EC TAX REVIEW 2014–4

Editorial

Where is EU Law in the OECD BEPS Discussion?

Eric C.C.M. Kemmeren*

1 Who is accountable for BEPS?

Around the globe, a fierce discussion on BEPS (Base Erosion and Profit Shifting) is going on. The focus seems to be predominantly on actions of the business society reducing its corporate tax burden. Reputations of a number of MNEs are under discussion, also in the main press. I refer, e.g., to Starbucks, Google, Facebook, Ikea, the Rolling Stones and U2.

However, it should not be forgotten that benefiting from (differences in) tax systems has been made possible by the same countries who are now complaining about BEPS structures. They have made them possible by enacting the current national and international tax systems. MNEs and others make use of those benefits, not rarely promoted by the same countries in their other role as player of the game tax competition. In the context of tax competition, they did not only introduce specific national tax incentives, but they also used their national legislation in conjunction with their tax treaty networks to promote themselves as a great country to invest in or to use as an investment hub. They were not really interested in cooperating with each other to align tax systems, as long as they thought that they had more to gain from tax competition than from tax coordination.[1] More than a decade ago this triggered the debate on harmful tax competition amongst predominantly countries themselves.[2] Which country was to blame? The method of naming and shaming was also used, but at that time the countries themselves were the suspects.

However, times have changed. Budget deficits forced countries to look for 'new money'. Where the focus was for a long time on tax competition, now the focus is much more on tax coordination. This debate has been started by the Organisation for Economic Co-operation and Development (OECD).[3] It was successful to get BEPS on the political agenda of the G-20, and, subsequently, to get the assignment from that G-20 to come up with suggestions for actions against BEPS. BEPS is not only on the agenda of the G-20,but it also is on the EU agenda.[4] That is not very strange, because quite a number of the EU Member States are also involved in the OECD and the G-20.

However, what seems to be strange is that in the discussion within the OECD on BEPS, EU law does not play any (significant) role, at least not in the published OECD public discussion drafts up till now.[5] This is curious, because EU law may set restrictions on suggested actions. As a result, some of the suggested actions may not be as effective as the OECD seems to suggest if EU Member States are involved. If EU law does not allow the suggested actions, the suggested anti-BEPS actions can only be partly implemented, i.e., outside the EU context. Such a result does not contribute to a global level playing field and not to the further development of EU's internal market. One cannot just ignore EU law, because of the OECD's ambitious timeframe or because of the increasing complication of the discussions when EU law is taken into account. If countries want to implement effective measures against BEPS structures, they must also take

* Prof. Dr Eric C.C.M. Kemmeren is professor of international tax law and international taxation at the Fiscal Institute Tilburg of Tilburg University, The Netherlands. He is also a member of the board of the European Tax College, deputy justice of the Arnhem Court of Appeals (Tax Division), and of counsel to Ernst & Young Belastingadviseurs LLP, Rotterdam, The Netherlands.

1 Compare also, e.g., C.A.T. Peters, The Faltering Legitimacy of International Tax Law, PhD thesis Tilburg University, the Netherlands, p. 175, Peter Essers, International Tax Justice between Machiavelli and Habermas, *Bulletin for International Taxation*, 2014 (Volume 68), No. 2, 2014/02/01, and Eric C.C.M. Kemmeren, The Netherlands: Must a Fiscal Unity with a Company in Another Member State Be Allowed (Cases C-39/19 [SCA Group], C-40/13 [X AG] and C-41/13 [MSA International]) in: Michael Lang, Pasquale Pistone, Josef Schuch, Claus Staringer, and Alfred Storck, ECJ-Recent Developments in Direct Taxation 2013, Series on International Tax Law, volume 83, Linde Verlag Wien, Wien, Österreich 2014, pp. 169–170.

2 See, e.g., OECD, *Harmful Tax Competition, An Emerging Global Issue*, OECD Paris 1998, Resolution of the Council and the Representatives of the Governments of the Member States, Meeting within the Council of 1 Dec. 1997 on a Code of Conduct for Business Taxation, OJ C 2, 06/01/1998, 2 and Carlo Pinto, Tax Competition and EU Law, *EUCOTAX Series on European Taxation*, volume 7, Kluwer Law International, The Hague (The Netherlands), 2003.

3 See for more information about OECD BEPS initiative, e.g., http://www.oecd.org/ctp/beps.htm.

4 See, e.g., European Commission 6 Dec. 2012, C(2012) 8806 final: Recommendation on aggressive tax planning.

5 See for the published OECD public discussion drafts: http://www.oecd.org/ctp/beps.htm.

EU law into account. It is beyond this editorial to discuss all OECD public discussion drafts. It will only focus on BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances (hereafter also: OECD Draft), and, because of the same restrictions, it will only touch some of the suggested actions.

2 BEPS Action 6 (preventing the granting of treaty benefits in inappropriate circumstances) and EU law

This public discussion draft discusses treaty provisions and domestic rules to prevent the granting of tax treaty benefits in inappropriate circumstances. The report distinguishes cases where a person tries to circumvent limitations provided by the tax treaty itself and cases where a person tries to abuse the provisions of domestic tax law using tax treaties. Furthermore, it is emphasized that tax treaties are not intended to be used to generate double non-taxation. The draft ends with tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country. Below, two suggested actions to prevent treaty shopping will be addressed.

2.1 LOB and EU Law

The OECD Draft defines treaty shopping as:

> arrangements through which a person who is not a resident of a Contracting State may attempt to obtain benefits that a tax treaty grants to a resident of that State.[6]

First, it should be noted that not all treaty shopping should be classified as abuse. If a company must make an investment decision, sound entrepreneurship requires to take also into account taxes as one of the ordinary expenses. Efficiency considerations require to produce at the lowest costs possible, and those costs include taxes amongst which corporate income tax is only one of them. Therefore, reducing taxes is and should be part of any business strategy. In this context, not only domestic laws are relevant, but also tax treaties. Therefore, countries with a tax treaty network which may contribute to reducing corporate income taxes may be more attractive to invest in than other countries. The tax treaty network of a country may be one of the important reasons to allocate economic activities that country. In substance, this is also a case of treaty shopping but I do not see why obtaining the tax treaty benefits concerned should be classified as abuse. Essentially, the European Court of Justice (ECJ) has decided that benefiting from (differences in a) tax systems of EU Member States is fundamental to the EU.[7] This approach is not only relevant in respect of taxes, but is generally applicable. For example, the *Centros* and *Inspite Art* cases show that persons may take advantage from less restrictive company law systems of other Member States in order to exercise their freedom of establishment through which they intend to avoid the application of more restrictive company law rules of their state of origin.[8] Therefore, I believe that the wide OECD perspective that treaty shopping is (almost) per se abuse does not really match with the ECJ perspective which is more restrictive.

In order to prevent tax treaty shopping as defined in the OECD Draft, it suggests to include in tax treaties a specific anti-abuse rule: a limitation on benefits (LOB) provision similar to Article 22 of the US Model Tax Convention (2006).[9] However, this and similar provisions have been very much debated. Are they consistent with EU law?[10] Opinions differ, but a large part of academic literature believes that these LOB provisions are not consistent with EU law at all. Others are less sceptical. My personal opinion is that, because of the active-conduct-of-a-trade-or-business-test,[11] the provisions are to be considered to be in line with EU law with the exception of the exclusion of the business of making or managing investments.[12] In any case, it is not self-evident the these LOB provisions may survive the test to EU law, because DTCs must also be consistent with EU law,[13] also DTCs concluded with third countries.[14] Up till now, the ECJ did not decide an LOB

[6] See OECD Draft, 3.

[7] See, e.g., ECJ 12 May 1998, Case C-336/96 (*Gilly*), ECJ 26 Oct. 1999, Case C-294/97 (*Eurowings*), and ECJ 3 Oct. 2002, Case C-136/00 (*Danner*).

[8] See ECJ 9 Mar. 1999, Case C-212/97 (*Centros*) and ECJ 30 Sep. 2003, Case C-167/01 (*Inspire Art*).

[9] See OECD Draft, pp. 5–9.

[10] See, e.g., Dirk van Unnik & Maarten Boudestijn, *The New US-Dutch Tax Treaty and the Treaty of Rome*, EC Tax Rev. (1993/2), Adolfo J. Martín-Jeménez, *EC Law and the Clauses on 'Limitation of Benefits' in Treaties with the US after Maastricht and the US-Netherlands Tax Treaty*, EC Tax Rev. (1995/2), A.H.M. Vredenbregt, *Beperking van voordelen onder het Nederlans-Amerikaans belastingverdrag in relatie tot het Verdrag van Rome*, WFR 1153–1166 (1994/6114), A.C.G.A.C. de Graaf, *De invloed van het EG-recht op het internationaal belastingrecht, beleids- en markintegratie* 184–186 (Kluwer 2004), Félix Vega Borrego, Limitation on Benefit Provisions in Double Taxation Conventions, *EUCOTAX Series on European Taxation*, volume 12, Kluwer Law International, London 2005, John Bates, e.a., *Limitation on Benefits Articles in Income Tax Treaties: The Current State of Play,* Intertax 395–404 (2013/6&7).

[11] See, e.g., Art. 22(3)(a) US Model Tax Convention (2006).

[12] See, e.g., Eric C.C.M. Kemmeren, The Netherlands, in: Peter HJ Essers, Guido JME de Bont, Eric CCM Kemmeren, The Compatibility of Anti-Abuse Provisions in Tax Treaties with EC Law, *EUCOTAX Series on European Taxation*, volume 1, Kluwer Law International, London 1998, 134–146, and Eric C.C.M. Kemmeren, *Principle of Origin in Tax Conventions*, A Rethinking of Models, diss. 2001, Katholieke Universiteit Brabant, Tilburg, pp. 177–188 en 282–290, available on: http://webwijs.uvt.nl/publications/304239_ext.pdf.

[13] See, e.g., ECJ 1 Jan. 2006, Case C-265/04 (*Bouanich*) and ECJ 28 Feb. 2008, Case C-293/06 (*Deutsche Shell*). The latter case dealt with a restriction without discrimination.

[14] See, e.g., ECJ 21 Sep. 1999, Case C-307/97 (*Saint-Gobain*).

case, although it is sometimes upheld otherwise based on the *ACT GLO* case,[15] but that case dealt only with a most favoured nation issue.[16] In any case, the BEPS discussions within the OECD on LOB provisions should at least address potential EU law conflicts.

2.2 Main Purpose Test and EU Law

Another suggestion to counter treaty shopping as defined by the OECD is to include a more general rule to address treaty avoidance cases, even in addition to specific LOB provisions: a main purpose rule.[17] The rule to be included reads as follows [italics added]:

> 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.

From an EU law perspective, at least two flaws may be identified. First, 'it is reasonable to conclude' may create too much uncertainty to taxpayers which is not acceptable to the ECJ. This is not only true in respect of discretionary powers of tax administrations as was at issue in, e.g., the *Biehl* case,[18] but as we learn from the ECJ case law this is also relevant in respect of the rules themselves which deal with transnational situations. They must be sufficiently clear, precise and predictable. For example, in the *Itelcar* case, the ECJ decided that the term 'special relations' in the Portuguese corporate income tax law which dealt with the limitation of interest deduction, violated the general principle of legal certainty:

> [. . .] the rules in question do not make it possible, at the outset, to determine their scope with sufficient precision. Accordingly, they do not meet the requirements of legal certainty, in accordance with which rules of law must be clear, precise and predictable as regards their effects, especially where they may have unfavourable consequences for individuals and companies. As it is, rules which do not meet the requirements of the principle of legal certainty cannot be considered to be proportionate to the objectives pursued.[19]

Second, tax treaty benefits will not be granted if obtaining of that benefit was 'one of the main purposes'. As explained in the draft, the [italics added]:

> reference to 'one of the main purposes' [. . .] means that obtaining the benefit under a tax convention need *not* be the sole or *dominant* purpose of a particular arrangement or transaction. It is sufficient that *at least one of the main purposes* was to obtain the benefit.[20]

This language is similar to the language used in Article 15 of the Tax Merger Directive [italics added]:[21]

> A Member State may refuse to apply or withdraw the benefit of all or any part of the provisions of Articles 4 to 14 where it appears that one of the operations referred to in Article 1:
>
> (a) has as its principal objective or as *one of its principal objectives* tax evasion or tax avoidance; [. . .]

In, e.g., the *Kofoed* case, the ECJ decided that this provision:

> reflects the general Community principle that abuse of rights is prohibited.[22]

This general principle was explained in a number of cases to which the ECJ also referred in the *Kofoed* case. It referred to both direct tax and indirect tax (VAT) cases and also to non-tax cases. Therefore, the abuse of rights concept is one overarching concept,[23] and not only applicable to tax cases. In the context of taxation, the ECJ repeated in, e.g., the *Part Service* case, that one of the conditions for applying this general principle is [italics added]:

> that *the essential aim* of the transactions concerned is to obtain a tax advantage. [24]

In the same ruling, it phrased this condition a bit differently, but this wording does not change the substance of the condition. It only confirms the condition in other words [italics added]:

15 See, e.g., John Bates, e.a., *Limitation on Benefits Articles in Income Tax Treaties: The Current State of Play*, Intertax 403–404 (2013/6&7).

16 See ECJ 12 Dec. 2006, Case 374/04 (*Test Claimants in Class IV of the ACT Group Litigation*). Compare also, e.g., E. C.C.M. Kemmeren, LOB ≠ MFN, in: D.A. Albregtse en P. Kavelaars, *Maatschappelijk heffen*, deel 1, Kluwer, Deventer 2006, pp. 417–431.

17 See OECD Draft, pp. 10–14.

18 See ECJ 8 May 1990, Case 175/88 (*Biehl*).

19 See, ECJ 3 Oct. 2013, Case C-282/12 (*Itelcar*), para. 44. See also ECJ 5 Jul. 2012, Case C-318/4255 (*SIAT*), paras 58–59. Compare also e.g., ECJ 8 Dec. 2011, Case C-81/10P (France Télécom), para. 100.

20 See OECD Draft, 12, para. 31.

21 See Council Directive 2009/133/EC of 19 Oct. 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States.

22 See ECJ 5 Jul. 2007, Case C-321/05 (*Kofoed*), para. 38. See also ECJ 10 Nov. 2011, Case C-126/10 (*Foggia*), para. 50.

23 See also, e.g., Dissenting e.g., Ben Kiekebeld, *Anti-abuse in the Field of Taxation: Is There One Overall Concept?* EC Tax Rev. 144–145 (2009/4). Dissenting, e.g., Frans Vanistendael, Halifax & Cadbury Schweppes, *One single European theory of abuse in tax law?* EC Tax Review 1992–195 (2006/4).

24 See ECJ 21 Feb. 2008, Case 425/06, (*Part Service*), para. 42.

> that there can be a finding of an abusive practice when the accrual of a tax advantage constitutes *the principal aim* of the transaction or transactions at issue.[25]

Taken this case law together, the conclusion must be that the wording of 'one of its principal objectives' in the Tax Merger Directive must, as a reflection of the general principle of prohibition of the abuse of rights, be interpreted that the *essential* or *principal* aim of the transaction is to obtain a tax advantage. In other words, the minimum threshold for refusing benefits under the EU abuse of law concept is that the *dominant* purpose of a particular arrangement is obtaining the tax benefit concerned. The OECD upholds in its Draft exactly the opposite. I can only conclude that the OECD position is not in line with EU law, because also tax treaties must be interpreted and applied consistently with EU law as we have learned from, e.g., the *Saint-Gobain*, *Bouanich* and *Deutsche Shell* cases.

[25] See para. 45.

3 Conclusion

From the above, I believe that it is obvious that the countries themselves are (at least partly) accountable for BEPS. They are also accountable for ignoring the (potential) impact of EU law within the OECD discussions on actions to counter BEPS. If they continue do so, they will also be accountable for the result that a number of actions may not be as effective suggested by the OECD. Therefore, it is time to broaden the OECD discussions on BEPS with the EU law perspective.