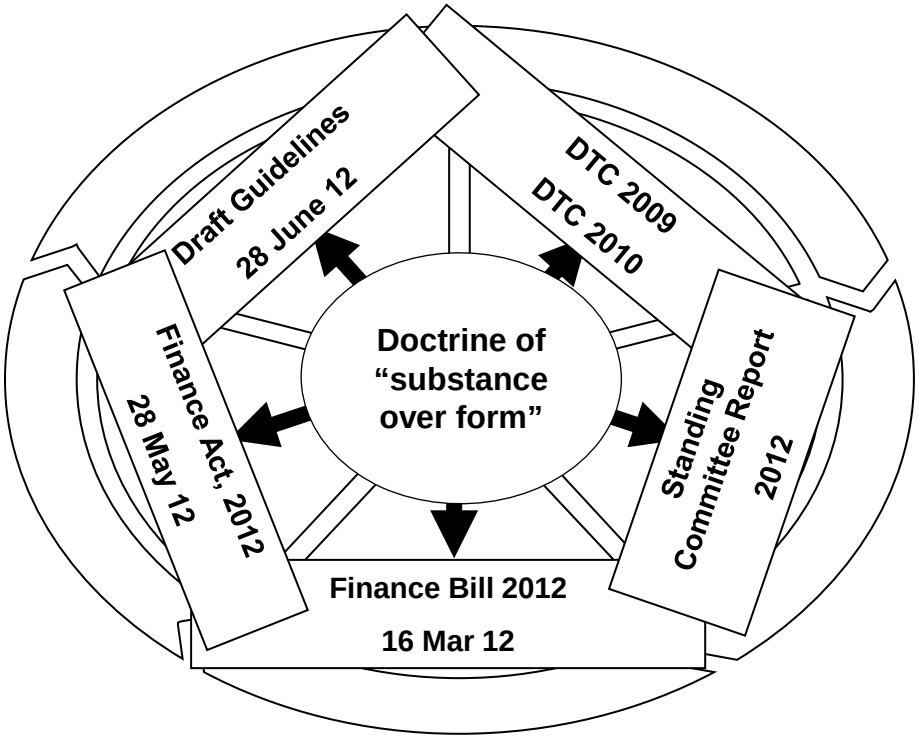
- **Indirect Transfer of China Taxable Assets – Bulletin 7**
  (国家税务总局公告2015年第7号)
  - Indirect transfer of China taxable assets conducted by non-resident enterprises through arrangements that do not have reasonable commercial purposes, which results in avoidance of EIT, shall be deemed as direct transfer of China taxable assets and thus subject to EIT in China.
  - Indirect transfer of China taxable assets: a non-resident enterprise transfers the equity (or other similar interests) of a foreign enterprise which directly or indirectly holds China taxable assets, which achieves the same or a similar result as or to that of a direct transfer.
  - China taxable assets: assets owned by business establishment in China, immovable properties situated in China, equity investment in resident enterprises.
  - The tax authority shall apply GAAR in the investigation and adjustment of indirect transfer of China taxable assets.

GAAR in India

India – Prelude to GAAR

- Substance over form
- Tax avoidance vs. tax evasion
- Use of treaty – intermediary
- Holding company structure
- Judicial anti-avoidance rules

India – Evolution to GAAR



14 July, 2012	Formation of review Committee
1 September, 2012	Committee deferred GAAR by 3 years.
14 January, 2013	Final report of committee and GAAR deferred for 2 years i.e. effective from F.Y. 2016-17.
27 September, 2013	GAAR Rules notified.

Finance Minister in Budget Speech 2012

"I propose to introduce GAAR in order to counter aggressive tax avoidance schemes…."

Explanatory Memorandum to Finance Bill, 2012

*….keeping in view the **aggressive tax planning** with the **use of sophisticated structures**, a need for statutory provisions so as to **codify the doctrine of "substance over form"**……*

Finance Minister in Budget Speech 2015

"There are also certain contentious issues relating to GAAR which need to be resolved. It has therefore been decided to defer the applicability of GAAR by two years."

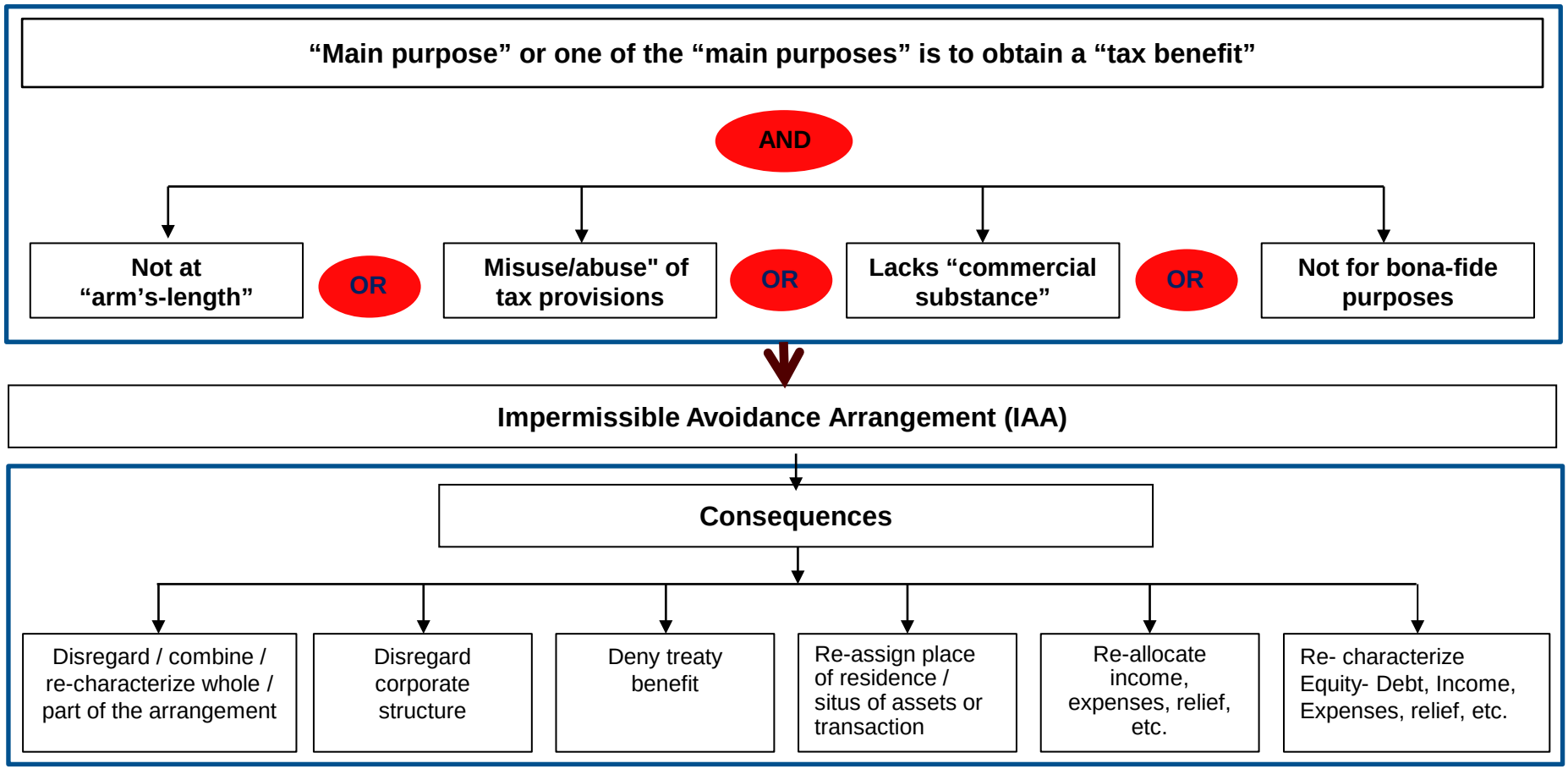
India – Continued Incertitude

Particulars	DTC 2009	DTC 2010	Finance Bill 2012	Finance Act 2012
Implementation Date	1 April 2011	1 April 2012	1 April 2012	1 April 2013
Burden of proof	Taxpayer	Taxpayer	Taxpayer	Tax Authorities
Scope	Wide	Wide	Wider than DTC	Wider than DTC
Reference to approving panel	NO	NO	YES	YES
Final authority to invoke GAAR	Commissioner	Commissioner	Approving Panel (Only Commissioners)	Approving Panel (Commissioners + Jt.Secretary from Ministry of Law)
Option to obtain AAR ruling	NO	NO	NO	YES

India – Mutation

- **The Central Board of Direct Taxes in September 2013 notified amendments in the Income Tax Rules, 1962, for the purpose of implementation of the GAAR regime**
  - **Relevant date**
    - Rule 10U(2) of Chapter X-A shall apply to any arrangement, irrespective of the date on which it has been entered into, in respect of the tax benefit obtained from the arrangement on or after the 1st day of April 2015
    - Investments made before Aug. 30, 2010, would not attract the provisions of GAAR
- **2015 Budget Proposals**
  - GAAR to be applicable prospectively to investments made on or after April 1, 2017
  - Investments made up to March 31, 2017 shall not be subjected to GAAR

India – GAAR Illustrated



Applies to both Indian Residents and Non-Residents

GAAR to override Treaties

India – 2015 Budget Proposal to Curb Black Money

- **The Undisclosed Foreign Income and Assets (Imposition of Tax) Bill, 2015**
- **Benami Transaction (Prohibition) Bill**

India – Undisclosed Foreign Income & Assets Bill 2015

- **The New Act shall be applicable from April 01, 2016**
- **Objectives of the Bill**
  - To tax undisclosed foreign income and assets acquired from such undisclosed foreign income
  - To punish the persons indulging in illegitimate means of generating money causing loss to the revenue
  - To prevent illegitimate income and assets kept outside India from being utilized in ways which are detrimental to India's social, economic and strategic interests and its national security
- **Salient features of the Bill**
  - Regular tax, interest, penalty, prosecution regime for undisclosed foreign income and assets of an ordinarily resident
  - Flat 30% tax on total undisclosed foreign income and asset
  - FMV of undisclosed foreign asset shall be taxable in year in which it comes to notice of Assessing Officer
  - One-time limited window compliance scheme – levy of tax, lower penalty of up to 100% of tax computed and no prosecution
  - No wealth tax and no interest under section 234A, 234B or 234C of Income Tax Act, 1961
  - Concealment of income/evasion of income in relation to a foreign asset to be made a predicate offence under Prevention of Money Laundering Act, 2002 ("PMLA"). As a result, the enforcement agencies to attach and confiscate unaccounted assets held abroad and launch prosecution against persons indulging in laundering of black money.
  - Severe penalty along with punishment of rigorous imprisonment up to ten years.

India – Benami Transaction (Prohibition) Bill

- **The Bill**
  - In order to curb domestic black money, a new Benami Transaction (Prohibition) Bill is proposed to be introduced to enable the confiscation of benami property
- **Salient features of the Bill**
  - Prohibits acceptance or payment of an advance of INR 20,000 or more in cash for any transaction in immovable property
  - PAN to be mandatory for any purchase or sale exceeding INR 100,000
  - Third party reporting entities would be required to furnish information about foreign currency sales and cross-border transactions
  - Enabling information sharing among various authorities to improve tax administration. Central Board of Direct Taxes (CBDT) and Central Board of Excise and Customs (CBEC) to use technology and exchange information in each other's database use of tools for utilization of such information to ensure compliance

GAAR in Denmark

Denmark – Prior to GAAR

- **Current Danish tax law**
  - Denmark has up to this point only had specific anti-abuse rules (SAAR), which have targeted specific practices which have been deemed to be abusive
- **The Danish Tax Authorities reasoning for a change**
  - The Danish tax authorities have faced several potential abuse cases
  - Combating tax havens
  - Expected amendments to EU Parent/Subsidiary Directive
  - The reasoning behind action point 6 of the BEPS initiative

Denmark – Two Parts of the Same Provision

- **Outline of the new rule**
  - The proposed provision has been divided into two parts:
    1. An EU tax directive anti-abuse provision
    2. A tax treaty anti-abuse provision

1. The EU tax directive anti-abuse provision

- Provision more /less mirrors the wording of the amended EU Parent/Subsidiary Directive
- Denmark "*shall not grant the benefits of this Directive to an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances*."
- "*An arrangement or series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.*"

Denmark – Two Parts of the Same Provision (cont.)

2. The tax treaty anti-abuse provision

- Treaty benefits will not be granted if "*it is reasonable to establish, taking into account all relevant facts and circumstances, that obtaining the benefit is one of the most significant purposes of any arrangement or transaction which directly or indirectly leads to the benefit, unless it is established that granting the benefit under such circumstances would be in accordance with the content and purpose of the tax treaty provision in question.*"

- **There is no real difference in the black letter law of the provisions**

Denmark – Application of the Proposed Rule

- **The range of the Danish GAAR**
  - The proposed Danish GAAR would cover not only the EU Parent/Subsidiary Directive, but also:
    - Danish double tax treaties
    - The EU Interest-Royalty Directive
    - The EU Merger Directive
  - The GAAR will not apply to the treaties or directives if the transactions have been put into place for valid commercial and economic reasons
  - Certain EU countries may be viewed as tax havens for Danish tax purposes
  - The provisions are scheduled to take effect 1 May 2015
  - No grandfathering rule will apply

Denmark – Criticism of the Proposed Rule Changes

- **The preparatory work is still in progress**
  - The BEPS initiative has not yet been concluded
    - ICC strongly cautions countries from taking unilateral action before the BEPS project has successfully been concluded and consensus has been reached
  - The expected EU amendment is developed through Court rulings
    - The range and interpretation of the EU amendments has yet to be fleshed out by the EU court system, which could be a very long process
    - If the range and interpretation is to be done by the individual courts of the membership states it will create uncertainties in predicting the outcome of cross-border transactions

Denmark – Criticism of the Proposed Rule Changes (cont.)

- **Uncertainty in the application of the proposed provisions**
  - The comments to the proposal states that potential differences b/t the two provisions must be determined through court proceedings incl. the EU courts.
    - This gives an impression that the Danish Parliament would have to accept the rule in blind faith to its application
  - The provisions are very vague and the commentaries to the proposal only marginally guide the interpretation
    - This gives the Danish Tax Authorities an uncertain amount of power, which could lead the tax authorities to test its limits
  - No real guidance as to when an arrangement is set up for valid commercial and economic reasons
    - The only guidance is found in the comments, which states that the distinction is to be based on an objective analysis of the factual and legal circumstances

Denmark – Conclusion for Now

- **Due caution must be shown**
  - With the amount of uncertainty regarding the application of the rules, caution should be shown and specific tax advice thereon should be obtained, in particular when implementing financial or organizational structures.
    - Even if legitimate business reasons exist to implement the structure in question, the structure may by the Danish Tax Authorities be deemed to be “tax-motivated”

GAAR IN US

US View on Anti-Abuse Measures

- **Historically**
  - **Treaty provisions**
    - Limitation on Benefits (LOB) provisions
    - Beneficial ownership
  - **Domestic law provisions**
    - Specific anti-abuse rules (*e.g.,* § 482, conduit-financing)
    - Judicial doctrines (*e.g.,* step-transaction, substance-over-form)
    - Generally no codified GAAR (until March 2010)

US View on GAAR

- **Economic Substance Doctrine – § 7701(o)**
  - **Codified as domestic law – March 2010**

> *In the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if:*
>
> *(1) The transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position; and*
>
> *(2) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.*

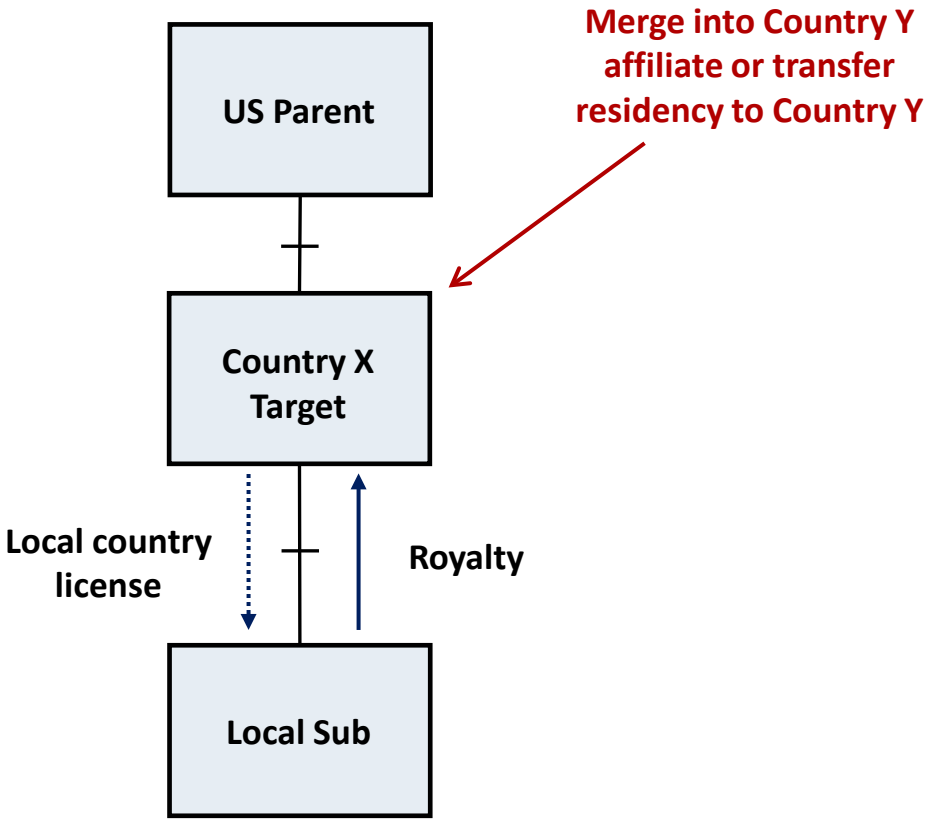
  - **Application**
    - Transactional
    - Strict liability penalty – 20% (40% if not disclosed)
    - Some published guidance regarding interpretation

US Treaties

- **Treaty position**
  - **2006 US Model Treaty & Treasury Technical Explanation**
    - Limitation on Benefits (LOB) provisions
    - Beneficial ownership / anti-conduit principles
  - **2016 US Model update?**

Application & Resolution

Application – Example



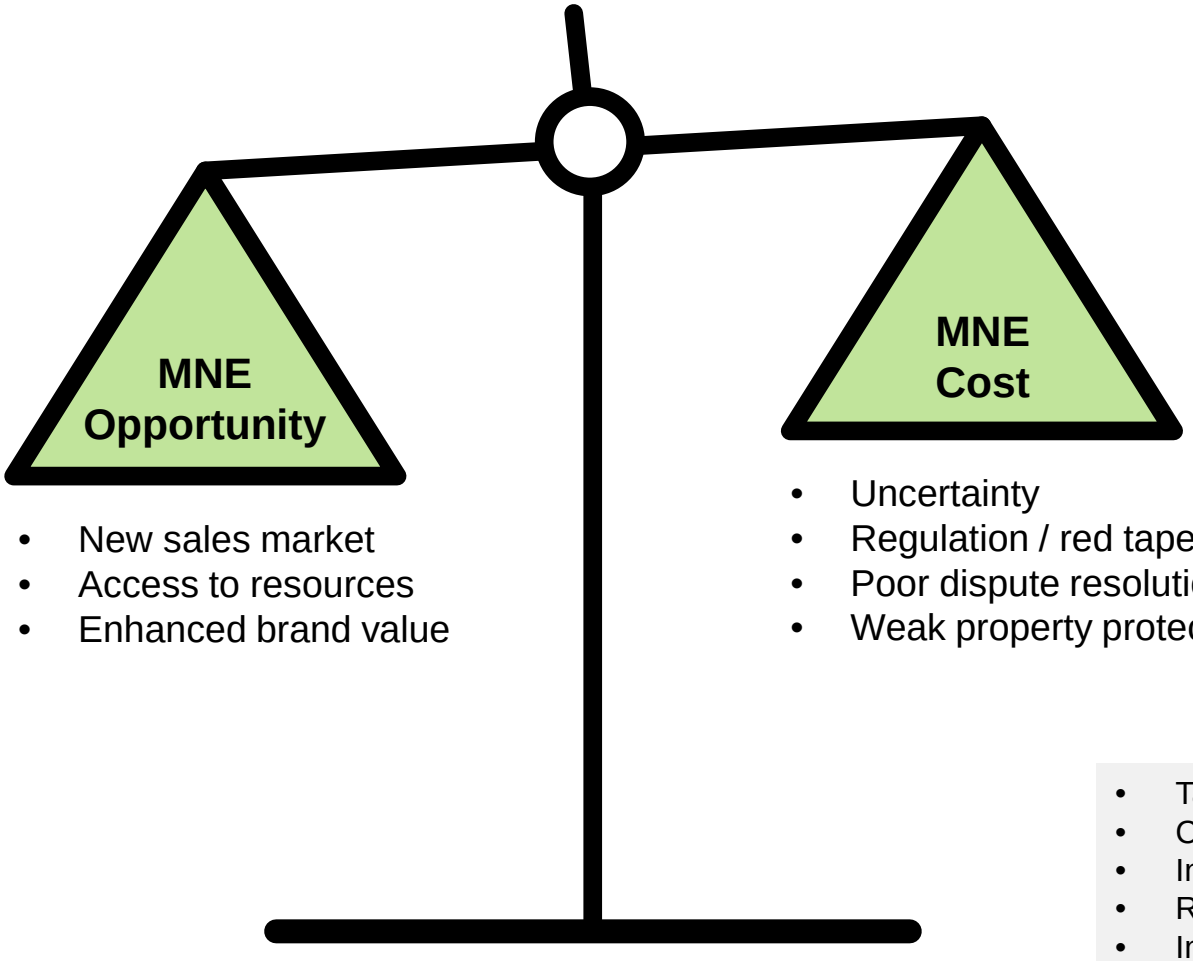
- **Country X – Local Country treaty provides 15% WHT on royalties and no Art. 13 exemption**
- **Country Y – Local Country treaty provides 0% WHT on royalties and full Art. 13 exemption**
- **Consider alternatively:**
  - Target is newly-acquired, and merges into existing Country Y affiliate
  - Target is old/cold and merely shifts residence to Country Y

QUERY: How would GAAR be applied if Local Sub was in your jurisdiction?

MNE's Perspective on PPT

- **Significant concern**
  - **Lack of certainty** – PPT is highly subjective / potential for inconsistent interpretations
    - Financial reporting concerns (*e.g.,* ASC 740 / FIN 48)
    - May negatively influence FDI decisions
    - US Senate rejected MPT in 1999 for similar reason
  - **Threshold issue concerns** – as drafted, tax administrators have low threshold to apply ("reasonable to conclude," "one of the principal purposes," "directly or indirectly") whereas taxpayers have high hurdle to rebut (must "establish" that granting benefit is in accordance with "object and purpose")
    - Merely because present in jurisdiction (*e.g.,* small vs. large country)?
  - **General critique of OECD's approach**
    - Has not obviously reduced (and has possibly hastened) unilateral action
  - **Dispute resolution?**

MNE's Perspective on FDI



- New sales market
- Access to resources
- Enhanced brand value

- Uncertainty
- Regulation / red tape
- Poor dispute resolution process
- Weak property protections

Translated to Tax

- Tax law ambiguity / uncertainty
- Compliance / reporting costs
- Inadequate respect for rule of law
- Revenue-driven tax enforcement
- Inadequate dispute resolution process

GAAR & Dispute Resolution

- **Dispute resolution is critical PPT issue**
  - Effective / timely administrative process requested
  - Concerns about local country bias (conscious or not)
  - Advance ruling / pre-clearance mechanism?
  - Senior review board approval before application of PPT?
  - Want to avoid drawn-out MAP where CAs disagree on PPT application
  - Binding arbitration?
- **Action 6 / Action 14**
  - **September / November 2014** – Action 6 re domestic / treaty GAAR conflicts
    - New commentary to confirm PPT does not modify views on domestic GAAR / treaty interaction, but inquires whether further clarity needed
    - Asks whether PPT should be excluded from scope of Art. 25(5) arbitration
    - Asks whether should be administrative process so that PPT applied only senior-level review

GAAR & Dispute Resolution (cont.)

- **Action 6 / Action 14 (cont.)**
  - **December 2014 –** Action 14 discussion draft released

> *Make dispute resolution mechanisms more effective. Develop solutions to address obstacles that prevent countries from solving treaty-related disputes under MAP, including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases.*
>
> – BEPS Action 14 (2014)

  - **No strong endorsement for mandatory binding arbitration**
  - **What is / is not MAP-able?** Access to MAP uncertain when domestic / treaty GAAR implicated
    - Interpretation of Action 6's PPT seemingly should be MAP-able
    - Consider providing MAP access if disagreement re whether treaty GAAR met or whether domestic GAAR conflicts with treaties
    - If limit / deny MAP, perhaps specifically agree on such limitations with treaty partners
    - If deny MAP based on domestic GAAR or treaty GAAR, notify of case / circumstances

QUESTIONS?