THE 2003 REVISIONS TO THE COMMENTARY TO THE OECD MODEL ON TAX TREATIES AND GAARS: A MISTAKEN STARTING POINT

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Resumen: En enero de 2003 la OCDE introdujo importantes reformas en los Comentarios al Convenio Modelo en relación con el problema la de aplicación de cláusulas internas anti-abuso en un contexto internacional. Conforme a la nueva posición de los Comentarios la aplicación de dichas cláusulas nunca podría dar lugar a un conflicto con los convenios de doble imposición pues constituyen exclusivamente reglas para determinar los hechos que eventualmente pueden dar lugar al nacimiento de la obligación tributaria. Nuestro trabajo tiene como objetivo aflorar algunas debilidades de esta posición: 1) Resulta jurídicamente inconsistente y promueve la confusión entre transacciones simuladas y elusivas; 2) Se aparta de la verdadera solución del problema que pasa por el análisis de las técnicas de aplicación de normas desde una perspectiva de teoría del Derecho. Conforme a este análisis demostramos cómo gran parte de los supuestos de *treaty shopping* pueden resolverse mediante una correcta interpretación de los criterios de imputación de rentas regulados por el Derecho interno. 3) El *principio guía* elaborado por los Comentarios facilita la aplicación de cláusulas generales anti-abuso a transacciones que ni siquiera resultan artificiales lo que, a su vez, conduce a que dicha posición sea más que cuestionable desde la perspectiva del Derecho Comunitario Europeo.

Palabras clave: Convenios de Doble Imposición, OCDE, Comentarios al Convenio Modelo de la OCDE, Cláusulas generales anti-abuso, Simulación, Compra de tratados, Compra de reglas del tratado, Imputación de rentas, Interpretación teleológica, Principio-Guía, Negocios totalmente artificiales.

Abstract: In January 2003 the OECD issued an important revision to the Commentary to the OECD Model concerning the improper use of tax treaties. Based upon the idea that *GAARs* are rules set by domestic tax laws for determining which facts give raise to a tax liability, no conflict may arise with tax treaties. Our contribution tries to prove several weaknesses of this argument: 1) It is legally inconsistent and encourages confusion between sham and avoidance in the tax field. 2) Moves away from the real solution of the issue which requires an in deep analysis on the existence of a universal law-application theory (*e.g.* concepts of interpretation and analogy). According to this, we demonstrate that many treaty shopping cases might be faced by a mere interpretation of the attribution rules set up by domestic tax laws. 3) The *guiding principle* elaborated by the OECD Commentaries also merits criticism as it might encourage the application of a domestic GAAR to non-artificial transactions generating thereby also serious concerns from a European Law perspective.

Key words: Double Taxation Conventions, OECD, Commentary to the OECD Model, General anti-avoidance Rules, Sham, Treaty Shopping, Rule Shopping, Attribution of Income to a Person, Purposive Interpretation, Guiding Principle, Wholly Artificial Arrangements.

I. Introduction. Scope and structure of the article

1. More frequently than it would be desirable, publications with arguable legal nature are taken, by scholars, tax administrations and Courts as real norms and therefore invested with ability to settle prior legal disputes. This attitude is based upon a mistaken understanding of binding rules and favours a gradual decrease in technical consistency of the publications being it obvious that an organization invested with normative powers may find less incentive to properly justify its decisions than if it is merely stating an opinion. Finally, the growing trend towards an ambulatory effect of these publications in relation to the real binding rules to which they are referred, brings forward a whole array of constitutional issues normally regarding legal certainty.

2. These reflections might well be applied to the Commentaries on the Articles of the OEDC Model Tax Convention on Income and Capital (OECD Commentary, hereinafter) especially in relation to the improper use of tax treaties, clearly as for the application of the general anti-abuse provisions of domestic law in a tax treaty context. It is well known that in January 2003, the OECD issued extensive revisions to the OECD Commentary in order to "clarify" this difficult task. If indeed the new version of the OECD Commentaries has been well received, by certain scholars and practitioners, regarding this issue[1], it still fails to properly resolve the problem relying upon solid basics. The inclusion in the Commentary of a starting point which might be contentious and the existence of an important amount of contradictions in it, accompanied by more than a few gaps, might depreciate the "high persuasive value" which has been conferred to the OECD Commentaries[2]. This value might be even reduced taking into account the ambulatory application principle pretended by the Committee on Fiscal Affairs of the OECD which, as it has been stated, might claim for the declining effect of the OECD Commentaries[3].

3. As stated before, the 2003 OECD Commentary introduced important changes in relation to its article 1 on the improper use of tax treaties. Even though there are excellent descriptions of these changes –comparing the 2003 update with its former version[4]- we should briefly point at them as they represent a starting point for our construction.

4. After decades defending that States wishing to preserve the application of their domestic anti-avoidance provisions in situations governed by a tax treaty must insert a specific provision to that effect in their treaties, the 2003 OECD Commentary dramatically withdrew its former position by partially

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1 Sasseville, "Tax Avoidance involving Tax Treaties", in Jirousek/Lang (eds.) *Praxis des Internationalen Steuerrechts, Festschrift für Helmut Loukota zum 65. Geburtstag* (2005) p. 451 (p. 459 et seq.). Sasseville, A Tax "Treaty Perspective: Special Issues", in Maisto (ed.) *Tax Treaties and Domestic Law* (2006), p. 37 (p. 55 et seq).

2 De Broe, *International Tax Planning and Prevention of Abuse* (2008), p. 323.

3 Martín Jiménez, "The 2003 Revision of the OECD Commentaries on the Improper Use of Tax Treaties: A Case for the Declining Effect of the OECD Commentaries?", *Bulletin for International Fiscal Documentation* 2004, p. 27-30.

4 Martín Jiménez, *Bulletin for International Fiscal Documentation* (2004), p. 17-20. Arnold, "Tax Treaties and Tax Avoidance: The 2003 Revisions to the Commentary to the OECD Model", *Bull. IBFD* 2004, p. 244-247. De Broe, *International Tax Planning and Prevention of Abuse*, p. 377-403.

deleting § 7 of the Commentaries on article 1 in which this assertion was included[5]. In order to justify its new approach the Commentary distinguishes between those States for which an abuse of a tax treaty is also seen as an abuse of domestic law and those that consider these abuses as being abuses of the treaty itself[6]. The former will not find legal problems by applying domestic anti-abuse provisions in a treaty context as far as those are considered part of the basic rules for determining the facts that give raise to tax liability, not addressed therefore in tax treaties and not affected by them[7]. On the other hand, the latter States will be able to attack treaty abuses by means of a proper construction of the Convention resulting from its object and purpose as well as the obligation of interpreting it in good faith[8]. Anyways in both cases, the application of domestic anti-abuse provisions, in a tax treaty context, does not seem troublesome[9]. In relation to both approaches the OECD Commentaries clarify that it should be not lightly assumed that a tax payer is entering into abusive transactions and therefore provides a –so called- *guiding principle.* According to this principle the benefits of a 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[10].

5. This article tries to critically review the OECD position especially in relation to domestic general anti-avoidance rules and general anti-avoidance judicial doctrines (GAARs hereinafter[11]). For these purposes we will follow the very structure of the OECD reasoning, analyzing on the one hand the possible application of GAARs in a treaty context and, on the other hand, the guiding principle referred above. When it comes to analyzing the first issue, we will first put the OECD statement on the factual nature of GAARs - basic rules for determining the facts that give raise to tax liability- under scrutiny (section 2) supporting the mere legal nature of these provisions and extracting consequences thereof (section 3). After these reflections, we will focus on the guiding principle analyzing its consistency and linkage with the case law of the European Court of Justice (ECJ, hereinafter) on income tax matters (section 4).

II. The factual approach to GAAR's. A technical mistake and a misleading starting point

6. The OECD Commentaries stress repeatedly that anti-avoidance rules are part of the basic domestic rules set by domestic tax laws for determining which facts give rise to a tax liability, they are not addressed in tax treaties and are therefore not affected by them[12]. This position, frequently labelled as *factual approach*[13], has also been used in different States for mere domestic purposes. As we will try

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5 This statement dated back to the 1977 OECD Model which contained the first reference in the Commentary to the improper use of tax treaties.

6 OECD Commentaries on Art. 1 § 9.2. and 9.3.

7 OECD Commentaries on Art. 1 § 9.2. This statement is also repeated in OECD Commentaries Art. 1 § 22.1.

8 OECD Commentaries on Art. 1 § 9.3.

9 OECD Commentaries on Art. 1 § 9.4. Nevertheless, as stated by De Broe, these distinction might be artificial and unjustified whilst creating differences between those States that will always be faced with the constraints imposed by the interpretation rules of the Vienna Convention on the Law of Treaties, and those which, might apply their domestic anti-abuse rules unrestrictedly (De Broe, *International Tax Planning and Prevention of Abuse*, p. 388).

10 OECD Commentaries on Art. 1 § 9.5.

11 Even if the term GAAR should be reserved for domestic legal provisions, in order to achieve a certain terminological simplicity we will also use it by referring to anti-abuse judicial doctrines.

12 OECD Commentaries on Art. 1 § 9.2 and § 22.1.

13 Designated as *factual approach* in: Arnold, *Bulletin for International Fiscal Documentation* 2004, p. 251. Zimmer, "Domestic Anti-Avoidance Rules and Tax Treaties – Comment on Brian Arnold's Article", *Bulletin for International Fiscal Documentation,* 2005, p. 25-26. Arnold; Wheegel, "The Relationship between Tax Treaties and Domestic Anti-abuse Measures", in Maisto (ed.) *Tax Treaties and Domestic Law* (2006), p. 91. It has also been labeled as *fact finding approach* (De Broe, *International Tax Planning and Prevention of Abuse*, p. 390-391) or even *transactional approach* (Goyette, "Tax Treaty Abuse: A Second Look", *Canadian Tax Journal,* 2003, Vol 51, Nº 2, p. 780 *et seq*).

to demonstrate this approach does hold a bit of ambiguity, at least in its formulation by the OECD, is normally used to avoid the real nature of GAARs and might encourage wrong solutions in certain jurisdictions. These objections must be considered separately.

1. The factual approach is ambiguous

7. The wording of the OECD Commentaries on this issue allows several interpretations. One could say that the OECD means by that approach that GAARs are rules that determine the taxable event[14]. But one could also say that, according to the above mentioned words, the OECD considers GAARs to be rules establishing the facts to which domestic and conventional provisions are applied. Even if we reject a pure factual approach to GAARs, just this second interpretation seems to be in line with the Commentaries intentions[15]. Anyways the OECD's approach needs clarification.

2. The factual approach is a goal-oriented reasoning

8. The factual approach has not only been suggested in relation to this particular issue but also in different contexts. In any case, and as we will try to demonstrate, this approach has always been proposed in order to escape the unwelcome consequences of an interpretative approach. This attempt to avoid at all costs the interpretative approach implies supporting complicated theories on the relationship between facts and law that deserve critical review.

9. The application of a rule, whatever its nature may be, implies the determination of the facts to which that rule will be applied. These facts are what the taxpayer really did, without any legal labelling. Once these facts have been properly determined they call for the application of a rule be it domestic or conventional[16]. The problem, in abusive transactions, is that the facts will be developed in a way that a rule either cannot be applied (*abuse through avoidance*) or is applied even if not intended for cases of the kind (*abuse through capture*)[17]. In any case, the application of GAARs to these abuse strategies does not and cannot imply a mere determination of the facts but rather a sort of application of the avoided or captured rule[18]. There is little room for doubt that even for tax authorities invested with far-reaching powers, faking the existence of certain facts that did not really occur seems excessive. This would be equal to depriving rules of validity.

10. In order to overcome the inconsistencies of this version of the factual approach, a further meaning of the term fact has been developed so as to refer to the so called "legal facts" (referred also as

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[14] This interpretation matches in fact with the French version of the Commentary (*...dispositions determinant les faits générateures de l'impôt*) as stated by De Broe, *International Tax Planning and Prevention of Abuse*, p. 389. This seems to be also the position of Martín Jiménez on stating: "*According to Para. 9.2, as long as anti-abuse rules affect the taxable event…*" (Martín Jiménez, *Bulletin for International Fiscal Documentation* 2004, p. 19).

[15] In fact this second interpretation is supported by a good number of scholars: Arnold, *Bulletin for International Fiscal Documentation* 2004, p. 251 De Broe, *International Tax Planning and Prevention of Abuse*, p. 389-391.

[16] It has been suggested that the application process implies two different steps: characterisation of the facts and interpretation of the law. These considerations may be valid in a mere theoretical approach but in real application cases both characterization and interpretation take place simultaneously. In short, paraphrasing German scholars: *the eye of the judge wander from the text of the law to the facts and from the facts to the law* (Kaufmann, *Analogie un Natur der Sache.* 2nd ed. (1982), p. 38).

[17] These are the two main abuse strategies that have been described by German scholars (see the concepts of *Tatbestandumgehung vs. Tatbestanderschleichung* in Kruse, Steuerumgehung zwischen Steuervermeidung und Steuerhinterziehung*, Steuerberater-Jahrbuch*, 1978-1979, p. 454-455). Also in Spanish literature: Báez; López, "Nuevas perspectivas generales sobre la elusión fiscal y sus consecuencias en la derivación de responsabilidades penales. (Comentario a la Sentencia del TS de 30 de abril de 2003, rec. num. 3435/2001)"*, Estudios Financieros Revista de Contabilidad y Tributación (legislación, consultas, jurisprudencia)*, nº 251, 2004, p. 124, Báez, *Los negocios fiduciarios en la imposición sobre la Renta* (2009), p. 191.

[18] This approach will be analyzed in paragraph 3.

to "secondary facts"). They have been defined as "facts" established by the rules of private law or other non-tax fields of law, for instance, how a contract should be interpreted, whether an exchange of letters amounts to a contract, or whether a payment from a company to a shareholder should be considered as a salary, loan, dividend or capital gain[19]. This alternative *factual approach* is in our opinion a sort of conceptual hocus-pocus. If we say that "legal facts" are the legal acts actually performed[20], it seems obvious that we are making reference to facts that have been characterized according to a specific previously interpreted applicable rule. In short "legal facts" are not facts but actually the result of the application of a construed law. To name an example, if we consider that a *sale and lease-back* agreement does not amount to a sale this does not imply a simple assessment of the facts, but really the result of a certain interpretation of the legal concept of sale. Definitively, this second variant of the "factual approach" is just a transvestited version of a simple interpretative approach which will be analyzed in following paragraphs[21].

11. So, if all this is true, why then such an insistence on a factual approach? Hence we come, to the core of this position. It has been said that whether the factual or interpretative approach is used, depends on a choice of perspective rather than on inherent differences in the rules as such and, therefore, it does not seem logical to attach serious legal consequences to the choice of approach[22]. One might share this opinion only by assuming, as a given, that internal GAARs might be applied in a tax treaty context. Nevertheless, such a reasoning may be circular when it comes precisely to deciding whether or not GAARs conflict with double taxation conventions. This issue will be considered further ahead in the text. At this moment we just want to emphasize that the factual approach in either of its versions is just aimed to avoid conflicts between GAARs and double taxation conventions. Indeed, if the tax authorities or the Courts applying a GAAR merely determine the facts to which a conventional rule will be either applied or not applied, no conflicts will arise with double taxation conventions. The very statements of the OECD Commentary make its aim quite clear: "…to the extent these anti-avoidance rules are part of the basic domestic rules set by domestic tax laws for determining which facts give rise to a tax liability, they are not addressed in tax treaties and are therefore not affected by them. Thus, as a general rule, there will be no conflict between such rules and the provisions of tax conventions"[23]. In fact, one might say that factual approaches have been always, in this and other contexts, just a goal oriented reasoning aimed at avoiding different problems that might result from a mere interpretative approach.

12. Nevertheless the above described inconsistencies are not the main problem to which a factual approach might lead in this context. As we will try to demonstrate in the following paragraph the OECD reasoning might give rise to a serious -and dangerous- misleading effect.

3. Factual approach and widening of the concept of sham: a risk in certain jurisdictions

13. The borderline between sham and avoidance has never been an easy task[24]. In fact the delicate distinction between both concepts seems to have been perceived for ages[25] and has provoked, in certain

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[19] Zimmer, *Bulletin for International Fiscal Documentation,* 2005, p. 25. In the same direction but less clearly: Zimmer, "General Report", in *Form and Substance in Tax Law* (2002), p. 28-29.

[20] As stated for example in: Zimmer, General Report, in *Form and Substance in Tax Law*, p. 29.

[21] We think this is exactly the conclusion of Prof. Zimmer when he states: "*Thus, the factual approach embedded in the OECD Commentaries implies legal (including tax law) considerations, as does the interpretative approach*" (Zimmer, *Bulletin for International Fiscal Documentation,* 2005, p. 25-26).

[22] Zimmer, *Bulletin for International Fiscal Documentation,* 2005, p. 25.

[23] OECD Commentaries on Art. 1 § 9.2.

[24] As Zimmer states: "…in countries which have anti-avoidance rules, the borderline between sham/simulation and avoidance may be blurred" (Zimmer, "General Report", in *Form and Substance in Tax Law*, p. 31).

[25] Medieval scholars (Baldus) already stated *tot modis committitur simulatio quot modis comittitur fraus* (sham is performed in the same way as avoidance). As quoted by: „Coing, Simulatio und Fraus in der Lehre des Bartolus und Baldus", in *Festschrift für Paul Koschaker*, Vol. 3 (1939), p. 402.

jurisdictions, a gradual approach (confusion) of both instruments[26]. This rapprochement, as for countries which have anti-avoidance rules, makes sense as a proposal *de lege ferenda*, but leaves the problem unresolved especially for those regulations in which sham transactions and GAARs have different procedural requirements and legal consequences. On the other hand, we think there is a possible criterion in order to make a distinction between sham and abusive transactions. In our opinion the whole confusion is originated by the very classical criterion used in order to portray the concept of sham requiring that the transaction be conducted with an element of deceit, an element which in turn would be absent in abusive transactions. The fact is, and this has been frequently stressed by scholars, that abusive transactions incorporate a certain element of deceit as well[27], which might be identified with the element of artificiality inherent in abusive transactions. In a nutshell, under this approach there is no way sham and avoidance could be distinguished. In our opinion, even if both, simulation and avoidance, share a fake element this refers to different objects[28]. In sham transactions tax payers lie on what has been labelled as "pure or real facts[29]" (was the price actually paid?; did that person really take part in that meeting?). In turn, in abusive transactions, tax payers do not hide real facts – actually they pretend their legal consequences- but the purpose of the transactions they have conducted[30].

14. Once we have proved the existence of a real –and justifiable- borderline between sham and abusive transactions, we are in a position to analyze how the factual approach, as proposed by the OECD Commentaries, might cause confusion in relation to the above mentioned distinction. As we saw before, the factual approach –or at least one of its versions- is based upon the assumption that, in certain circumstances, the "legal facts", as assessed by tax payers, might be correctly characterized by tax authorities (or Courts) in order to take into account the "real legal facts". This process can be illustrated resorting to an easy dividend-stripping transaction. The legal facts as presented by the tax payers (a capital gain) might be replaced by the tax authorities with the "real legal facts" they assume to have taken place (a dividend). As described by Zimmer, according to the factual approach, even if the legal form is a gain "in fact" the payment is a dividend for tax purposes[31]. Even if it is evident that in this kind of transactions there is no deceit in relation to real or pure facts, certain countries might succumb to temptation and make use of the shamed transaction doctrines or rules in order to correct these situations.

15. This confusion has been reported in relation to States that lack GAARs[32]. But this mistake is

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26 This trend has been described by several scholars all around the World. As for Spain: Báez, *Los negocios fiduciarios en la imposición sobre la Renta*, p. 204 et seq, in relation to fiduciary structures; Ruiz, *El fraude a la ley tributaria a examen* (2006), p. 114 et seq. In the UK: Ballard; Davison, United Kingdom, in *Form and Substance in Tax Law* (2002), p. 569 (p. 572), describing the existence of certain hints in several cases that sham may have a wider meaning than that referring to simple factual deceit. In the US: Streng; Yoder, *United States,* in *Form and Substance in Tax Law* (2002), p. 595 (p. 596) referring to the confusing "economic sham doctrine".

27 This idea has been frequently stressed by Spanish scholars when dealing with the penalisation of tax avoidance strategies: Palao Taboada, *Los instrumentos normativos contra la elusión fiscal,* en La justicia en el diseño y aplicación de los tributos (2005), p. 111 (p. 120 et seq). Alonso Madrigal; Gómez-Lanz, "Fraude a la ley tributaria, ilícito e infracción tributaria y delito de defraudación", *Estudios Financieros. Revista de contabilidad y tributación,* Nº 281-282, 2006, p. 3 (p. 41). Ruiz, *El fraude a la ley tributaria a examen,* p. 115.

28 We cannot share therefore the opinion, as stated by Ruiz Almendral, that sham and avoidance share the same nature, differing only in the degree of bluntness or sophistication that the avoidance transaction has been dressed up with (Ruiz-Almendral, "Tax Avoidance and the European Court of Justice:What is at Stake for European General Anti-Avoidance Rules", *Intertax*, Vol. 33, Nº 12, 2005, p. 562 (p. 564).

29 Using the words of: Zimmer, "General Report", in *Form and Substance in Tax Law*, p. 19 (p. 28). Zimmer, *Bulletin for International Fiscal Documentation* 2005, p. 25.

30 This question really surpasses the scope of this article. For an in depth analysis see: Báez, *Los negocios fiduciarios en la imposición sobre la Renta*, p. 205 et seq.

31 Zimmer, *Bulletin for International Fiscal Documentation* 2005, p. 26.

32 This is the case in Colombia and Mexico. If we analyze the arguments exposed by Colombian and Mexican reporters in the 56th Congress of the IFA in order to consider a dividend-stripping as a case of sham we will conclude that they are totally in line with a sort of factual approach as it is defended by the OECD Commentaries. As for the Colombian Report it is stated that: "…once the tax office is able to cut through this apparent legal reality the

also present even in those countries, like Spain, which have a GAAR (Art. 15 of the Spanish *Ley General Tributaria*). In order to expose an example in line with the reflections of the 56th Congress of the IFA, let us describe the position of the Spanish Tax Administration in relation to international dividend-stripping cases in which a double taxation convention was applicable[33]. In a typical dividend-stripping set of transactions[34], the Spanish *Tribunal Económico Administrativo Central*[35] stated that "...in fact we are in front of a set of purchase agreements which constitute the sham transactions that hide the real transaction really performed, a payment of dividends. [...] Therefore we should tax the real taxable event performed by the tax payer, regardless what legal form they have used. […] If what we really have is a mere power of attorney the only income to be taxed would be the commission paid by the grantor to the grantee"[36].

16. One might check easily that all these reflections are totally in line with a factual approach as it is exposed by the OECD Commentaries. Actually, the factual approach, even if not intended in that way, might encourage a total confusion between sham and abusive transactions even in those countries, like Spain, which have a GAAR. Therefore, in order to properly analyze the relationship between domestic GAARs and double taxation conventions, one should depart from a strict interpretative (applicative) approach as will be exposed in the following paragraphs.

III. Legal approach to GAAR's. The need to add nuances

17. The preceding reflections clearly show that GAARs must be considered as instruments which embody a process of legal application as the very consequence of tax avoidance. As clear as this may be in the theory, the question remains of exactly what can be considered application in the context of GAARs. The problem emerges due to the fact that there are different views regarding the very nature of legal application.

18. It is a widespread position, among scholars, that domestic anti-avoidance rules and judicial anti-avoidance doctrines are interpretative principles under which tax law applies only to transactions with economic or commercial substance; therefore tax legislation is interpreted not to apply to transactions that lack economic substance or business purpose. Keeping with this idea, there would be no conflict between tax treaties and domestic GAARs[37].

19. This is also the position assumed by the OECD Commentaries when referring to States that

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truth surfaces, that the transaction lacks real economic substance (and so is not a real economic tax event), which takes us into the sphere of tax evasion" (Paniagua-Lozano; Mayorga-Arango, *Colombia* in *Form and Substance in Tax Law* (2002), p. 213 (p. 220). As for the Mexican Report: "If the judge decides that the act is simulated, it would probably be determined that what the parties really agreed to was that C (Company which pays the dividends) would pay dividends to A (original holder of shares) and A would pay to B (Company purchasing the shares according to the dividend-stripping transaction) a certain amount of money" (Moreno Gómez de Parada, *Mexico,* in *Form and Substance in Tax Law* (2002), p. 429 (p. 434).

33 Nevertheless there are further examples of this position, even assumed by the Courts both administrative and criminal, which cannot be reported in this article.

34 A company, resident in the UK, sells to another company, resident in Spain, shares which in turn have been issued by a third company also resident in Spain, days before the dividends are paid. After the payment of the dividend the UK Company purchases the shares according to reciprocal call and put options previously agreed obtaining a gain equivalent to the dividend minus an amount which is actually the commission received by the second Spanish Company.

35 TEAC 15 June 2006, (JT 2006, 1421).

36 There are also other rulings in this same line: TEAC 16 September 2005 (JT 2006, 85) and TEAC 2 February 2006 (JUR 2006, 157322)

37 Martín Jiménez, *Bulletin for International Fiscal Documentation* 2004, p. 19. Sasseville, "Tax Avoidance involving Tax Treaties", in Jirousek/Lang (eds.) *Praxis des Internationalen* Steuerrechts, p. 459. Arnold, *Bulletin for International Fiscal Documentation* 2004, p. 251. De Broe, *International Tax Planning and Prevention of Abuse*, p. 387, implicitly when analyzing the distinction between States that consider an abuse of a tax treaty as an abuse of domestic law and those that consider an abuse of a treaty as being independent.

label abuses as being abuses of the convention itself, and concluding that these States consider that a proper construction of tax conventions (resulting from their object and purpose) allows them to disregard abusive transactions[38]. This position closes the circle of the new OECD approach in relation to domestic GAARs and double taxation conventions: the factual approach is the solution as for States which consider that an abuse of a tax treaty is also an abuse of domestic law; in turn, the interpretative approach saves the application of domestic GAARs in States that label abuses as being abuses of the convention itself.

20. Apart from the fact that the distinction upon which the OECD position is based has been reasonably considered artificial and unjustified[39], the interpretive approach, as described above, merits criticism. These reflections manage a far reaching and confusing concept of interpretation which is not unknown to the European legal tradition. In order to clarify this point we will first focus on the very concept of interpretation especially by stating its limits. After this, we will try to extract the consequences for the issue under scrutiny in this article.

1. Nature and limits of interpretation.

21. The identification of GAARs with interpretative techniques departs from a wide-reaching concept of interpretation that makes it equal to the application of rules in general. This assimilation between GAARs and interpretative methods is evident in certain scholars dealing with the special problematic of this article.

22. Let us take the opinion from Martín Jiménez who, in an article previous to the 2003 version of the OECD Commentaries, stated: "The current situation of domestic anti-abuse measures in a tax treaty context may be affected by a misunderstanding on the part of the OECD. It has been shown that the rigid application of the *pacta sunt servanda* principle, is not justified from the international law point of view. […] Thus, it seems that the OECD's starting point in 1977 generated a fake debate: from the point of view of international law, the obligations stemming from a treaty are not those derived from a literal wording of the treaty, but the obligations derived after a process in which the principle of good faith and a teleological interpretation are critical[40].

23. Nevertheless, this position is neither new nor especially focused on the relationship between GAARs and double taxation conventions. In fact, this particular understanding of GAARs is as old as GAARs themselves[41], and is frequently used by German and Austrian scholars in order to deny these rules an own normative meaning being their nature a mere statement of the necessity of an interpretation according to the purpose of the avoided or caught provision[42].

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38 OECD Commentaries on Art. 1 § 9.3.

39 De Broe, *International Tax Planning and Prevention of Abuse*, p. 387.

40 Martín Jiménez, "Domestic Anti-Abuse Rules and Double Taxation Treaties: a Spanish Perspective – Part I"., *Bulletin for International Fiscal Documentation*, November 2002, p. 542 (p. 550). This same idea is repeated in later articles with different words: "…general domestic anti-abuse rules do not extend the taxable event by adding to it certain conduct where an elusive element is presumed or conduct that is economically equivalent to that defined in the taxable event" (Martín Jiménez, *Bulletin for International Fiscal Documentation* 2004, p. 19).

41 As far as we know, in relation to tax matters, this debate started with the introduction of a GAAR in § 5 of the German *Reichsabgabenordnung* (1919). Many German authors from the 20's and 30's considered a GAAR unnecessary, for it was enough a simple interpretation of the avoided provisions: Ball, *Steuerrecht und Privatrecht* (1924), p. 130-132; 142-147; Becker, *Die Reichabgabenordnung.* 7th ed. (1930), p. 109-113.

42 This idea has generated an important dispute in Germany between those who are in favor of the, so called, *Innentheorie* and those who advocate the *Außentheorie.* As for Germany see: Tipke, *Die Steuerrechtsordnung. Band III: Föderative Steuerverteilung, Rechtsanwendung und Rechtschutz, Gestalter der Steuerrechtsordnung* (1993) p. 1286 et seq. See, in relation to Austrian legal doctrine: Hohenwarter, Austria, in Maisto (ed.) *Tax Treaties and Domestic Law* (2006) p.161 (p. 195-196).

24. The mere assimilation of GAARs and interpretation techniques generates severe inconsistencies whose detailed analysis would considerably surpass the scope of this contribution. Notwithstanding we should emphasize that, one the one hand, the above described position might generate certain doubts as to when using mere interpretative techniques and when resorting to GAARs[43]. On the other hand, and this is in our opinion the main point at stake, this simple assimilation creates serious doubts on the very limits of the interpretation process. This last reflection can be illustrated, for the purposes of this article, with the following statements of De Broe: "The result of the recharacterization or redetermination in which domestic anti-avoidance provisions often result can only be given effect for treaty purposes if that result is supported by the text of the tax treaty, construed in its context and light of its object and purpose"[44]. The question raises immediately: if the result of the re-characterization or redetermination is supported by the text of the treaty, why is it necessary the resort to GAARs? Why are the general interpretation techniques not enough for the purposes of combating tax avoidance? In our opinion, these questions might not be answered without a solid basis on the nature and limits of interpretation.

25. In our opinion the whole confusion on this issue is generated by the traditional interpretative criteria which have been accepted worldwide. The core of the problem is the distinction between literal and teleological interpretation in relation to the same provision and leading to different results[45]. The solution for this conceptual question might be found in the law theory[46].

26. The wording of a legal provision might be polysemous in those cases in which it can be attributed different meanings. Interpreting a provision, or the term contained in a legal provision, implies the selection of one of its possible meanings according to several criteria among which the purpose of the interpreted rule might be considered crucial[47]. In this context, it is far from clear what does "written law", "wording" or "literal interpretation" mean. The text of a provision is just the starting point for its interpretation and, at the same time, the limit for this process as the interpreter cannot go beyond the possible sense(s) of those words (*Wortsinn* in German legal theory[48]). Thus, every interpretation must be literal as it departs, when determining the possible sense of the words, from written law. At the same

[43] And this might be a problem for those countries in which the legal consequences of the different applicative techniques may considerably diverge.

[44] De Broe, *International Tax Planning and Prevention of Abuse*, p. 387.

[45] This distinction might be found when dealing with GAARs as a general issue. Especially in relation to GAARs and double taxation conventions in: Martín Jiménez, *Bulletin for International Fiscal Documentation* 2002, p. 550: "The rules of interpretation […] in Arts. 31 to 33 of the Vienna Convention on the Law of Treaties […] do not proclaim a literal interpretation as the main rule. Thus, a real interpretation of a treaty is needed which takes into account its purpose"; Vega Borrego, *Las medidas contra el treaty shopping* (2003) p. 101: "…the goal of these rules –referring to GAARs- is to restrict a formalist interpretation which primes the text over the purpose favoring avoidance". Goyette, *Canadian Tax Journal,* 2003, p. 769: "Paragraphs 9.3 and 9.5 of the commentary evidence a desire to go beyond the mere letter of treaties and to consider their object and purpose"; following AG Tesauro, Sasseville, "A Tax Treaty Perspective: Special Issues", in Maisto (ed.) *Tax Treaties and Domestic Law*, p. 60: "Such a rule, conceived as a principle of interpretation, constitutes an indispensable safety-valve for protecting the aims of all provisions of Community law against a formalistic application of them based solely on their plaing meaning"; De Broe, *International Tax Planning and Prevention of Abuse*, p. 245: "Such interpretation may require that a purely literal interpretation is abandoned if such interpretation would do harm to the parties' common intentions and expectations and/or the treaty's object and purpose".

[46] In this contribution we depart from the classical view of Larenz (Larenz, *Methodenlehre der Rechtswissenschaft* (1969), p. 342) which has been assumed by German scholars and case law. See: Báez, *Los negocios fiduciarios en la imposición sobre la Renta*, p. 31.

[47] As stated by Lang and Heidenbauer: "… the wording of a provision, if analysed carefully enough, usually leaves much room for heterogeneous results of interpretation. Taking into account the object and purpose of a provision, together with other means of interpretation, leads to a limitation of the number of possible different meanings" (Lang; Heidenbauer, "Wholly Artificial Arrangements", in (Hinnekens; Hinnekens eds.) *A vision of Taxes within and outside European Borders. Festschrift in honor of Prof. Dr. Frans Vanistendael* (2008), p. 597 (p. 609).

[48] As opposed to the words of a provision designated so as to *Wortlaut.*

time every interpretation that pretends to be correct, must be teleological, if we take into account that the selection of the proper meaning must be guided and rational, and that rules must be considered as instruments to achieve certain goals. If all this is true, it seems evident that considering GAARs as a mean to go beyond the letter of a tax statute implies a logical contradiction.

27. In this context, the limits of interpretation must be defined according to the possibility of attributing different meanings to a single legal term. This might not be an easy task in those cases in which private law concepts are used in tax statutes, either by a simple or explicit remission. Even if legal theory states that the same term contained in different rules might be understood differently by following their respective legal purposes[49], the practice in several countries shows a broad range of approaches in relation to this problem[50]. By contrast, as it has been stated, even in jurisdictions with a strict adherence to private law concepts in tax law, there may be concepts in tax statutes that do not correspond to private law concepts or where the legislator has made it clear that the concept should have a different content from private law relations[51]. In these cases the private law meaning is not binding and the possibility of defining several possible senses, from a strict tax law perspective, is certainly easier.

28. In short, when tax statutes make use of private law concepts it seems difficult to face tax avoidance by means of a simple interpretation of the avoided provision. In these cases it is necessary to go beyond the possible senses of the legal wording resorting to GAARs. Nevertheless, the problem might be different when tax laws contain autonomous concepts as we will try to show in the next paragraph.

2. Combating intended avoidance. The case of attribution

29. The above mentioned reasons justify that, in certain cases, tax payers intend the avoidance or capture of a tax statute (*i.e.* double taxation conventions) but this attempt might be faced with a simple construction of the avoided or unlawfully captured provision. As has been said, real avoidance starts exactly there where the art of interpretation starts to fail[52]. For the same reason, every intended avoidance does not require the application of a GAAR. It is obvious that this way of facing pretended tax avoidance cannot affect the *pacta sunt servanda* principle. As Lowe pointed out, being true that a treaty must be honoured, this does not say anything about the content of the pact that must be respected. In short, for certain cases, a proper interpretation of domestic or conventional provisions, within the limits previously described, will be enough to counteract abusive transactions.

30. Scholars have pointed out several areas, in relation to treaty shopping, in which this way of thinking might bear fruits[53]. Nevertheless a comprehensive analysis of these areas surpasses the scope of this article and therefore we will merely focus on one of these issues, namely the attribution of income to tax payers. An artificial use of the legal rules and principles that guide the attribution of income to tax payers is behind an important amount of abusive transactions in general and treaty-shopping structures

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[49] This is in fact an old idea frequently named as "legal concept's relativity". See: Engisch, *Die Einheit der Rechtsordnung.* Unveränd. reprograf. Nachdr. d. 1935 (1987) p 45.

[50] In relation to this see: Zimmer, "General Report", in *Form and Substance in Tax Law*, p. 25 et seq.

[51] Zimmer, General Report, in *Form and Substance in Tax Law*, p. 27.

[52] Hensel, "Zur Dogmatik des Begriffs "Steuerumgehung"", in *Bonner Festgabe für Ernst Zittelmann zum fünfzigjährigen Doktorjubiläum*, (1923), p. 244. Also, in recent publications as for The Netherlands: van Wheegel, *The Improper use of Tax Treaties. With Particular Reference to the Netherlands and the United States* (1998), p. 165.

[53] Hohenwarter, Austria, in Maisto (ed.) *Tax Treaties and Domestic Law,* p. 206, making special references to the very concept of residence in relation to holding companies set up in low-tax jurisdictions. In a similar way, in relation to the corporate residence concept: Loomer, "Tax Treaty Abuse: is Canada responding effectively?", *Oxford University Centre for Business Taxation, Working Papers,* WP 09/05.

in particular[54] and this justifies our intention to shed certain light on it[55].

31. Being treaty shopping, briefly described, the situation in which a person resident of a given state who is not entitled to the benefits of a tax treaty sets up an entity in another State in order to obtain those treaty benefits that are not directly available to him[56], it seems obvious that this kind of strategies are conducted through a particular configuration of the criteria normally used so as to attribute income to tax-payers. This assertion might be illustrated with a well-known example of the Spanish practice.

32. In the early 90s several sportsmen resident in Spain transferred their appearance rights to non-resident companies which in turn assigned these rights to the entity for which the sportsmen rendered their personal services (also resident in Spain). It goes without saying that this peculiar structure was designed in order to achieve several tax advantages (reduction of withholding taxes, tax deferral, avoidance of personal income tax…). Regardless of the solutions that the Spanish Tax Administration and Tax Courts have given for these transactions, one might bear in mind that this example clearly shows how ordinary attribution criteria are managed by the tax payers in order to obtain tax savings. An income which would be normally attributed to a sportsman, performing personal services, is deviated to a non-resident legal entity in order to obtain tax advantages.

33. In the presence of this kind of constructions the resort to GAARs seems a temptation difficult to resist. Nevertheless, this kind of transactions might be faced with different instruments that would be less problematic from the point of view of the rule of law and, summing up, of the *pacta sunt servanda* principle. This mechanism is nothing other than that of interpreting the rules under which the attribution of income is governed by in the source State taken that, as a general rule, attribution issues are not dealt with in double taxation conventions[57].

34. In this context one should depart from a particular analysis of attribution rules. It has been said that according to prevailing opinion, income is attributable to the person that disposes of the source of income and the resulting benefits *inter partes*, i.e. the person that has the possibility of using market opportunities or withholding performances[58]. These considerations may, but need not always, be valid. As mentioned above, a solution that relies upon attribution rules might depart from the very analysis of that rules, bearing in mind that attribution of income might be designed on the basis of legal or economic entitlement[59]. According to this, we should refuse “standardized solutions” and resolve the sportsmen case taking account of the Spanish general attribution rules.

35. When referring to attribution issues, Spain might not be easily classified neither as a legal nor

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[54] On the importance of attribution criteria in the tax avoidance field: Báez, *Los negocios fiduciarios en la imposición sobre la Renta*, p. 56 et seq. with an analysis of the German bibliography and case law on this particular issue.

[55] This does not mean that the reflections and procedures described hereinafter might not be useful for other areas.

[56] As described in: De Broe, *International Tax Planning and Prevention of Abuse*, p. 5.

[57] An exceptional position in relation to this issue might be found in Henkel for whom attribution is effectively ruled in double taxation conventions because, otherwise, their rules would be incomplete. (Henkel, in Mössner (ed.) *Steuerrecht international tätiger Unternehmen* (1998), Rdn. E 491. Nevertheless it has been stated that in many countries treaties do not generally give any guidance on how the connection between income and a person is to be made for treaty purposes (Wheeler, “General Report”, in *Conflicts in the attribution of income to a person* (2007), p. 17 (p.22). In the same direction Lang states: “…tax treaties do not take any independent attribution decisions. […] Tax treaties are hence based on the domestic attribution decision” (Lang, “CFC Regulations and Double Taxation Treaties”, *Bulletin for International Fiscal Documentation* 2003, p. 51 (p. 54).

[58] Hohenwarter, Austria, in Maisto (ed.) *Tax Treaties and Domestic Law,* p. 207.

[59] In relation to this issue: Wheeler, “General Report”, in *Conflicts in the attribution of income to a person,* p. 20 *et seq.* In relation to Spain and considering fiduciary structures: Báez, *Los negocios fiduciarios en la imposición sobre la Renta*, p. 66 *et seq.*

as an economic country[60]. The Spanish tax system contains different attribution criteria depending on the nature of the taxable person (natural or legal person) and the affected tax (personal income tax, corporate tax or withholding tax). Focusing on the sportsmen case one should consider the sportsman as a taxable person subject to personal income tax according to either legal (for capital income) or economic attribution criteria (for income from employment) and the non-resident company subject to withholding taxes according to economic criteria (on the basis of the autonomous concept of *obtaining*)[61]. An attribution of income to the sportsman on the basis of pure economic criteria (it is the sportsman who disposes of the source of income and the resulting benefits) might on occasion prove demanding especially if the income resulting from the transfer of appearance rights is classified as capital income. Nevertheless, even in that case, there are good grounds for attributing the income to the sportsman: 1) There is a rather general consensus on the very concept of obtaining[62]. 2) The attribution of the income to the non-resident company would be contrary to the economic criteria set up by the Withholding Tax Act[63]. 3) Last, but not least, if the attribution criteria are aimed at the taxation of income in the hands of the tax payer who actually shows ability to pay in relation to that income[64], it seems logical to attribute the income to its "economic owner", at least in those cases in which the interpretation of these criteria offer a wide range of possibilities (different meanings for a single legal wording).

36. Summing up, this attempt of avoidance might be faced with a simple construction of the avoided or unlawfully captured provision which, in this case, must be identified with the rules governing the attribution of income.

37. In order to offer a comprehensive picture of this issue, there are still two further questions which might be taken into account:

38. a) As already mentioned, the OECD Commentaries clarify that it should be not lightly assumed that a tax payer is entering into abusive transactions, and therefore provides a –so called- *guiding principle.* The technical elements of this guiding principle will be analyzed in further paragraphs of this contribution. At this moment we will focus only on a very special issue in relation to the interpretative solution previously described. The guiding principle is exposed and designed as a limit to the application of domestic GAARs in a tax treaty context. What about cases, like those already exposed, in which an avoidance attempt is faced by means of a proper interpretation of domestic rules? In our opinion it is evident that these cases are beyond the scope of the guiding principle[65]. There are two reasons which

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60 Even if we consider that this classification is rather simplistic as the so called "economic criteria" are also "legal criteria" as they are reflected in legal (tax) rules.

61 For these rules in detail: Báez, *Los negocios fiduciarios en la imposición sobre la Renta*, p. 66 *et seq.*

62 Started in Germany and Austria in the late 70s (Ruppe. "Möglichkeiten und Grenzen der Übertragung von Einkunftsquellen als Problem der Zurechnung von Einkünften", in Tipke (ed.) *Übertragung von Einkunftsquellen im Steuerrecht* (1978), p. 7-40) and recently used in Spain in relation to fiduciary structures (Báez, *Los negocios fiduciarios en la imposición sobre la Renta*, p. 161 et seq) or even to the transfer of appearance rights (Ortiz, Las rentas derivadas de la cesión de derechos de imagen de los deportistas profesionales: su discutida calificación Jurídico-Tributaria, *Revista Aranzadi de Derecho de Deporte y Entretenimiento* 2009, p. 113 (p. 124 *et seq.*). Even the US Tax Court has made use of a similar reasoning helding that interest payments made from a US corporation to a related Honduras corporation, where an equivalent amount of interest was paid onward to a related Bahamas corporation were actually "paid" to the Honduran entity ((1971) 56 TC 925 (USTC) as quoted by Loomer, "Tax Treaty Abuse: is Canada responding effectively?", *Oxford University Centre for Business Taxation, Working Papers* 2009, no page indication). It is of the most importance that the court considered that the Honduran entity did not have complete dominion and control over the funds, a similar reasoning to the concepts frequently used by European scholars and Courts in relation to the concept of income obtaining.

63 Article 12 of the *Texto Refundido de la Ley del Impuesto sobre la Renta de los no Residentes.*

64 This idea is to be found in European scholars with different legal traditions: Jarach. *El hecho imponible: teoría general del derecho tributario sustantivo.* 3rd. Edition (1996), p. 168. Tipke, *Die Steuerrechtsordnung. Band III: Föderative Steuerverteilung, Rechtsanwendung und Rechtschutz, Gestalter der Steuerrechtsordnung* (1993) p. 1353. Báez, *Los negocios fiduciarios en la imposición sobre la Renta*, p. 135.

65 A different opinion in a similar case (rather ambiguous): Garcia-Prats, "La interpretación jurisprudencial

might justify this statement: 1) The guiding principle, as formulated by the OECD Commentaries, is applicable to anti-avoidance rules. It seems evident that the mere interpretation of a domestic attribution rule cannot be included under that category. It must be taken into account that even the beneficial owner requirement in Arts. 10, 11 and 12 of the OECD Model –whose resemblance with income attribution criteria seems evident- have been reputed fundamental rules of taxation rather than anti-avoidance rules[66]. 2) Were the guiding principle also applicable to interpretations followed to counteract avoidance attempts, it would not affect interpretations as those exposed above. It should be taken into account that corrections of attribution based upon the interpretation guidelines previously described, exclude the very application of the potentially concerned double taxation convention (i.e. the income is attributed to the resident sportsman as if paid directly by the resident corporation). Thus, it is evident that once the application of the double taxation convention has been excluded, the reflections of the OECD Commentaries do not play any role, as the problem turns into a pure domestic situation.

39. Nevertheless, this discussion might turn out to be unsignificant in the practice. As stated before, the application of the concept of income-obtaining requires the identification of the person that has the possibility of using market opportunities or withholding performances in relation to the income. If this person is correctly identified, and the treaty shopper is regarded for tax purposes, this identification will be normally in line with the general criteria set-up by the guiding principle which will be considered in detail in subsequent paragraphs. The *Prévost Car* case might be an example of what has been previously exposed even if it considers the concept of beneficial ownership[67]. In this case the Canada Tax Court rejected a possible disregard of the treaty shopper (resident in the Netherlands) as there was no predetermined or automatic flow of funds to its shareholders (resident in the UK and Sweden) and theoretical beneficial owners[68]. In short, the concept of income-obtaining if properly applied excludes the possibility of disregarding a non artificial transaction.

40. b) The above mentioned cases implied a correction of avoidance attempts in mere treaty shopping cases; as stated before a proper construction of the obtaining concept excluded the very application of the potentially concerned double taxation convention. Nevertheless this interpretative approach might find further problems if applied to rule-shopping cases (i.e. improper use which affect objective rules of tax treaties as for example conversion of dividends into capital gains). In these cases even if a proper understanding of the attribution criteria might correct the tax avoidance strategy, the tax treaty is still applicable but making use of a different distributive rule (e.g. dividends instead of capital gains rules). The previously defended idea regarding that certain avoidance attempts might be faced with a simple construction of the avoided or unlawfully captured provision, seems too simple for these cases, taking into account that the double taxation convention is to be applied but using a different qualification of the income[69]. In short this is not a mere interpretation of attribution rules but requires additionally an application of the treaty rules which might go beyond the possible sense(s) of its words. All this might be illustrated with a simple dividend-stripping example.

41. A, resident in the State A, owns shares of the Company B, resident in the State B. A can sell the shares free from capital gains tax and it sells the shares to C, resident in the State B, some days before the distribution of dividends. Just after the distribution of dividends, A buys the shares back for a price set in advance which takes into account the value of the distributed dividend[70].

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como mecanismo para hacer frente a la elusión tributaria", *Tribunal Fiscal,* nº220, 2009, p. 22 (p. 35)

66 Arnold, *Bulletin for International Fiscal Documentation* 2004, p. 248.

67 It is worth stating though the strong resemblance between the income-obtaining and the beneficial ownership concepts: Hohenwarter, Austria, in Maisto (ed.) *Tax Treaties and Domestic Law,* p. 207.

68 Loomer, "Tax Treaty Abuse: is Canada responding effectively?", *Oxford University Centre for Business Taxation, Working Papers* 2009, no page indication).

69 For that reason the general approach to improper use of tax treaties, valid both for treaty and rule shopping, demanded by Martín Jiménez (Martín Jiménez, *Bulletin for International Fiscal Documentation* 2002, p. 549-550) need not always be valid.

70 This is the basic dividend-stripping scheme which of course might be conducted by means of more com-

42. It has been defended that this kind of constructions could be faced by means of a proper construction of attribution rules as it seems evident that the income is obtained, as far as market opportunities or withholding performances are concerned, by the original owner of the shares. The dividends should be attributed therefore to A, resident in the State A, and not to B[71]. Nevertheless rule-shopping strategies require a further step if we take into account that the proper solution implies not only attributing the income to a person different from that originally pretended by the tax payers, but also a different qualification of the attributed income (capital gains qualified for tax purposes as dividends).

43. In our opinion, even in rule shopping cases, like dividend-stripping, a mere interpretation of attribution criteria would be enough to counteract avoidance attempts. In short, as in pure treaty shopping cases, there is no need to resort to GAARS. This statement requires an explanation.

44. Even if it seems that a (re) qualification from capital gain to dividend requires going beyond the possible sense(s) of the very legal terms "dividend" and "capital gain", one should bear in mind the content of article 10(3) of the OECD Model Tax Convention: "The term "dividends" as used in this Article means income from shares,"jouissance" shares or "jouissance" rights, mining shares, founders' shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident". Even if the debate over the correct meaning of the bold text is still open[72], it is also true that the OECD Commentaries have stressed: "Article 10 deals not only with dividends as such but also with interest on loans insofar as the lender effectively shares the risks run by the company, i.e. when repayment depends largely on the success or otherwise of the enterprise's business. Articles 10 and 11 do not therefore prevent the treatment of this type of interest as dividends under the national rules on thin capitalisation applied in the borrower's country". Therefore sharing the risk might also justify a qualification as dividend without going beyond possible sense(s) of the very legal terms of article 10 (3) of the OECD Model Tax Convention. In this context one should bear in mind the special circumstances of a dividend-stripping case as described above. Even if the original holder does not receive dividends in a formal sense, it seems evident that it shares (or at least has shared) the risk run by the company and, in fact, this might be the reason, under the attribution rules previously described, for attributing the income to the original holder and not to the formal recipient of the dividends.This means that paragraph 3 of article 10 is not just a *renvoi* to domestic law originated by the remaining dissimilarities between Member countries in the field of company law and taxation law as regards the concept of dividend. Even a domestic treatment as dividends based upon a special anti avoidance rule, a GAAR or even a mere interpretation of attribution rules fit in with article 10(3) of of the OECD Model Tax Convention[73].

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plex structures specially with regard to the transaction used for (re) purchasing the shares.

[71] In relation to a similar case with (re)purchase making use of reciprocal put and call options: Báez, *Los negocios fiduciarios en la imposición sobre la Renta*, p. 156 et seq.

[72] Avery Jones (et al.), "The Definitions of Dividends and Interests in the OECD Model: Something Lost in Traslation?", *British Tax Review,* Nº 4, 2009, p. 406 (p. 422 et seq.).

[73] As stated by De Broe (De Broe, *International Tax Planning and Prevention of Abuse*, p. 486) Courts in Canada have included the result of similar recharacterization under their domestic anti-avoidance rules within Art. 10 of the relevant treaties and the application of Dutch and US anti-avoidance doctrines in a domestic context also leads to a characterization as a dividend. Nevertheless these cases merit further discussion as far as Canada frequently deviates from the OECD definition of dividends. In relation to this Li and Sandler have indicated: "If the Canadian treaty definition of "dividends" is used in a particular treaty, a deemed dividend under section 212.1 is clearly a "dividend" for treaty purposes even if the treaty was concluded before the introduction of section 212.1. Therefore, there is no conflict between section 212.1 and the dividend article of most of Canada's tax treaties. If, however, the OECD definition of "dividends" is included in a particular treaty, it is arguable that a deemed dividend under section 212.1 is not a "dividend" for treaty purposes because it is not "income from other corporate rights." The definition of "dividends" in article 10(3) of the OECD model is exhaustive. Except to the extent specifically provided in that provision, reference to Canada's domestic law is not permitted under either article 3(2) of the OECD model or section 3 of the ITCIA. In this situation, unless section 212.1 constitutes a treaty override, the provisions of the treaty are paramount and a provision based on article 13(4) of the OECD model, discussed below, would exclude the gain from the sale of shares from tax in Canada" (Li; Sandler, "The Relationship Between

3. Real avoidance cases.

45. When we face real avoidance cases –*i.e.* attempts which cannot be counteracted with a simple construction of the avoided or unlawfully captured provision- the question arises wether or not the application of a domestic GAAR could be in breach of the *pacta sunt servanda* principle.

46. Apart from "*limitation of benefits provisions*" –which are kept out of this article- certain States have decided to expressly allow, in a tax treaty context, to apply domestic anti-avoidance rules. This is the case, for example, in several Canadian[74], Belgian[75] and Spanish[76] Tax Treaties. With different nuances the wording of these conventional rules provides as follows: "*Nothing in the agreement shall be construed as preventing a Contracting State from denying benefits under the Agreement where it can reasonably be concluded that to do otherwise would result in an abuse of the provisions of the Agreement or of the domestic laws of that State*"[77]. Even if this kind of provisions have been severely criticized by scholars[78], it is obvious that they allow going beyond the possible sense(s) of the Convention wording and, therefore, resolve an eventual breach of the *pacta sunt servanda* principle.

47. The situation turns problematic in those cases in which tax treaties keep silent on the application of GAARs in the treaty context. But, even for these cases some jurisdictions, and a wide range of scholars[79], take the view that a principle prohibiting treaty abuse is inherent in tax treaties. The existence of this principle is frequently linked to the general principles recognized by civilized nations according to article 38(1) of the Statute of the International Court of Justice. Moreover, this seems to be also in line with the recent birth of a general principle of abuse of law in general Community Law[80], and at least ina bilateral dimension, also the OECD Commentaries flirt with that idea[81]. The existence of this principle is an enormous topic in its own right that would require an in-depth analysis of the legality principle and sources of international public law[82]. According to the limited approach of this contribution we should focus, anyways, on the most practical issue at stake in relation to these cases.

48. Both conventional references to domestic GAARS and the implicit principle prohibiting treaty abuse pose similar problems. They might generate diverging and contradictory results taking into

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Domestic Anti-Avoidance Legislation and Tax Treaties", *Canadian Tax Journal*, Vol. 45, Nº 5, p. 891 (p. 935).

[74] Article 29(6) of the Canada-Germany Tax Treaty and article 29 A (7) of the Canada-US Tax Treaty (quoted by Loomer, "Tax Treaty Abuse: is Canada responding effectively?", *Oxford University Centre for Business Taxation, Working Papers* 2009, no page indication).

[75] Tax Treaties with Germany, Luxembourg, Austria, Egypt and Hong-Kong (quoted by De Broe, *International Tax Planning and Prevention of Abuse*, p. 461 et seq.).

[76] Tax Treaty with Costa Rica.

[77] For different models of this provision see: De Broe, *International Tax Planning and Prevention of Abuse*, p. 462 et seq.)

[78] These provisions are considered to have been done less rigorously than special LOBs (Loomer, "Tax Treaty Abuse: is Canada responding effectively?", *Oxford University Centre for Business Taxation, Working Papers* 2009, no page indication). These provisions have been also considered to promote legal uncertainty: Hortalà i Vallvè, *Comentarios a la Red Española de Convenios de Doble Imposición* (2007), p. 48.

[79] Ward, *Ward's Tax Treaties 1996-1997* (1996), p. 61. Vogel, *Klaus Vogel on Double Taxation Conventions.* 3rd ed. (1997), p. 125.

[80] Even if that principle is a matter of discussion. Very critical against the existence of this principle: De Broe, *International Tax Planning and Prevention of Abuse*, p. 828 et seq.

[81] OECD Commentaries on Art. 1 § 7.1: "*Taxpayers may be tempted to abuse the tax laws of a State by exploiting the differences between various countries' laws. Such attempts may be countered by provisions or jurisprudential rules that are part of the domestic law of the State concerned. Such a State is then unlikely to agree to provisions of bilateral double taxation conventions that would have the effect of allowing abusive transactions that would otherwise be prevented by the provisions and rules of this kind contained in its domestic law. Also, it will not wish to apply its bilateral conventions in a way that would have that effect*".

[82] A good overview of these problems in: Paschen, *Steuerumgenhung in nationalen und internationalen Steuerrecht* (2001), p. 125 et seq.

account the variety of anti-abuse rules worldwide. On the other hand, and this is specially applicable to the pretended existence of an implicit principle, the configuration and the conditions upon which the anti-avoidance rule might be applied remain totally open. This seems particularly worrying if the implicit international anti-abuse principle is merely identified with a substance over form-principle[83], being substance over form a mere description of the result of the application of a GAAR which does not provide a single clue on the conditions of its application.

49. In our opinion the core goal of the guiding principle designed by the OECD is facing the above mentioned problems[84]. In short, the real question at stake is not the possibility, in abstract terms, of going beyond the possible sense(s) of the Convention wording, but the conditions upon which this might be made.

IV. The guiding principle. A critical analysis of its components according to legal theory and European community law

50. As stated before, the OECD Commentaries have construed a guiding principle which consists of two components[85]. One referred to the purpose of the transaction and another to the purpose of the avoided or caught treaty provision. Both components have to be analyzed carefully as they embody the core of the OECD's position on the issue under scrutiny. The principle might also be of a high interest if we take into account that certain commentators have suggested that the two elements enshrined in the guiding principle can be also recognized in the emerging jurisprudence of the ECJ on the conditions under which a measure that hinders the basic freedoms of the Treaty could be justified on the basis of the prevention of tax avoidance[86]. If this is true the guiding principle will provide Member States with a secure instrument to apply GAARs in a treaty context without compromising the basic European freedoms.

Both components must be analysed separately.

1. Main purpose of the transaction.

51. According to the first component of the guiding principle, the benefits of a convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position. This "main purpose requirement" has received much criticism among scholars specially focused on its wording (specially the reference to the "main" instead of the "sole" or the "principal" purpose of the transaction[87]) and its connection with certain examples introduced in the Commentaries in order to illustrate this component[88]. In our opinion this first component is deeply rooted in the business purpose test doctrine which, notwithstanding its literal design (main/sole/principal purpose), has serious drawbacks as pre-requisite to decide whether or not a transaction is to be considered abusive.

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83 As in the standard formula of Vogel: Vogel, *Klaus Vogel on Double Taxation Conventions.* 3rd ed. (1997), p. 125.

84 Also suggested by De Broe: De Broe, *International Tax Planning and Prevention of Abuse*, p. 317.

85 There is a conceptual issue in relation to the guiding principle that merits certain attention. The question is weather the guiding principle constitutes an anti-abuse rule in its own right or merely establishes limits in relation to domestical GAARs. This might be important as for those States (like Spain) that require a special procedure in order to apply its domestical GAAR. Suggesting (not categorically) that the guiding principle is an anti-abuse rule: De Broe: De Broe, *International Tax Planning and Prevention of Abuse*, p. 317-318. Arnold is more emphatic stating that the guiding principle may be tantamount to establishing a treaty anti-avoidance rule (Arnold, *Bulletin for International Fiscal Documentation* 2004, p. 247).

86 Sasseville, "Tax Avoidance involving Tax Treaties", in Jirousek/Lang (eds.) *Praxis des Internationalen* Steuerrechts, p. 463.

87 De Broe, *International Tax Planning and Prevention of Abuse*, p. 319 et seq.

88 Specially in relation to the case in which an individual who, essentially in order to sell the shares and escape taxation in that State on the capital gains from the alienation (by virtue of paragraph 5 of Article 13), transfers his permanent home to the other Contracting State, where such gains are subject to little or no tax (OECD Commentaries on Art. 1 § 9). Critical against the first component in relation to this example: Martín Jiménez, *Bulletin for International Fiscal Documentation* 2004, p. 19. De Broe, *International Tax Planning and Prevention of Abuse*, p. 321.

52. The resort to this particular anti-avoidance doctrine, whatever its formulation might be, may well lead to the exclusion of lawful tax planning transactions from treaty protection[89]. This does not mean that the lack of commercial or business purpose test in a transaction be totally irrelevant in order to conclude its abusive character. This lack might well be a sign of artificiality. The problem of the guiding principle, as we will see in the next paragraph, is that its second element has been designed without any reference to artifice and in a rather circular and self-referencial manner[90]. This might lead to characterize a transaction as abusive even in the absence of artifice.

53. This is also the key factor in order to decide weather or not the first component of the guiding principle is in line with the case law of the ECJ on tax avoidance. The existence of a wholly artificial arrangement has become a frequent requirement of the ECJ case law in tax avoidance cases. Apart from this reference, which is absent in the guiding principle, we must take into account several nuances, especially introduced in its ruling in *Cadbury Schweppes*, in which the European Court of Justice explicitly questions the business purpose test as a valid guide: "*…in this case CS decided to establish CSTS and CSTI in the IFSC for the avowed purpose of benefiting from the favourable tax regime which that establishment enjoys does not in itself constitute abuse*"[91]; "*…the fact that none of the exceptions provided for by the legislation on CFCs applies and that the intention to obtain tax relief prompted the incorporation of the CFC and the conclusion of the transactions between the latter and the resident company does not suffice to conclude that there is a wholly artificial arrangement intended solely to escape that tax*"[92]; "*In those circumstances, in order for the legislation on CFCs to comply with Community law, the taxation provided for by that legislation must be excluded where, despite the existence of tax motives, the incorporation of a CFC reflects economic reality*"[93]. The conclusion is evident: an isolated[94] business purpose test is not acceptable from a community law perspective.

2. Tax treatment contrary to the object and purpose of the relevant provisions of the treaty.

54. As stated before the OECD guiding principle incorporates a second element that relies on the fact that the obtaining of favourable treatment, previously described, would be contrary to the object and purpose of the relevant treaty provisions[95]. This second element is accompanied by an addition of a new objective to the traditional purpose of double taxation - to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons convention- which relies in the prevention of tax avoidance and evasion[96]. This new drafting of the purposes of double taxation conventions seems logical, at least *prima facie*, if we take into account that its primary goal –eliminating international double taxation- might encourage tax avoidance strategies rather than help to its correction[97].

55. But even this new purpose attributed to double taxation conventions, certainly created by the

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[89] As denounced by: Martín Jiménez, *Bulletin for International Fiscal Documentation* 2004, p. 19. De Broe, *International Tax Planning and Prevention of Abuse*, p. 321.

[90] For that reason the use of the business purpose test as an element of anti-abuse rules is not problematic if the GAAR also enshrines artifice requirements as is the case for the Spanish GAAR (article 15 of the *Ley General Tributaria*). The real problem appears in those cases in which business purpose test is explicitly the only parameter of abuse or, in those cases, as the OECD guiding principle in which business purpose test is not formally but *de facto* the unique element in order to characterize a transaction as abusive.

[91] ECJ 12 September 2006, C-196/04, *Cadbury Schweppes* [2006] ECR I-7995, para 38.

[92] ECJ 12 September 2006, C-196/04, *Cadbury Schweppes* [2006] ECR I-7995, para. 63.

[93] ECJ 12 September 2006, C-196/04, *Cadbury Schweppes* [2006] ECR I-7995, para. 65.

[94] As we will see in the next paragraph the special design of the guiding principle turns the main purpose element into the only abuse requirement according to the OECD position.

[95] OECD Commentaries on Art. 1 § 9.5.

[96] OECD Commentaries on Art. 1 § 7.

[97] It has been stated in fact that authors go on to say that, if one of the general objectives of tax treaties is to promote enhanced flows of International trade and investment, it is arguable that it does not matter if the desirable result is achieved by the direct use of tax treaties or by their indirect use (Loomer, "Tax Treaty Abuse: is Canada responding effectively?", *Oxford University Centre for Business Taxation, Working Papers* 2009, no page indication).

OECD out of thin air[98], merits criticism. The main problem of this second element is that it is self-serving and circular[99]. Once it has been ascertained that the main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position (element one) it must be determined wether or not that tax treatment would be contrary to the object and purpose of the relevant treaty provisions (element two) which is identified with the prevention of tax avoidance. One should not forget that the aim of the guiding principle is to define what exactly constitutes tax avoidance. Therefore, in order to decide wether an arrangement might be reputed abusive one should previously ascertain that it is abusive! Apart from the logical inconsistency, the evident risk when it comes to the application of the guiding principle is that, once the main purpose of securing a more favourable tax position has been proved, the abusive character of the arrangement be automatically concluded. In fact the risk of the second element is its practical inexistence and therefore it might encourage the exclusion of lawful tax planning transactions from treaty protection[100].

56. Taking into account that none of the above mentioned purposes of tax treaties seem suitable for a purposive correction of tax avoidance under the second element of the guiding principle, we should reconsider the whole issue. According to this reality one should consider separately:

57. a) Treaty shopping structures. Under a different approach, one should not forget that a tax treaty does not merely pretend the elimination of international double taxation but pursues this objective based on the principle of reciprocity, which is one of the fundamental principles of tax treaty policy[101]. Even if reciprocity might not be a purpose of a double taxation convention it may well indicate how, or to which extent, the contracting states agree to correct double taxation. Treaty shopping breaches the principle of reciprocity and destroys the incentive for countries to negotiate and conclude new treaties[102]. Under this approach the reciprocity principle seems a valid purpose in order to counteract improper use of tax treaties. Even if this reasoning seems less circular than that enshrined in the second element of the OECD guiding principle, the same problem remains as to the fact that this purpose does not indicate when a conduit company must be reputed abusive and therefore be disregarded[103].

58. b) Rule shopping structures. It is evident that the reciprocity principle is totally alien to a purposive correction of rule shopping strategies. Moreover, unless we find a purposive logic for distributive rules in a double taxation convention[104], it seems a difficult task to correct this kind of strategies taking into account the purpose of the avoided or caught treaty provisions.

59. And hence we come to the real core of the problem. Taking into account that (i) none of the pretended purposes of tax treaties (correction of double taxation or prevention of tax avoidance and evasion) seem suitable for a purposive correction of the improper use of tax treaties; (ii) the principle of reciprocity might well be concerned by treaty shopping structures but does not allow to determine what is really an abuse and (iii) it seems impossible to find a teleological design behind tax treaty distributive rules, is it possible to construct a guiding principle or, more generally, a standard to decide wether or not

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98 Arnold, *Bulletin for International Fiscal Documentation* 2004, p. 249.

99 As stated by Arnold (Arnold, *Bulletin for International Fiscal Documentation* 2004, p. 249) but with different arguments as those exposed in this contribution.

100 As has been said according to the OECD's view, treaties are no longer instruments to distribute tax jurisdiction between two states, but instruments to ensure that income is taxed at least once in one of the states (Martín Jiménez, *Bulletin for International Fiscal Documentation* 2004, p. 27). A critical review of the prevention of double non taxation as a treaty purpose in: Lang, "General Report", *Double Non Taxation* (2004).

101 De Broe, *International Tax Planning and Prevention of Abuse*, p. 350.

102 These are in fact the two main concerns put forward in the OECD Conduit Report against treaty Shopping. See: Loomer, "Tax Treaty Abuse: is Canada responding effectively?", *Oxford University Centre for Business Taxation, Working Papers* 2009, no page indication.

103 This explains the distinction between "treaty routing" and "treaty shopping" drawn by several authors. See: (Loomer, "Tax Treaty Abuse: is Canada responding effectively?", *Oxford University Centre for Business Taxation, Working Papers* 2009, no page indication).

104 As pretended for example by Paschen, *Steuerumgenhung in nationalen und internationalen Steuerrecht*, p. 182 et seq.

an arrangement might be considered abusive in a tax treaty context? As far as the purposive approach of the OECD is maintained the answer must be no.

60. The only way to properly resolve this problem is to design a standard that does not rely on the object and purpose of the treaty provisions but on the special characteristics of the arrangements[105]. In this context, and as we stated before, when dealing with the first component of the guiding principle, the key issue must be the concept of artificial arrangements. This requirement is common to many GAARs and therefore conceptually extended in many States[106]. Moreover the concept of wholly artificial arrangements has been repeatedly used in the case law of the ECJ on tax avoidance and recently explained in more detail[107]. Therefore a guiding principle construed on this base might match better in the European legal context. Last but not least, this approach resolves many of the inconsistencies present in the OECD Commentaries on this particular issue.

61. Defining what is a "wholly artificial arrangement" might not be an easy task. Suffice is to say here that this is the proper way that should be experienced in the next years.

105 We have come to the same conclusion in a case that is quite alike to the improper use of tax treaties: Báez, Bad Laws Make Hard Cases: Halifax and the avoidance of inconsistent tax rules, *forthcoming*.

106 Ruiz-Almendral, *Intertax*, 2005, p. 565.

107 Lang; Heidenbauer, Wholly Artificial Arrangements, (2008), p. 597-615.