

# Kluwer International Tax Blog

## Shall International Tax Planning Drop Dramatically by Virtue of BEPS? It Depends

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### I. Introduction

Shall international tax planning decrease after the implementation of BEPS? The reply is “depends” by virtue of the subject’s exposure to several variables.

Obviously, one should consider the question in the light of the legislative framework and tax environment of the relevant country which is in principle the country for which tax planning is being done. For a multinational company, it may be the State of residence of a subsidiary if the tax planning is targeted at reduction of source State taxation. Conversely, tax planning may also be looked at in the country of residence of the parent company when residence tax is at stake in the tax planning exercise such as escaping CFC rules or otherwise enhancing deferral of corporate tax liability. Depending on the targeted country for the tax planning, the reply to the question (“shall international tax planning drop?”) may change.

### II. States which have GAAR rules already

Countries which have a comprehensive and well established GAAR or anti-abuse doctrine may have little to change to achieve BEPS compliant standards. In such countries international tax planning has dropped already in the last decade so that BEPS shall result into minor legislative changes and little impact on international tax planning which has decreased already in prior years. This is certainly true if the judiciary of such countries has affirmed the applicability of GAAR in the presence of tax treaty provisions.[1. E.g. the compatibility of CFC rules with tax treaties has been upheld in Finland, Sweden, the UK and Japan] The 2003 revision of OECD Commentary[2. See paragraphs 9.2, 9.5, 22.1 and 23 of the Commentary to Article 1.] does endorse this view and the number of countries which follow this approach has increased over time.

Practitioners and tax directors are aware of this evolution and have realistically given up tax driven structures in such jurisdictions.

So, the impact of BEPS in such countries is that no many changes are required to either domestic or treaty provisions. Existing GAAR adapt substantive tax law rules to anti-erosion requirements and already achieve a BEPS equivalent result. For instance, Action 6 of BEPS deals extensively with avoidance of PE status through fragmentation of auxiliary and preparatory activities as covered by Article 5(4) OECD Model Convention. In this context, it is suggested a new paragraph

4(1) to be added to Article 5 of the OECD Model Convention to prevent abuses of the PE exclusion provision.

Case law of some countries achieved the same result through domestic GAAR or substance over form interpretation. The Italian Supreme Court ruled for instance that the existence of a permanent establishment must be ascertained in light of substantive rather than formal elements. In the interpretation handed down by the Italian Supreme Court it was of no relevance the circumstance that the activities were carried out in Italy (i.e. the source State) via several distinct entities rather than a sole entity on the grounds that such entities were formally distinct but economically and substantially integrated into a unitary structure, whose aim was to achieve the business purpose of the foreign head office in Italy (Decision No. 20597 of 7 October 2011).

### **III. The role of the BEPS multilateral tax treaty**

A major role for the future of “smart” (but not abusive) international tax planning is the reaction of States to the multilateral tax treaty which is expected to cover several BEPS actions. The failure by some States to ratify some of the provisions to be contained in the multilateral treaty may result in more differences between tax treaties and in greater scope for international tax planning.

For instance, the USA has expressed concerns regarding subjective anti-abuse provisions which rely on the intent of the taxpayer to deny treaty benefits.[3. See the Senate Finance Committee Chairman Orrin Hatch and House Ways & Means Committee Chairman Paul Ryan’s letter dated June 9, 2015 to the Treasury Secretary Jack Lew.] Such reluctance to adopt intent based anti-abuse treaty rules is not new as a few US treaty provisions were rejected by the Senate when the tax treaties with Slovenia and Italy had been submitted for ratification so that such provisions had to be dropped from such treaties to obtain approval on the respective bilateral conventions.[4. See for instance the Report submitted by the Committee on Foreign Relations in relation to the tax convention US concluded with Italy, where it was maintained that “(t)he new main purpose tests in the proposed treaty are subjective, vague and add uncertainty to the treaty. It is unclear how the provisions are to be applied”.]

By contrast, some other States may decide not to adopt LOB provisions as they are not needed to cope with treaty shopping insofar as domestic GAAR constitute already a sufficient tool for that. Furthermore, LOB if adopted might require adjustments by Member States of the EU so that the limitation of treaty relief should be applied to EU residents rather than to the Contracting State’s residents. The EU Commission just announced an infringement procedure against the Netherlands in respect of LOB provisions contained in the treaty with Japan.[5. See the European Commission’s request to the Netherlands to amend the Limitation on Benefits (LOB) clause in the Dutch-Japanese Tax Treaty, which entered into force on 1 January 2012.] EU adjusted LOB might create room for tax planning when investing outside the EU. EU residents could decide from which Member State to invest into a non-EU State without being affected by LOB provisions in the relevant treaty with the non-EU State. So, for instance, in an ideal world: (a) EU countries adopt LOB provisions following BEPS (b) they adjust the LOB treaty provisions and make them EU compliant (c) non-EU States accept the EU adjusted LOB provisions (d) EU based group may direct their investment from one specific Member State to enjoy the benefit of a particular tax treaty with the non-EU State of investment.

### **IV. Revisiting Domestic tax planning?**

Narrower scope for international tax planning and stricter scrutiny of cross-border transactions and treaty application by tax administrations may direct taxpayers to look at domestic tax rules and focus on domestic tax planning more closely. After all, a foreign group is equally pleased to reduce its overall tax burden either by reducing source State withholding taxes or by reducing source State corporation tax applied to the group affiliate.

NID and patent box regimes are good examples of rules which have been adopted in some States to make domestic tax systems more attractive without affecting compliance with EU law. They are not GAAR tainted as both tax savings (NID and patent boxes) intentionally constitute the scope of the respective rules so that exposure to GAAR is limited. It is not a coincidence that BEPS takes NID outside the scope of BEPS and hybrids.

## V. Conclusion

In conclusion, we may expect three directions in which tax planning may go: in some countries (GAAR compliant) practitioners and tax directors shall look more into domestic tax planning when addressing reduction of group's corporate tax rate internationally. In other countries international tax planning might be revamped by virtue of inconsistent implementation of the forthcoming multilateral tax treaty by States. EU member States might have more room for tax planning when investing outside the EU. A consistent approach by States shall be the result.

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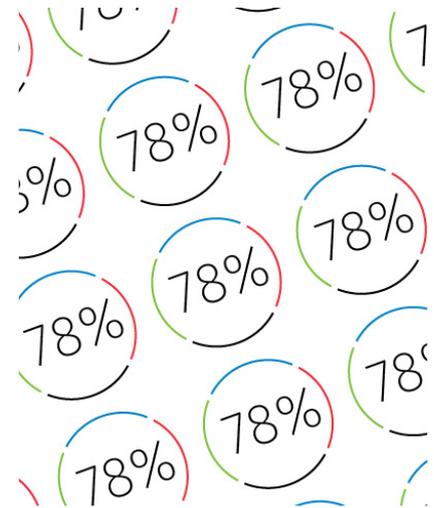
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