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Title of Paper: **Countering Treaty Abuse Using Singapore's General Anti-Abuse Rule and the Principal Purpose Test**[1] [2]

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ABSTRACT

To counter treaty abuse, Singapore may apply the domestic General Anti-Abuse Rule ("GAAR") under the Income Tax Act or the Principal Purpose Test (PPT) under the tax treaties. However, uncertainties abound not only in their interpretation but also in their interaction and application.

This paper looks into the scope and operation of Singapore's GAAR and the PPT to tackle treaty abuse. It first deals with the ambiguity concerning the applicability of GAAR on Singapore's tax treaties. Based on purposive interpretation, the author concluded that Singapore's tax treaties do not preclude the application of GAAR. However, any GAAR analysis must consider the rationale underlying the specific treaty provision, in context of the rest of the tax treaty and its preamble.

Next, the paper investigates whether conflicts would arise when both rules are applicable. Based on a comparative analysis of the main aspects, the author concluded that Singapore's GAAR and the PPT are in conformity. Therefore, conflicts between the two rules will not arise.

Thirdly, the paper examines whether the application of one rule would supplant the other. If so, which rule is meant to be the predominant rule? Based on the findings, nothing in Singapore's domestic law or in the OECD Commentaries suggests that the GAAR will supplant the PPT or vice versa. In the author's opinion, no predominant rule exists as the rules are meant to operate independently. It is also not necessary to prescribe a predominant rule as a matter of policy.

Lastly, the paper considers which rule is the more appropriate remedy to counter treaty abuse. The author concluded that the appropriate remedy depends on the nature of the treaty abuse. Where the abuse is to circumvent the limitation of the treaty itself, the PPT would be the relevant rule to ensure consistency with the treaty's object and purpose. Where the abuse is to circumvent the limitations of domestic tax law using treaty benefits, Singapore's GAAR would be the relevant rule to establish the factual matrix that gives rise to a tax liability under domestic law.

[1] For the avoidance of doubt, the analyses and conclusions made in this paper on the interaction between the GAAR and the PPT and their application are limited to Singapore's GAAR (i.e. section 33 of the Income Tax Act (Cap.134)) and Singapore's tax treaties.

[2] All analyses and conclusions made in this paper are based on the Singapore's legislation and tax treaties prevailing as at 1 February 2020.

1 Introduction

'What people really want is fairness. They want people paying their fair share of taxes.'

Barack Obama, 2013

1.1 Amidst the US austerity programme in 2012, several multinational enterprises ("MNEs") had come under fire for avoiding paying income tax on their corporate profits.[3] There was much public anger and the tide of public opinion had turned on policy makers and tax authorities to be tougher on tax-avoiding MNEs.

1.2 Improving the operation of anti-tax avoidance provisions is at the heart of preserving public trust in international tax regimes. Internationally, the G20 countries and the Organisation for Economic Co-operation and Development ("OECD") had responded with the Base Erosion Profit Sharing ("BEPS") Project to protect tax bases while offering certainty and predictability to taxpayers.

1.3 Singapore joined the Inclusive Framework on BEPS in June 2016 to work with other jurisdictions in the implementation and monitoring phase of the BEPS Project. As a BEPS associate, Singapore is committed to the implementation of the four minimum standards under BEPS.[4]

1.4 One of the minimum standards is Action 6 i.e. preventing treaty abuse. To meet this standard, Singapore has adopted the Principal Purpose Test ("PPT") in the OECD's Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("MLI"). The MLI has enabled Singapore to swiftly amend her tax treaties with other jurisdictions to implement the tax treaty related BEPS recommendations.[5]

1.5 In addition to the PPT, Singapore has a General Anti-Abuse Rule ("GAAR") in her domestic tax law to tackle tax avoidance. The GAAR is provided in section 33 ("s 33") of the Income Tax Act (Cap.134) ("ITA")[6]. Under s 33, the Comptroller of Income Tax ('the Comptroller') may disregard or vary any arrangement and make such adjustments as he considers appropriate to counteract any tax advantage obtained.

1.6 Despite its wide powers, the applicability of GAAR on Singapore's tax treaties is not a settled law in Singapore.[7] [8] Section 49 of the ITA ("s 49") provides that the effect of Singapore's tax treaties prevails over any contrary written law. The general overriding effect of tax treaties

[3] Schumpeter "The price isn't right – corporate tax avoidance" *The Economist*, 21 Sep 2012.

[4] The four minimum standards are: (1) Countering harmful tax practices; (2) Preventing treaty abuse; (3) Transfer pricing documentation; and (4) Enhancing dispute resolution.

[5] Singapore has ratified the MLI which is effective from 1 April 2019. As at 1 February 2020, 28 Singapore's tax treaties had been revised by the MLI, and five new tax treaties were concluded with the MLI changes. See **Annex A** for the revised and new tax treaties.

[6] Please note that subsequent to the completion of this paper, the Ministry of Finance has proposed legislative amendments for section 33 in the Income Tax (Amendment) Bill 2020, first released for consultation in July 2020. The proposed legislative amendments were not considered in this paper.

[7] Telfer, J. H. "General Anti-Avoidance Provisions: The Singapore Position and Australasian Comparisons" (1990) 32 Mal LR 20, pp 319-321.

[8] See also Ng Keat Seng and Yeoh Lian Chuan "Chapter 37 Tax Treaties and Treaty Interpretations" The Law and Practice of Singapore Income Tax Act 2nd Edition Vol II LexisNexis, at paragraphs 37.267 – 37.269 pp 767-768.

over domestic law has casted doubts on whether the GAAR has any role at all in tackling treaty abuse.

1.7 This paper looks into the scope and operation of Singapore's GAAR and the PPT to counter treaty abuse. Specifically, the questions that this paper will address are the following.

a. Is the application of domestic GAAR precluded or limited by Singapore's tax treaties? If so, to what extent?

b. Would conflicts arise in the scope or operation of the GAAR and the PPT when both rules are applicable, and one rule has not been impliedly excluded by the existence of the other?

c. If both the GAAR and the PPT can be invoked to counter treaty abuse, does the application of one rule supplant the other? If so, which rule is meant to be the predominant rule?

d. Which rule is the more appropriate remedy to counter treaty abuse?

1.8 Aside from the present introductory section, this paper is divided into six further sections. Section 2 will first deal with the issue on the applicability of GAAR on Singapore's tax treaties. This will be followed by Section 3 which examines the PPT with a focus on its interpretation issues. The questions on the differences and interaction between the two rules will be dealt with in Sections 4, 5 and 6 respectively. Lastly, Section 7 will conclude with a short summary.

2 Applicability of GAAR on Singapore's tax treaties

Brief introduction on Singapore's GAAR

2.1 Singapore's GAAR has its origins in the Income Tax Ordinance, 1947[9] and the provision had remained intact until the re-enactment of s 33 by the Income Tax (Amendment) Act 1988. The pre-1988 GAAR had many interpretation issues and generally considered to be inadequate to address tax avoidance.[10] Consequently, a policy decision was made in 1988 to strengthen the GAAR through legislative changes.

2.2 Section 33 in its current form (as re-enacted in 1988) reads as follows:

> *"S 33.—(1) Where the Comptroller is satisfied that the purpose or effect of any arrangement is directly or indirectly —*
>
> *(a) to alter the incidence of any tax which is payable by or which would otherwise have been payable by any person;*
>
> *(b) to relieve any person from any liability to pay tax or to make a return under this Act; or*
>
> *(c) to reduce or avoid any liability imposed or which would otherwise have been imposed on any person by this Act,*

[9] Section 29 of the Income Tax Ordinance, 1947.

[10] Loke Kit Choy "Singapore Income Tax Act: The Enigma of Section 33", (December 1972) MLR Vol.14 No.2, pp 209 – 215.

> *the Comptroller may, without prejudice to such validity as it may have in any other respect or for any other purpose, disregard or vary the arrangement and make such adjustments as he considers appropriate, including the computation or re-computation of gains or profits, or the imposition of liability to tax, so as to counteract any tax advantage obtained or obtainable by that person from or under that arrangement.*
>
> *(2) In this section, "arrangement" means any scheme, trust, grant, covenant, agreement, disposition, transaction and includes all steps by which it is carried into effect.*
>
> *(3) - This section shall not apply to —*
>
> *(a) any arrangement made or entered into before 29th January 1988; or*
>
> *(b) any arrangement carried out for bona fide commercial reasons and had not as one of its main purposes the avoidance or reduction of tax."*

2.3 Despite the 1988 re-enactment, questions have arisen on whether the GAAR can be invoked to counter treaty abuse.[11] To-date, this issue has not been dealt with by any Singapore courts.

Uncertainties over the applicability of GAAR on Singapore's tax treaties

2.4 The uncertainties stem from the provisions of section 49 ("s 49") of the ITA. Singapore's tax treaties are granted the authority of law through s 49 (1) and it reads as follows:

> *"S 49.—(1) If the Minister by order declares that arrangements specified in the order have been made with the government of any country outside Singapore with a view to affording relief from double taxation in relation to tax under this Act and any tax of similar character imposed by the laws of that country, and that it is expedient that those arrangements should have effect, the arrangements shall have effect notwithstanding anything in written law."*

2.5 The overriding effect of s 49 over domestic law had called into question the applicability of domestic GAAR provision on tax treaties under the principle of pacta sunt servanda[12]. In other words, whether the application of the domestic GAAR must be provided for in the tax treaty ("the GAAR clause") to preserve its use in countering treaty abuse. The inclusion of the GAAR clause in only a small number of Singapore's tax treaties further muddies the water as by negative inference it may be construed that s 33 is inapplicable to the other treaties which are silent on GAAR.[13]

Purposive interpretation of s 49

2.6 In Singapore, any common law principle of interpretation, such as the plain meaning rule and the strict construction rule, must yield to the purposive interpretation stipulated by section 9A(1) of the Interpretation Act (Cap.1) ("IA").[14] All written law must be interpreted purposively. Other common law principles come into play only when their application coincides with the purpose underlying the written law in question, or alternatively, when

[11] This is unlike domestic tax laws in Australia, Canada, New Zealand and United Kingdom which provide that their domestic GAARs can override tax treaty provisions. See **Annex B** for details.
[12] Latin for "agreements must be kept".
[13] As at 1 February 2020, only seven out of 93 Singapore's tax treaties have a clause that provides for the use of domestic GAAR. See **Annex A** for details.
[14] See **Annex C** for the provision of s 9A(1) of the Interpretation Act.

ambiguity in that written law persists even after an attempt at purposive interpretation has been properly made.[15]

2.7 Based on the IA, a purposive construction of s 49 should be adopted in determining the applicability of GAAR on Singapore's tax treaties. In this regard, the subordinate clause in s 49 i.e. *"the arrangements shall have effect notwithstanding anything in written law"* may be interpreted purposively in the following manner:

a. Under s 9A(1) of the IA, any purposive interpretation must promote the purpose or object underlying the written law. As s 49 is a provision to accord Singapore's tax treaties with the authority of the law through Ministerial orders, it may be inferred that the object and purpose of s 49 are to be derived from those of the tax treaties.

b. The object and purpose of a tax treaty can be determined based on the Vienna Convention on the Law of Treaties ("VCLT") and the OECD Commentaries on the Model Tax Convention. Although Singapore is neither a signatory to the VCLT nor a Member State of the OECD, in principle both materials should still be relevant.[16] The OECD Commentaries can either serve as "context" within the meaning of article 31(1) or as "preparatory work of the treaty or circumstances of its conclusion" under article 32 of the VCLT.[17] Singapore courts had stated their commitment to adhere to international comity in the past.[18] Therefore it is likely the courts would consider the VCLT and the OECD Commentaries as relevant extrinsic materials under s 9A(2)(a) of the IA.[19]

c. The OECD Commentaries state that the principal purpose of double taxation conventions is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons. The OECD further clarified in the 2003 Commentaries that the purpose of tax conventions is also to prevent tax avoidance and evasion ("2003 OECD revisions").[20] The 2003 OECD revisions had referred to article 31 of the VCLT which enshrined the principle of good faith in treaty interpretation.[21] This implies that there is an inherent anti-abuse rule in tax treaties. By virtue of the VCLT and the 2003 OECD revisions, it may be inferred that the prevention of tax avoidance and evasion is one of the purposes of tax treaties.

d. It is inconceivable that Singapore Parliament had contemplated only the effect of relieving double taxation in s 49 given that tax treaties may also serve other purposes such as the exchange of information between contracting states and the prevention

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[15] *Public Prosecutor v Low Keng Heng [2007] 4 SLR(R) 183 at 196.*

[16] Ng Keat Seng and Yeoh Lian Chuan "Chapter 37 Tax Treaties and Treaty Interpretations" *The Law and Practice of Singapore Income Tax Act 2nd Edition Vol II LexisNexis*, at paragraphs 37.246– 37.250, pp761-762.

[17] Linderflak and Hilling (2015) "The Use of OECD Commentaries as Interpretative Aids – The Static / Ambulatory – Approaches Debate Considered from the Perspective of International Law" *Nordic Tax Journal 2015;* 1 pp44-47.

[18] *The Sahand and other applications [2011] 2 SLR 1093*, at paragraph 33 - "*That said, I should state unequivocally that the courts will always strive to give effect to Singapore's international obligations within the strictures of our Constitution and laws."*

[19] See **Annex C** for the provision of s 9A(2) of the Interpretation Act.

[20] The clarification was made in 2003 update, Paragraph 7 of the OECD Commentaries on Article 1 under the section on "Improper use of the Convention".

[21] At paragraph 9.3 of the 2003 OECD Commentary on article 1.

of tax avoidance and evasion. Furthermore, sections 49(7) and 49(8) of the ITA were legislated in 2017 to provide for the effects of tax treaties to also extend to BEPS matters such as the fulfilment of Singapore's obligations under the MLI. In the author's opinion, the words *"the arrangements shall have effect"* in s 49 should be construed purposively to cover all effects arising from the tax treaty's object and purpose.

2.8 Based on the purposive interpretation, the GAAR is not prohibited by s 49 where its application is consistent with the treaty's purpose and effect in preventing tax avoidance. While the overarching object and purpose of Singapore's tax treaties are similar, the applicability of GAAR may differ from treaty to treaty as specific treaty provisions can be different. A more in-depth analysis of Singapore's tax treaties is therefore required and is provided below.

Determining whether application of GAAR is consistent with the treaty's purpose and effect

2.9 How may the application of GAAR be consistent with the purpose and effect of a tax treaty? The question may be dealt with by classifying Singapore's tax treaties into different categories and evaluating whether the application of GAAR Is consistent with the treaty's purpose and effect in each category. The suggested categories of tax treaties are as follows:

a. Tax treaties that provide for the application of domestic GAAR;

b. Tax treaties that are silent on the application of domestic GAAR but their preambles are revised by the MLI changes, or newly concluded tax treaties that incorporated the MLI changes;

c. Tax treaties that are silent on the application of domestic GAAR, not revised by the MLI but concluded based on the 2003 OECD revisions; and

d. Tax treaties that are silent on the application of domestic GAAR, not revised by the MLI and concluded before the 2003 OECD revisions.

Category A: Singapore's tax treaties that provide for the application of domestic GAAR

2.10 In this category, the application of GAAR to counter treaty abuse was contemplated and provided for in the treaties. Hence, there is no conflict.

Category B: Singapore's tax treaties that are silent on the application of domestic GAAR but their preambles are revised by the MLI, or newly concluded Singapore's tax treaties that incorporated the MLI changes

2.11 Under article 31(1) of the VCLT, the ordinary meaning to be given to the terms of the treaty are to be read in their context and in the light of its object and purpose.[22] Under article 31(2), the context for the purpose of the interpretation of a treaty includes its preambles and annexes.[23] Accordingly, treaty interpretation must consider the preamble of the treaty and any subsequent changes to it.

[22] Article 31(1) - *"A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose".*

[23] Article 31(2) - *"The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preambles and annexes…".*

2.12 As mentioned, most of Singapore's tax treaties will be amended by the OECD MLI. Amongst the treaty amendments, article 6 of the MLI will revise the preamble of a tax treaty which provides for the purpose of the covered tax agreement. Singapore had chosen the following treaty position in respect of the revised preamble:

> *"Paragraph 1 – To include a statement in the preamble of the DTA to clarify that the DTA is intended to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance;*
>
> *Paragraph 3 – To include a statement in the preamble to reflect a desire to further develop economic relationship or enhance cooperation in tax matters."*

As the preamble changes are intended to clarify the intent of the Contracting States to ensure that Covered Tax Agreements be interpreted in line with the preamble language in article 6, the changes will be applicable to all arrangements on an ambulatory approach.[24]

2.13 As the revised preamble states unequivocally that tax treaties are not intended to create opportunities for reduced or non-taxation through tax avoidance or evasion, the application of GAAR to counter treaty abuse will be consistent with the treaty's purpose and effect.

Category C: Singapore's tax treaties that are silent on the application of domestic GAAR, not revised by the MLI but concluded based on the 2003 OECD revisions

2.14 For these treaties, the 2003 OECD revisions would be highly persuasive in determining the object and purpose of the treaty. Indeed, the OECD Commentaries are viewed by many interpreters as an important interpretative reference and increasing so. Paragraph 29.3 of the Introduction to the OECD Commentaries reads as follows:

> *"29.3 – Bilateral tax treaties are receiving more and more judicial attention as well. The courts are increasingly using the Commentaries in reaching their decisions. Information collected by the Committee on Fiscal Affairs shows that the Commentaries have been cited in the published decisions of the courts of the great majority of Member countries. In many decisions, the Commentaries have been extensively quoted and analysed, and have frequently played a key role in the judge's deliberations. The Committee expects this trend to continue as the world-wide network of tax treaties continues to grow and as the Commentaries "gain even more widespread acceptance as an important interpretative reference."*

2.15 In the 2003 OECD Commentary on Article 1, substantial changes were made to the section on "Improper use of the Convention" ("2003 OECD revisions"). OECD made clear that the purpose of tax conventions is also to prevent tax avoidance and evasion in paragraph 7 of the Commentary. In paragraphs 9.2 and 9.3, OECD laid out two approaches for characterising treaty abuses:

> *"Abuse of tax convention may be characterised as an abuse of domestic law. There is no conflict between domestic anti-abuse rules and tax conventions as the former are only rules set by domestic tax law for determining which facts give rise to a tax liability and they are not addressed by tax treaties and are therefore not affected by them;*
>
> *Abuses may also be characterised as abuse of the tax convention itself. Proper construction of tax conventions allows State to disregard abusive transactions. This*

[24] See paragraph 23 of the Explanatory Statement Notes to the MLI p8.

> *interpretation results from the object and purpose of tax conventions and the obligation to interpret them in good faith."*

Under both approaches, contracting states do not have to grant treaty benefits for abusive transactions.

2.16 The OECD guiding principle on countering treaty abuse is laid out in paragraph 9.5:

> *"It is important to note, however, that it should not be lightly assumed that a taxpayer is entering into the type of abusive transactions referred to above. A guiding principle is that the benefits of a double tax 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."*

2.17 The interaction between the GAAR and tax treaties are explained in paragraph 9.2 and 22.1 of the 2003 Commentary to Article 1. It provides that the GAAR is part of the basic domestic rules set by domestic tax laws for determining which facts give rise to a tax liability. These rules are not addressed in tax treaties and are therefore not affected by them. For example, to the extent that domestic GAAR results in a re-characterisation of income or in a redetermination of the taxpayer who is considered to derive such income, the provisions of the Convention will be applied considering these changes. Thus, as a general rule, there will be no conflict between the GAAR and the provisions of tax conventions.

2.18 The 2003 OECD revisions had made clear that tax treaties are not intended to facilitate tax avoidance or evasion. The revisions also clarified that there is no conflict between the GAAR and the treaty provisions. Therefore, the use of GAAR to counter treaty abuse will be consistent with the purpose and effect of Singapore's tax treaties that were concluded based on the 2003 OECD revisions.

Category D: Singapore's tax treaties that are silent on the application of domestic GAAR, not revised by the MLI and concluded before the 2003 OECD revisions

2.19 The analysis depends on taking an ambulatory or a static approach in treaty interpretation. If taking the ambulatory approach, the interpreter will accept the relevance of any subsequently adopted Commentaries. If taking a static approach, an interpreter will limit the use of the OECD Commentaries to those that existed at the conclusion of the treaty.

Ambulatory approach

2.20 The choice between the ambulatory or static approach is still one of the unresolved issues in modern international tax law.[25] Nonetheless, OECD generally prefers the ambulatory approach but with the caveat that the context must not require an alternative interpretation. Paragraphs 35 and 36 of the Introduction to the OECD Model Tax Convention read as follows:

> *"35. Needless to say, amendments to the Articles of the Model Convention and changes to the Commentaries that are a direct result of these amendments are not relevant to the interpretation or application of previously concluded conventions where the provisions of those conventions are different in substance from the amended Articles. However, other changes or additions to the Commentaries are normally applicable to the interpretation and application of conventions concluded before their adoption, because*

[25] Ibid footnote 17.

they reflect the consensus of the OECD member countries as to the proper interpretation of existing provisions and their application to specific situations.

36. Whilst the Committee considers that changes to the Commentaries should be relevant in interpreting and applying conventions concluded before the adoption of these changes, it disagrees with any form of a contrario interpretation that would necessarily infer from a change to an Article of the Model Convention or to the Commentaries that the previous wording resulted in consequences different from those of the modified wording. Many amendments are intended to simply clarify, not change, the meaning of the Articles or the Commentaries, and such a contrario interpretations would clearly be wrong in those cases.

36.1 Tax authorities in member countries follow the general principles enunciated in the preceding four paragraphs. Accordingly, the Committee on Fiscal Affairs considers that taxpayers may also find it useful to consult later versions of the Commentaries in interpreting earlier treaties."

2.21 The ambulatory approach is further supported in paragraph 2 of article 3 of the OECD Model Tax Convention. Paragraph 2 of article 3 and paragraphs 11 and 12 of the commentary to article 3 read as follows:

Paragraph 2 of article 3

"2. As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State."

Commentary to article 3

"11. This paragraph provides a general rule of interpretation for terms used in the Convention but not defined therein. However, the question arises which legislation must be referred to in order to determine the meaning of terms not defined in the Convention, the choice being between the legislation in force when the Convention was signed or that in force when the Convention is being applied, i.e. when the tax is imposed. The Committee on Fiscal Affairs concluded that the latter interpretation should prevail, and in 1995 amended the Model to make this point explicitly.

12. However, paragraph 2 specifies that this applies only if the context does not require an alternative interpretation. The context is determined in particular by the intention of the Contracting States when signing the Convention as well as the meaning given to the term in question in the legislation of the other Contracting State (an implicit reference to the principle of reciprocity on which the Convention is based). The wording of the Article therefore allows the competent authorities some leeway."

2.22 There is also judicial support for the ambulatory approach. In the case of *Prévost Car Inc v The Queen [2010] FCR 65 ("Prévost")*, the Canadian Federal Court of Appeal held that OECD Commentaries published subsequent to the completion of a tax treaty are a widely-accepted guide to the interpretation and application of pre-existing tax treaties when they represent a fair interpretation of the words of the Model Tax Convention and do not conflict with the Commentaries in existence at the time a specific treaty was entered and when, of course, neither treaty partner has registered an objection to the new Commentaries and/or are

intended to simply clarify, not change, the meaning of the Articles or the Commentaries. It is notable that the Canadian Federal Court in *Prévost* had overruled a major decision in *MIL (Investments) S.A. v. Canada [2006] DTC 3307* in which the Canadian Tax Court had taken a static treaty interpretation.[26] To-date, the ambulatory approach in *Prévost* has not been overruled in Canada.

2.23 Under the ambulatory approach, the 2003 OECD revisions will be applicable regardless of when the Singapore tax treaty was concluded. Accordingly, the use of GAAR to counter treaty abuse will be consistent with the treaty's purpose and effect.

Static approach

2.24 If taking the static approach, the 2003 OECD revisions will not be applicable to Singapore's tax treaties that were concluded prior to the revisions. Instead the analysis will be guided by the contemporaneous OECD Commentaries that existed at the negotiation and conclusion of the treaty.

2.25 OECD's work on treaty abuse was first mentioned in paragraph 7 of the Commentaries to Article 1 of the 1977 Model Tax Convention which provide that tax treaties should not help tax avoidance or evasion. However, the 1977 Commentaries also provided that if Contracting States wish to preserve the application of GAAR, they should make provision for so in the tax treaty.[27]

2.26 Despite the 1977 Commentaries, negotiators of the pre-2003 tax treaties might not see the need to include a GAAR clause if there was no conflict to begin with. Based on a 2010 report from International Fiscal Association ("IFA")[28], many countries' domestic GAAR are generally in line with tax treaty obligations, relatively few tax treaties contained a provision that allows the application of domestic GAAR. Hence the IFA report concluded that the suggestion in 1977 Commentaries for the inclusion of GAAR provision in the tax treaties was the exception rather than the standard norm.

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[26] In *MIL*, the Respondent (Canadian revenue authority) had contended that there was an anti-abuse rule inherent in the treaty itself, apart from the domestic GAAR. The Respondent was relying on the 2003 revisions to the OECD commentary as support for the existence of an inherent anti-abuse rule in tax treaties. However, the Canadian tax court noted that the 2003 revisions were not applicable to the treaty as the treaty was concluded in 1990 before the revisions were made. Instead, the court relied on the commentaries to the 1977 OECD Model Tax Convention which provided that Contracting States should include the GAAR rule in the treaty if they wish to preserve the application of GAAR contained in the domestic law. Owing to the fact that both Canada and Luxembourg did not include an explicit reference to anti-avoidance rules in their carefully negotiated treaty, the Canadian tax court found that there was no ambiguity in the tax treaty, permitting it to be construed as containing an inherent anti-abuse rule. Simply put, the ordinary meaning of the treaty allowing the Appellant to claim the exemption must be respected.

[27] Paragraph 7 of the Commentary to Article 1 of the 1977 OECD Model Tax Convention, which reads:

> "The purpose of double tax conventions is to promote by, eliminating international double taxation... they should not, however, help tax avoidance or evasion. True, taxpayers have the possibility, double taxation conventions being left aside, to exploit the differences in tax levels as between States and the tax advantages provided by various countries' taxation laws, but it is for the States concerned to adopt provisions in their domestic law, to counter possible manoeuvres. Such states will then wish, in their bilateral double taxation conventions, to preserve the application of a provision of this kind contained in their domestic laws."

[28] Weeghel "Conflicts between domestic GAAR and Tax Treaties" IFA Annual Congress Rome 2010, General Report.

2.27 Furthermore, the 1977 Commentaries clarified that tax treaties are not meant to help tax avoidance or evasion. This position is consistent with the "good faith" requirement in articles 26 and 31 of the VCLT, which implies the presence of an inherent anti-abuse rule in tax treaties.

2.28 There is judicial support for the inherent anti-abuse rule. In the Switzerland case, *A Holding ApS v Federal Tax Administration (2005) 8 ITLR 536 ("A Holding Aps")*, the Swiss court referred to the principle of good faith that should be observed in the interpretation of treaties and held that the principle of good faith entailed the prohibition of treaty abuse. Similarly, in another case *Antle v. Canada 2009 D.T.C. 1305 ("Antle")*, the Canadian tax court considered that the spirit and purpose of the tax treaty did not conflict with the domestic GAAR.

2.29 In Singapore, in an e-tax guide published by the Inland Revenue Authority of Singapore ("IRAS") on tax treaty interpretation, IRAS had clarified that tax treaties were negotiated and concluded based on principle of good faith and tax treaties are not to be used in avoidance transactions.[29]

2.30 Based on the above findings, it is the author's opinion that the pre-2003 Singapore's tax treaties have the prevention of tax avoidance and evasion as one of their purposes all along by virtue of the principle of good faith. Accordingly, the static approach shares the same conclusion as the ambulatory approach.

2.31 Based on the analyses in Categories A to D, the author concluded that Singapore's tax treaties do not preclude the application of GAAR. A summary of the findings is tabulated in **Annex A**.

Limitation of GAAR to counter treaty abuse

2.32 The application of GAAR to counter treaty abuse is not without strictures. In *Alta Energy Luxembourg SARL v R 2018 TCC 152 ("Alta Energy")*, the Canadian Tax Court held that under the GAAR analysis, the Court must identify the rationale underlying specific treaty provisions, not a vague policy supporting a general approach to the interpretation of the treaty. In that case, the specific treaty provision in question was a carve-out for immovable property contained in the Treaty and this carve-out was a departure from the OECD Model Tax Convention. The court held that this departure was intentional, and a result of a bargain struck between treaty negotiators. The court was therefore inclined to give effect to the carve-out and was reluctant to apply the GAAR to disturb the bargain struck between the two states. In other words, the states were presumed to know each other's tax laws when they concluded the treaty, and so double non-taxation was envisaged.

2.33 Based on the purposive interpretation of s 49 and the decision in *Alta Energy*, it is the author's opinion that Singapore courts may be disinclined to disregard specific treaty provisions using GAAR where the provisions had operated as intended by treaty negotiators. This may be so even in double non-taxation arrangements. Hence, the application of GAAR to counter treaty abuse must be treated with caution. Before applying the GAAR, the analysis must examine whether the application is consistent with the rationale underlying the specific treaty provision.

[29] IRAS e-tax guide "Avoidance of Double Taxation Agreements (Second Edition)" published on 15 June 2018, at paragraphs 4.3 and 4.4.

Conclusion on Question (a): Is the application of domestic GAAR precluded or limited by Singapore's tax treaties? If so, to what extent?

In conclusion, the purposive interpretation of s 49 supports the application of GAAR to counter treaty abuse where the application is consistent with the treaty's purpose and effect. However, the use of GAAR must be treated with caution. The GAAR analysis must examine whether the application is consistent with the rationale underlying the specific treaty provision, particularly if that treaty provision is a departure from OECD Model Tax Convention. Where the specific treaty provision had operated in the manner as intended by treaty's negotiators, then there is no treaty abuse and the GAAR is inapplicable. This may be so even if the arrangement resulted in double non-taxation.

3 The Principal Purpose Test (PPT)

Brief introduction on the PPT

3.1 The guiding principle on countering treaty abuse was first provided in paragraph 9.5 of the 2003 OECD Commentary on article 1 of the Model Tax Convention. BEPS Action 6 had built on the work of the 2003 OECD Commentary which led to the PPT.

3.2 BEPS Action 6 final report states that the PPT is a codification of the OECD guiding principle on treaty abuse. The final report also includes changes to the OECD Model Tax Convention aimed at ensuring that treaties do not inadvertently prevent the application of domestic anti-abuse rules.

3.3 The PPT is found in paragraph 9 of article 29 of the 2017 OECD Model Tax Convention. Paragraph 9 reads as follows:

> *"Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention."*

3.4 For Singapore, the PPT will be included into her tax treaties via the OECD MLI. Singapore had adopted the following treaty positions on article 7 of the MLI (prevention of treaty abuse):

> *"Paragraph 2 – To adopt the Principal Purpose Test in Singapore's DTAs to prevent treaty abuse. Asymmetrical application of simplified limitation of benefits rules will not be allowed.*
>
> *Paragraph 4 – To include the discretionary relief provision which would give a competent authority discretion to grant treaty benefits to a taxpayer, upon request, despite the taxpayer failing the Principal Purpose Test."*

Interpretation of the PPT based on the 2017 OECD Commentary on article 29 ("2017 Commentary")

3.5 *"Notwithstanding the other provisions of this Convention…"*

3.5.1 The above clause means the PPT will prevail over the other treaty provisions. Paragraphs 171 to 173 of the 2017 Commentary provides that the PPT is a stand-alone test. This implies that the PPT is not affected by other specific anti-abuse rules e.g. the Limitation of Benefit clause, the Beneficial Owner Test or the domestic GAAR and vice versa.

3.6 *"a benefit under this Convention shall not be granted in respect of an item of income or capital…"*

3.6.1 The clause provides the right for contracting states to deny treaty benefits in tax avoidance arrangements. However, the PPT does not grant contracting states the right to re-construct the factual matrix or to impose domestic tax.

3.6.2 "A benefit under this Convention" refers to an improvement in tax situation of the person by relying on the tax treaty in comparison to the application of the domestic tax law. The benefit must be in respect of an item of income or capital.

3.6.3 Paragraph 175 of the 2017 Commentary provides clarification on the definition of benefits. It refers to all limitations (e.g. a tax reduction, exemption, deferral or refund) on taxation imposed on the State of Source under Articles 6 through 22 of the Convention, the relief from double taxation provided by article 23, and the protection against discrimination under article 24 or any other similar limitations (e.g. tax sparing provisions).

3.6.4 It is noted that the PPT affects only the benefits provided in the treaty. It does not extend to benefits found in other treaties.[30] For example, the PPT does not affect the fiscal privileges provided in Article 28 (granted to members of diplomatic missions and consular posts).

3.7 *"if it is reasonable to conclude, having regard to all relevant facts and circumstances that obtaining that benefit was one of the principal purposes"*

3.7.1 The PPT has a "reasonableness" test which entails an objective examination of all relevant facts and circumstances. The PPT thus assumes that principal purpose(s) can be deduced from observable facts and circumstances of the arrangement/transaction.

3.7.2 Paragraph 178 of the 2017 Commentary states that where an arrangement can only be reasonably explained by a benefit that arises under a treaty, it may be concluded that one of the principal purposes of that arrangement was to obtain the benefit. Paragraph 179 further clarifies the determination requires reasonableness, suggesting that the possibility of different interpretation of events must be objectively considered. The references to the reasonability standard and objectively proven facts and circumstances imply that tax authorities need only to find observable/deducible purpose rather than proving subjective motivation.

3.7.3 The clause "one of the principal purposes" means that there could be more than one principal purpose in an arrangement and obtaining treaty benefit does not have to be the sole purpose of the arrangement.

3.7.4 However, paragraph 181 of the 2017 Commentary provides that obtaining a tax benefit will not be considered a principal purpose if the benefit was not the principal consideration and would not have justified entering into any arrangement or transaction that has, alone or together with other transactions, resulted in the benefit. Where an arrangement is

[30] Lang, Michael (2014) "BEPS Action 6: Introducing an Anti-abuse Rule in Tax Treaties" *Tax Notes International*, pp 655-664.

inextricably linked to a core commercial activity, and its form has not been driven by considerations of obtaining a benefit. The OECD Commentary suggests that commercial justification of an arrangement will be key considerations. The onus will be on taxpayers to show that there are other substantial commercial benefits (e.g. cost savings from operational efficiency or from economies of scale) in addition to the treaty benefit.

3.7.5 Paragraph 181 also clarified that the choice of treaties in itself is not abusive. It is the use of the tax treaty that must be examined. In Example K of paragraph 182, OECD provides that given the intent of tax treaties is to provide benefits to encourage cross-border investment, it is therefore necessary to consider the context in which the investment was made, including the reasons for establishing RCO in State R and the investment functions and other activities carried out in State R.

3.8 *"of any arrangement or transaction that resulted directly or indirectly in that benefit,"*

3.8.1 Paragraph 176 of the 2017 Commentary states that the clause is deliberately broad and is intended to include situations where the person who claims the application of the benefits under a tax treaty may do so with a transaction that is not one that was undertaken for one of the principal purposes of obtaining that treaty benefit. In other words, an arrangement may still be caught under the PPT even if the impugned transaction was not undertaken by the person who is claiming the tax benefit. The clause thus broadens the scope of the PPT.[31]

3.9 *"unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention."*

3.9.1 The clause *"unless it is established"* means that the onus of proof is on taxpayer to show that tax benefit had been granted in accordance with the object and purpose of the relevant treaty provision.

3.9.2 The exclusion clause is based on an objective criterion that the tax benefit would be in accordance with the object and purpose of the treaty provision. This exception clause is consistent with article 31 of the VCLT which focuses on the object and purpose of a rule for treaty interpretation.

3.9.3 However, there are practical difficulties as it is generally not obvious whether a treaty provision has a specific object or purpose, and whether the objective criterion should be examined by reference to the treaty as a whole including its revised preamble. A plausible interpretation is that the treaty's object and purpose are only some of the elements that need to be considered for interpretation purposes and they cannot override the treaty's clear substantive provisions.[32]

3.9.4 Another unresolved issue is that while the revised preamble made clear that tax treaties should not be used to create opportunities for non-taxation or reduced taxation through tax evasion or tax avoidance, their primary objective is still the elimination of international double taxation. An alternative view is that this hierarchy should not be ignored in the interpretation of the PPT.[33]

[31] For illustration, see the assignment of income source example in paragraph 176 of 2017 Commentary.
[32] L. De Tax Treaty and EU Law aspects of the LOB and PPT provision proposed by BEPS action 6" *Institute for Tax Law* pp 203-204 (Kluwer/Schulthess 2017).
[33] R. Danon and H. Salome (2018) "Treaty abuse in the post-BEPS world: Analysis of the policy shift and impact of the principal purpose test for MNE groups" *Bulletin for International Taxation* IBFD.

3.9.5 Paragraph 173 of the 2017 Commentary on Article 29 provides some guidance in this regard. It states that the PPT must be read in the context of the relevant provisions as well as the rest of the Convention including its preamble. The Commentary gave the example of a public-listed company which would have satisfied the definition of a "qualified person" in paragraph 2 of Article 29 and is consistent with the object and purpose of paragraph 2 i.e. to establish a threshold for the treaty entitlement of public companies whose shares are held by residents of different States. However, if such a public company is a bank that enters into a conduit financing arrangements intended to provide indirectly to a resident of a third State the benefit of lower source taxation under a tax treaty, the PPT would apply to deny that benefit because paragraph 2 when read in context of the rest of the Convention and, in particular, its preamble, cannot be considered as having the purpose, shared by the two Contracting States, of authorising treaty-shopping transactions entered into by public companies.

4 Scope and operation of the GAAR and the PPT

4.1 This section sets out the similarities and differences in scope and operation between the GAAR and the PPT and discusses whether conflicts would arise when both rules are applicable.

4.2 For the purpose of the analysis, the GAAR (s 33) and the PPT are compared in the following main aspects:

a. the definition of arrangement;

b. the trigger provision for tax avoidance;

c. the counteracting measures permitted; and lastly

d. the exclusion clause.

The definition of arrangement

4.3 "Arrangement" is defined in s 33(2) of the Income Tax Act. It refers to any scheme, trust, grant, covenant, agreement, disposition, transaction and includes all steps by which the arrangement is carried into effect. In *Comptroller of Income Tax v AQQ [2014] 2 SLR 847 ("AQQ")*, the Court of Appeal held that a tax avoidance arrangement may constitute a combination of steps that may be individually unobjectionable. The Comptroller is entitled to particularize an impugned arrangement as a composite scheme that comprised both the corporate restructuring and the financing arrangement.

4.4 Regarding the PPT, paragraph 177 of the 2017 Commentary provides that "arrangement or transaction" are to be interpreted broadly and include any agreement, understanding, scheme, transaction or series of transactions, whether or not they are legally enforceable. They include the creation, assignment, acquisition or transfer of the income itself, or of the property or right in respect of which the income accrues. These terms also encompass arrangements concerning the establishment, acquisition or maintenance of a person who derives the income, including the qualification of that person as a resident of one of the Contracting States, and include steps that persons may take themselves in order to establish residence.

4.5 Based on the above findings, the term "arrangement" in the GAAR and the PPT are broadly defined to encompass all forms of schemes, transactions or steps of a conceived tax

avoidance plan. In the author's opinion, there is no material difference in the interpretation of the term "arrangement" in both rules.

The trigger provision for tax avoidance

4.6 For s 33, the trigger is provided in the three threshold limbs which consider the purpose or effect of an arrangement:

a. to alter the incidence of any tax which is payable by or which would otherwise have been payable by any person;

b. to relieve any person from any liability to pay tax or to make a return under this Act; or

c. to reduce or avoid any liability imposed or which would otherwise have been imposed on any person by this Act.

4.7 In *AQQ*, the Court of Appeal had applied the "predication principle" *in Lauri Joseph Newton and others v Commissioner of Taxation of the Commonwealth of Australia [1958] 1 AC 450 ("Newton")*. The Court of Appeal was concerned with the objective ends of the arrangement, that is, whether it may be predicated from the observable acts by which an arrangement is implemented that it was implemented in that way to achieve the ends stated in any of the limbs in s33(1). Such an examination is an objective analysis and is not concerned with the subjective motives of the taxpayer.

4.8 Regarding the PPT, the clause is triggered only if obtaining a treaty benefit was one of the principal purposes of the arrangement or transaction. Like s 33, the determination of the purpose of an arrangement in the PPT is based on an objective analysis. The guidance is found in paragraph 178 of the 2017 Commentary which provides that what are the purposes of an arrangement or a transaction is a question of fact which can only be answered by considering all circumstances surrounding the arrangement or event on a case-by-case basis. It is not necessary to find conclusive proof of the intent of a person concerned with an arrangement or transaction, but it must be reasonable to conclude, after an objective analysis of the relevant facts and circumstances, that one of the principal purposes of an arrangement or transaction was to obtain the benefits of the tax convention.

4.9 Based on the above findings, the trigger provision in the GAAR and the PPT are therefore similar. Both rules rely on the purpose of an arrangement as the test for tax avoidance and determine such purpose based on an objective analysis of the observable facts and circumstances. Similarly, there is no requirement for subjective inquiry into the state of mind of the taxpayer for the rules to be triggered.

The counteracting measures permitted

4.10 Once an arrangement falls within the threshold limbs of s 33, the Comptroller has the power either to disregard it or vary it to counteract the tax advantage. In addition, the Comptroller is empowered to make tax adjustments as he considers appropriate, including the computation or re-computation of gains or profits, or the imposition of liability of tax. These adjustments may be made without prejudice to such validity that the transaction or the arrangement may have. Section 33 thus confers the Comptroller with wide discretionary powers, particularly, the power to reconstruct the facts or deem income to be present in the taxpayer.

4.11 Indeed, it was held in *AQQ* that the Comptroller has wide powers under s 33 to counteract the tax advantage sought in an abusive arrangement. The Court of Appeal held that the standard of review to be adopted is that the Comptroller had to exercise his powers in a manner that was fair and reasonable. The court is entitled to strike down any variations or adjustments made by the Comptroller that are arbitrary or unreasonable as well as any excessive or abusive exercise of discretion that falls outside the scope of the Comptroller's powers under s 33(1). However, this review is necessarily limited, and where there are two or more methods to counteract a tax advantage, it is not for the court to decide that one particular method is to be preferred over the others. Such an attenuated standard of review would not render the statutory right of appeal under the Act nugatory *[at paragraph 124]*.

4.12 Unlike s 33, the PPT does not confer rights to the contracting states to re-construct or vary transactions or arrangements. The PPT is merely an annihilation provision. This is consistent with tax treaty principle as tax treaties can only restrict domestic tax law and do not create taxing rights. Taxing provisions are to be provided by domestic tax law.

4.13 The GAAR and the PPT are therefore dissimilar in terms of their counteracting measures. Section 33 provides wide discretionary power to counteract the tax advantage whereas the PPT provides the annihilation of the treaty benefit only.

The exclusion clause

4.14 Section 33(3)(b) sets out the exclusion clause in which an arrangement will not come within the operation of the GAAR i.e. the arrangement must have been carried out for bona fide commercial reasons: and had not one of its main purposes the avoidance or reduction of tax.

4.15 In *AQQ*, the Court of Appeal held that the first condition in s33(3)(b) is concerned with the taxpayer's subjective commercial motives for entering into a transaction, and the second condition is concerned with the subjective consequences that the taxpayer wishes to obtain. The court explained that similarly structured transactions may thus be taxed differently depending on whether the taxpayer had set out to create a result whereby his tax liability was avoided or reduced. This is to be seen in the context of the fact that s33(3)(b) only comes into play where the taxpayer is found to have derived a tax advantage based on one or more of the limbs of s33(1). In that situation, the question then becomes whether the taxpayer is able to take himself out of the operation of s33(1) by showing even if objectively it is predicated that he had acted in order to obtain a tax advantage, this was not what he had set out to do and that he was acting with bona fide commercial reasons *[at paragraph 74].*

4.16 The Court of Appel in *AQQ* also affirmed that s 33(3)(b) entails a subjective inquiry. The court may ascertain the taxpayer's motives by reference to evidence or testimony of the taxpayer's actual contemporaneous state of mind and assess the veracity of this by drawing the requisite inferences from the surrounding objective evidence or features of the arrangement. In *AQQ*, the Court of Appeal was satisfied that the one of the main purposes of the impugned arrangement was for the recovery of tax assets and had relied on the following testimony and evidence:

a. Chief Financial Officer's admission that the recovery of tax assets by deducting interest expenses against dividend income is one objective of the arrangement;

b. The corporate group to which AQQ belongs had made a public announcement to the Kuala Lumpur Stock Exchange that the issuance of the Notes in the arrangement was not intended to affect the consolidated borrowing position. The plan from outset was no real loan would be extended to AQQ;

c. The round-tripping of funds in a single day and the artificial interposition of the two external entities cross the line between tax efficiency and tax avoidance in the absence of any cogent explanation for why it was necessary for AQQ to choose this all too complicated method of transferring funds from one subsidiary of the group to another through the conduit of two external entities located in two different countries;

d. *AQQ* had failed to show how the arrangement, view as a whole, could be explained otherwise than as a contrived and concerted scheme to reduce AQQ's liability to tax on dividends.

4.17 It was also held in *AQQ* that the subject inquiry under s 33(3)(b) had to be established by objective evidence. The taxpayer was unable to rely on s 33(3)(b) merely by stating the commercial reasons without providing the objective evidence to support the veracity of his testimony. For the statutory exception to apply, the taxpayer must point to objective evidence which supports the argument that the commercial reason was his motive. The subjective inquiry in s 33(3)(b) therefore requires an objective analysis evidence or features of the arrangement.

4.18 For the PPT, the exclusion clause is based on an objective criterion that the benefit granted is in accordance with the object and purpose of the relevant provisions of the tax treaty. As provided in the 2017 Commentary, such an objective analysis entails the reading of the PPT in the context of the relevant provisions as well as the rest of the Convention including its preamble. Where it is difficult to assign specific purpose to the applicable treaty provision, the object and purpose of the tax convention (as stated in the preamble) may be relied upon.[34] Such an analysis is based on observable facts and circumstances and subjective motives are irrelevant.

4.19 Based on the findings, the GAAR and the PPT are similar in their exclusion clauses in three aspects:

a. Both rules require an objective analysis of the evidence and circumstances of the arrangement to establish that the conditions in the exclusion clause are met. The onus is on the taxpayer to provide the objective evidence to prove that avoiding tax was not one of his main or principal motivations.

b. Both rules require the courts to reconcile their applications with the relevant specific statutory provision or treaty provision. In other words, the rules do not automatically override a specific statutory provision or treaty provision simply because obtaining the tax / treaty benefit is one of the main purposes of the arrangement. The court is required to consider whether the grant of the tax / treaty benefit is consistent with the parliament's intent behind the statutory provision or in the case of treaty benefit, the object and purpose of the relevant treaty provisions. If affirmative, the rules will not apply.

c. Where taxpayer could substantiate the commercial reasons for entering into the arrangement such that it can be easily inferred that the tax benefit is not one of the main/principal purposes of the arrangement, the conditions in both exclusion

[34] This statement is subject to the caveat that the treaty's object and purpose are only some of the elements that need to be considered for interpretation purposes and they cannot override the treaty's clear substantive provisions. See example E of paragraph 182 of the 2017 Commentary on article 1 for illustration of clear substantive provisions.

clauses would be met. For s 33, the requirement for bona fide commercial reasons and non-tax purposes are expressively provided in the exclusion clause. As for the PPT, the nexus between the exclusion clause and commercial reasons of an arrangement is indirect. The exclusion clause provides that PPT will not be applicable if the benefit is granted in accordance with the object and purpose of the relevant treaty provisions. In most cases, this condition may refer to the object and purpose of the whole treaty as stated in the preamble. The preamble states that the main purposes of the treaty are to further develop economic relationship between contracting states, to enhance their cooperation in tax matters, and for the elimination of double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance. Where there are strong commercial reasons behind a cross-border arrangement, it may be argued that the grant of the tax treaty benefit is in accordance with the economic relationship purpose of the treaty. Accordingly, the PPT will not apply.[35]

4.20 For ease of reference, the comparative analysis on the GAAR and the PPT are summarised in the table in **Annex D.**

Conclusion on Question (c): Would conflicts arise in the scope or operation of Singapore's GAAR and the PPT when both rules are applicable, and one rule has not been impliedly excluded by the existence of the other?

Paragraph 77 of the 2017 OECD Commentary on article 1 provides that no conflict will arise or is possible where the main aspects of the domestic GAAR are in conformity with the guiding principle on treaty abuse or with the PPT. In other words, where the main aspects are in conformity, the GAAR would apply in the same circumstances in which the benefit would be denied under the PPT. Conflict is thus avoided.

The comparative analysis shows that most of the main aspects of Singapore's GAAR and the PPT are in conformity and therefore conflict will not arise. Although the counteracting measure differs, this difference is unlikely to result in conflict as it is not necessary for the PPT to have reconstruction power of GAAR. For example, where treaty benefits have been annihilated by the PPT, the source state domestic tax law will operate unimpeded, including the domestic GAAR. Therefore, conflict will not arise.

5 Which rule is the predominant rule?

5.1 Given that both the GAAR and the PPT may be applied to counter treaty abuse, this section examines whether the application of one rule will supplant the other, and if so, which rule is the predominant rule?

5.2 Nothing in Singapore domestic tax law or the tax treaties suggests that the GAAR will supplant or take precedence over the PPT or vice versa.[36]

5.3 In BEPS Action 6 final report, OECD provides that paragraph 7 (of article X, i.e. the PPT) allows States to address cases of improper use of the Convention, even if their domestic law does not allow them to do so in accordance with paragraphs 22 and 22.1 of the Commentary on

[35] See example K in paragraph 182 of OECD 2017 Commentary on article 29 for support.

[36] Based on Singapore's legislation and tax treaties prevailing as at 1 February 2020.

Article 1. It also confirms the application of these principles for States whose domestic law already allows them to address such cases.[37] Furthermore, the final report provides that the PPT does not modify the conclusions already reflected in the Commentary on Article 1 concerning the interaction between treaties and domestic anti-abuse rules and such conclusions remain applicable, in particular with respect to treaties that do not incorporate the PPT.[38]

5.4 Paragraph 77 of the 2017 OECD Commentary on article 29 further provides that where the main aspects of the GAAR and the PPT are in conformity, no conflict will be possible.

5.5 Hence, based on the BEPS Action 6 final report and the 2017 OECD Commentary, it is observed that OECD did not favour one rule over the other and both rules appeared to be of equal standing.

5.6 In the author's opinion, no predominant rule exists as both the GAAR and the PPT are intended to operate independently and not as supplementary measures. The choice of the relevant rule will depend on the nature of the treaty abuse i.e. whether the abuse is to circumvent the limitations provided by the treaty itself or the provisions of domestic tax law using treaty benefits.

5.7 Where the abuse is to circumvent the limitations provided by the treaty, significant weight should be given to the PPT ("the interpretative approach"[39]) because the rule is the codification of the guiding principle on treaty abuse. Through the PPT, the treaty benefit is denied as the grant of the benefit is inconsistent with the purpose and object of the relevant treaty provision.

5.8 Where the abuse is to circumvent the provisions of a domestic tax law, the GAAR may be applied to establish the factual matrix ("the factual approach"[40]) giving rise to the tax liability. Re-construction of the facts may take place to vary relevant transactions. After the factual matrix is established, the tax treaty may then be applied to the re-characterised facts to ascertain whether treaty benefit is available.

5.9 A policy question arises as to whether Singapore should adopt a predominant rule between the GAAR and the PPT. It is the author's opinion that it is not necessary for two reasons.

5.10 Firstly, it may be of little practical value in prescribing a predominant rule where conflict between the two rules will not arise or is possible. OECD Commentary has provided that no conflict will arise or is possible where the main aspects of the GAAR and the PPT are in conformity. The comparative analysis in section 4 showed that the main aspects of s 33 and the PPT are in conformity.

5.11 Secondly, different remedies may be required in different situations. Although the PPT is the codification of the guiding principle on treaty abuse, the operation of treaty provisions still depends on the application of domestic tax law. Therefore, where the abuse concerns the

[37] OECD/G20 BEPS Project "BEPS Action 6: 2015 Final Report – Preventing the Granting of Treaty Benefits in Inappropriate Circumstances" section A - paragraph 1 p55.
[38] BEPS Action 6: 2015 Final Report, section A - paragraph 58 p79.
[39] Ellife, Craig and Prebble, John (2009) "General Anti-Avoidance Rules and Double Tax Agreements: A New Zealand Perspective," *Revenue Law Journal*: Vol.19: Iss.1, Article 4.
[40] Ibid footnote 39.

circumvention of domestic tax law provisions using treaty benefit, the GAAR may be required to remedy the abuse. This area will be discussed in detail in section 6.

Conclusion on Question (b): If both the GAAR and the PPT can be invoked to counter treaty abuse, does the application of one rule supplant the other? If so, which one is meant to be the predominant rule?

Nothing in the Singapore domestic law or in the tax treaties suggests that the GAAR will supplant the PPT or vice versa. Based on the OECD Final Report on BEPS Action 6 and the 2017 OECD Commentaries, the OECD did not favour one rule over the other and both rules are of equal standing.

In the author's opinion, no predominant rule exists because both the PPT and GAAR are meant to operate independently and not as supplementary measures. Policy-wise, it is not necessary to prescribe a predominant rule because different remedies may be required in different situations. Furthermore, it may be of little practical value where conflicts between the two rules will not arise.

6 Determining the appropriate remedy

6.1 Given that both rules may be applicable, which rule is the more appropriate remedy to counter treaty abuse?

6.2 Based on OECD BEPS Action 6 final report[41], treaty abuse can be distinguished into two types:

a. Cases where a person tries to circumvent limitations provided by the treaty itself;

b. Cases where a person tries to circumvent the provisions of domestic tax law using treaty benefits.

The final report provides that as the first category of cases involve situations where a person seeks to circumvent rules that are specific to tax treaties, it is unlikely that these cases will be addressed by specific anti-abuse rules found in domestic law. Although a domestic GAAR could prevent the granting of treaty benefits in these cases, a more direct approach involves the drafting of anti-abuse rules to be included in the treaties (e.g. the PPT). The situation is different in the second category of cases; since these cases involve the avoidance of domestic law, they cannot be addressed exclusively through treaty provisions and require domestic anti-abuse rules (e.g. the GAAR), which raises the issue of the interaction between tax treaties and these domestic rules.

6.3 The BEPS Action 6 final report illustrates the possibilities of applying different remedies to tackle treaty abuse. These remedies will be examined in detail in the ensuing examples.

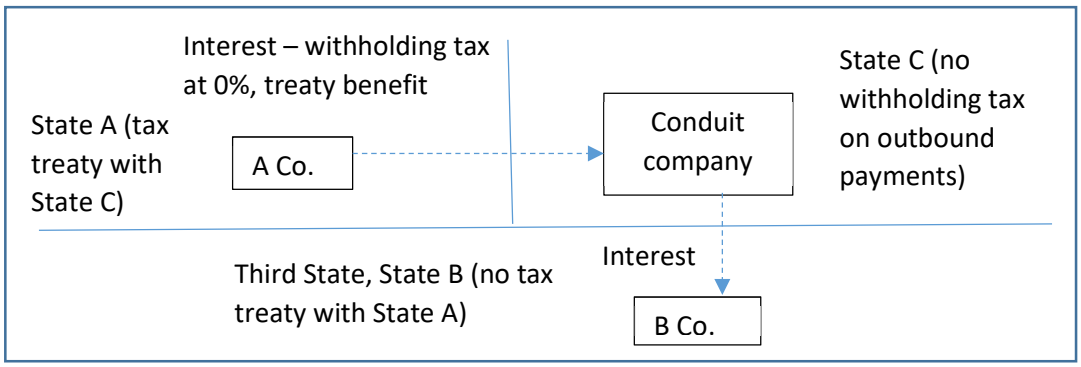
Cases where a person tries to circumvent limitations provided by the treaty itself

6.4 An example of the first category of treaty abuse is treaty shopping. To obtain benefits under a tax treaty, the first requirement is that the person must be "a resident of a Contracting State" as defined in article 4 of the OECD Model Tax Convention. Treaty shopping typically involves a person who is a resident of a third State attempting to access indirectly the benefits of a treaty between two Contracting States. This is usually done through an artificial

[41] BEPS Action 6: 2015 Final Report, section A - paragraph 15, p17.

legal construction (e.g. a conduit company) set up in a favourable jurisdiction which has a tax treaty with the Source State. In so doing, the limitation in the treaty (i.e. the person must be a resident of a Contracting State) is circumvented. A typical treaty shopping arrangement is depicted in Diagram 1 below.

Diagram 1 (Treaty Shopping)



6.5 As provided in the BEPS Action 6 final report and the OECD Commentary, countries may rely on anti-abuse rules found in treaty to counter treaty shopping. Some examples are the Beneficial Owner Test, the Limitation of Benefit rule or the PPT. Regarding the PPT, the rule may be applied to annihilate the treaty benefit on the interest payment where based on an objective analysis of the facts and circumstances of the arrangement, it can be concluded that obtaining the benefit is one of the principal purposes of the arrangement. The grant of the treaty benefit in such circumstances will be contrary to the object and purpose of the treaty provision.

6.6 Where the PPT is applied to remove the treaty benefit, the domestic tax law in State A will operate unimpeded. The interest payment will be subject to withholding tax at the domestic tax rate. In this situation, the PPT is adequate to counter the treaty shopping. There is no necessity to apply the domestic GAAR as there is no requirement to re-establish the factual matrix after the treaty benefit is removed.

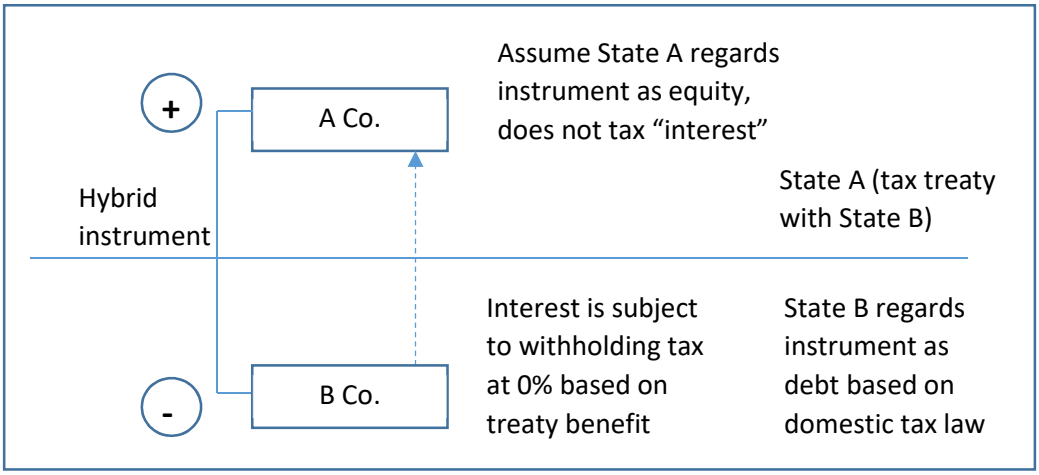
6.7 Hence, it can be observed that where the abuse is to circumvent limitations provided by the treaty itself, the PPT may be the more direct remedy than the GAAR to counter the circumvention. In the treaty shopping example, the application of the PPT would not contradict the object and purpose of article 4 of the tax treaty.

Cases where a person tries to circumvent the provisions of domestic tax law using treaty benefits

6.8 These cases refer to situations where tax avoidance risks that threatened the tax base are not caused by tax treaties but may be facilitated by tax treaties. The BEPS Action 6 final report provides that granting the benefits of these treaty provisions in such cases would be inappropriate to the extent that the result would be the avoidance of domestic tax. An example of such tax avoidance strategies is arbitrage transactions that take advantage of hybrid mismatches between the domestic law of two States and that are related to the characterisation of income or entities or related to timing differences.[42] An illustration of a hybrid mismatch arrangement is provided below.

[42] BEPS Action 6: 2015 Final Report, section A - paragraph 54, p78.

Diagram 2 (Hybrid Mismatch)

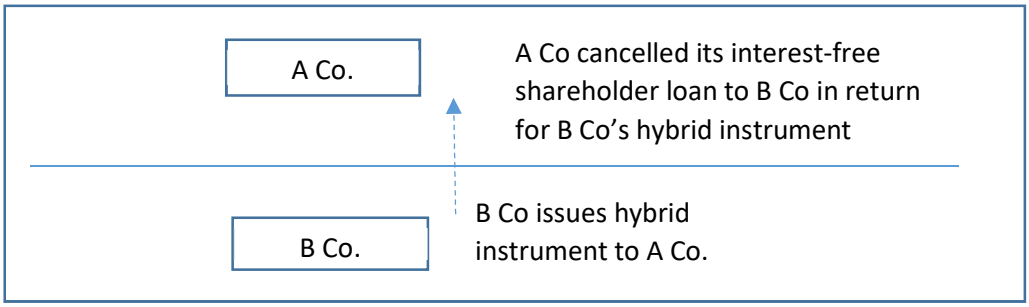


6.9 The arrangement depicted in Diagram 2 is a hybrid mismatch arrangement as the payments (interest) give rise to a deduction / no inclusion outcome (D/NI outcome), i.e. payments that are deductible under the rules of the payer jurisdiction and are not included in the ordinary income of the payee.

6.10 Based on BEPS Action 2 final report[43], if State A denies A Co the benefit of tax exemption for a deductible dividend then no mismatch will arise for the purposes of the hybrid financial instrument rule. If State A does not deny A Co the benefit of tax exemption, then the payment of interest will give rise to a hybrid mismatch within the scope of the hybrid financial instrument rule and State B should deny B Co a deduction for the interest paid to A Co. If State B does not apply the recommended response, then State A should treat the interest payments as ordinary income.

6.11 For the purpose of this discussion, it is assumed that A Co is the immediate holding company of B Co and that State A did not deny A Co the benefit of tax exemption. A hybrid instrument (with a 5% p.a. interest rate) was issued by B Co to A Co pursuant to a shareholder loan capitalisation exercise. Through the exercise, A Co had effectively substituted its interest free shareholder loan with an interest-bearing hybrid instrument without any real change in the group's financial position. See Diagram 3 below for illustration.

Diagram 3 (Shareholder Loan Capitalisation)



6.12 It is also assumed that A Co's loan capitalisation exercise was solely carried out to obtain the D/NI outcome. To that end, the corporate group would obtain the following benefits from

[43] BEPS Action 6: 2015 Final Report's Annex B, example 1.1.

the tax avoidance arrangement: (1) tax deduction on interest expense in State B; (2) treaty benefit on interest payments in State B; and (3) tax exemption of interest income in State A.

6.13 Based on Diagram 2, State B has two available remedies: (1) apply the domestic GAAR to establish the factual situation and the relevant counter measure (e.g. to disregard the interest expenses); or (2) apply the PPT to deny the treaty benefit and impose domestic withholding tax on the interest payments. From State B's perspective, the PPT is not the appropriate remedy as the hybrid instrument was issued to circumvent the domestic interest deduction provision and not the provisions of the tax treaty. This circumvention of the domestic tax law requires the GAAR to establish the factual matrix and the associated tax liability. Hence, the GAAR should apply.

6.14 One may ask whether both rules may be applied in the hybrid mismatch arrangement. For example, State B may invoke the GAAR to disregard the interest expenses and at the same time may apply the PPT to deny treaty benefit and impose domestic withholding tax on the interest payments. In the author's opinion, such a dual application is both inconsistent and inappropriate. Where it is determined under the GAAR that interest expenses are to be disregarded under domestic law, then consistent with this determination there should not be any domestic withholding tax liability on the disregarded interest payments. Consequently, there is no necessity to apply the PPT as there is no domestic withholding tax lability in the first instance.

6.15 It can be observed that where the abuse is to circumvent the provisions of domestic tax law using treaty benefits, the GAAR may be the more appropriate remedy than the PPT. In these situations, the PPT is inadequate as the remedy requires the operation of the GAAR to establish the factual matrix which the treaty provisions may then apply.

Conclusion on Question (d): Given that both rules may be applicable, which rule is the more appropriate remedy to counter treaty abuse?

The appropriate remedy will depend on the nature of the treaty abuse. Based on BEPS Action 6 Final Report, treaty abuse can be characterised into two types:

a. Cases where a person tries to circumvent limitations provided by the treaty itself; or
b. Cases where a person tries to circumvent the provisions of domestic tax law using treaty benefits.

Where the abuse is to circumvent limitations of the treaty itself, the PPT is the appropriate remedy because it is the codification of OECD's guiding principle on countering treaty abuse and therefore will ensure consistency with the purpose and object of the treaty. Where the abuse is to circumvent the limitations of domestic tax law using treaty benefits, the GAAR is the relevant rule to establish the facts that give rise to a tax liability under domestic law.

7 Conclusion

7.1 In conclusion, both Singapore's GAAR and the PPT may be applied to counter treaty abuse and they are very similar in scope and operation. Although there is no predominant rule between the two, the application of one rule will not give rise to a conflict with the other. The choice of the appropriate remedy is to consider the facts and circumstances of the impugned arrangement and the nature of the treaty abuse. Where the abuse is to circumvent the limitation of the treaty itself, the PPT is the relevant rule to ensure consistency with the object and purpose of the tax treaty. Where the abuse is to circumvent the limitations of domestic tax law using treaty benefits, the GAAR is the relevant rule to establish the facts that give rise to a tax liability under domestic law.

Annex A

Analysis – Singapore's tax treaties and s 33 (as at 1 February 2020)

Category	Tax treaty expressively permits the application of GAAR	Preamble of tax treaty is revised by the MLI or newly concluded treaties that incorporated the MLI changes	Tax treaty was concluded based on the 2003 OECD revisions	Tax treaty was concluded before the 2003 OECD revisions	Whether tax treaty precludes or restricts the application of s 33	Singapore's tax treaties with foreign jurisdictions that fall within this category / (number of tax treaties)[44]
A	Yes				Section 33 may be applied based on the treaty provision#	Belgium^, China, Ecuador, Germany, India^, Kenya and Saudi Arabia / (7)
B	Silent	Yes			Section 33 may be applied based on the MLI amendments#	Armenia*, Australia, Austria, Brazil*, Canada, Denmark, Finland, France, Gabon*, Georgia, Greece*, Guernsey, Ireland, Isle of Man, Israel, Japan, Jersey, Latvia, Lithuania, Luxembourg, Malta, Mauritius, the Netherlands, New Zealand, Poland, Slovak Republic, Slovenia, Turkmenistan*, Ukraine, UAE and the United Kingdom / (31)
C	Silent	No	Yes		Section 33 may be applied based on 2003 OECD revisions and s 9A of the IA#	Albania, Bahrain, Barbados, Belarus, Brunei, Cambodia, Estonia, Ethiopia, Fiji, Ghana, Kazakhstan, Laos, Libya, Liechtenstein, Malaysia, Nigeria, Oman, Panama, Qatar, Rwanda, San Marino, Seychelles, South Africa. Spain, Sri Lanka, Switzerland, Thailand, Tunisia, Uruguay, Uzbekistan / (30)
D	Silent	No	No	Yes	Section 33 may be applied using	Bangladesh, Bulgaria, Cyprus, Czech Republic, Egypt, Hungary, Indonesia, Italy, Korea, Kuwait, Mexico, Mongolia, Morocco,

[44] The Singapore's tax treaties with the following jurisdictions were concluded but have not been ratified yet and therefore do not have force of law: Armenia, Brazil, Gabon, Greece, Kenya, and Turkmenistan.

					ambulatory or static interpretation and s 9A of the IA[#]	Myanmar, Norway, Pakistan, Papua New Guinea, Philippines, Portugal, Romania, Russia, Sweden, Taiwan, Turkey, Vietnam / (25)

The GAAR analysis should examine whether the s 33 result is consistent with the rationale underlying the specific treaty provision, particularly if that treaty provision is a departure from OECD Model Tax Convention. Where the specific treaty provision had operated in the manner as intended by treaty's negotiators, then there is no treaty abuse. This is so even if the arrangement resulted in double non-taxation. In such a situation, s 33 is inapplicable based on the purposive interpretation of s 49.

^ MLI amendments were also made to Singapore's tax treaties with Belgium and India. The GAAR clause in these tax treaties are not affected by the MLI.

* Singapore's tax treaties with Armenia, Brazil, Gabon, Greece and Turkmenistan are newly concluded treaties which incorporated the MLI changes.

Annex B

Examples of GAAR which override treaty provisions in foreign jurisdictions

Jurisdictions	Domestic tax law expressively permits the domestic GAAR to override treaty provisions	Domestic law	Provisions
Australia	Yes	Section 4(2) of the International Tax Agreements Act 1953	The provisions of this Act have effect notwithstanding anything inconsistent with those provisions contained in the Assessment Act (***other than Part IVA of that Act***) or in an Act imposing Australian tax.
Canada	Yes	Section 245 (1) of the Canada Income Tax Act	245 (1) In this section, tax benefit means a reduction, avoidance or deferral of tax or other amount payable under this Act or an increase in a refund of tax or other amount under this Act, and includes a reduction, **avoidance or deferral of tax or other amount that would be payable under this Act but for a tax treaty or an increase in a refund of tax or other amount under this Act as a result of a tax treaty**;
New Zealand	Yes	Section BH1 (4) of the Income Tax Act 2007	*Overriding effect* (4) Despite anything in this Act, **except** subsection (5), or section RF 11C (Interest paid by non-resident companies to non-residents) or (5B) **or section BG 1 or GB 54 (which relate to tax avoidance)** or, or in any other Inland Revenue Act or the Official Information Act 1982 or the Privacy Act 1993, a double tax agreement has effect in relation to— (a) income tax: (b) any other tax imposed by this Act: (c) the exchange of information that relates to a tax, as defined in paragraphs (a)(i) to (v) of the definition of tax in section 3 of the Tax Administration Act 1994.

United Kingdom	Yes	Section 212 UK Finance Act 2013	212 Relationship between the GAAR and priority rules **(1) Any priority rule has effect subject to the general anti-abuse rule (despite the terms of the priority rule).** (2) A "priority rule" means a rule (however expressed) to the effect that particular provisions have effect to the exclusion of, or otherwise in priority to, anything else. (3) Examples of priority rules are— (a) the rule in section 464, 699 or 906 of CTA 2009 (priority of loan relationships rules, derivative contracts rules and intangible fixed assets rules for corporation tax purposes), and **(b) the rule in section 6(1) of TIOPA 2010 (effect to be given to double taxation arrangements despite anything in any enactment).**

Annex C

Extract of Section 9A of the Interpretation Act ("IA")

Section 9A ("s 9A") of the IA provides as follows:

> *Purposive interpretation of written law and use of extrinsic materials*
>
> *S 9A.—(1) In the interpretation of a provision of a written law, an interpretation that would promote the purpose or object underlying the written law (whether that purpose or object is expressly stated in the written law or not) shall be preferred to an interpretation that would not promote that purpose or object.*
>
> *(2) Subject to subsection (4), in the interpretation of a provision of a written law, if any material not forming part of the written law is capable of assisting in the ascertainment of the meaning of the provision, consideration may be given to that material —*
>
> *(a) to confirm that the meaning of the provision is the ordinary meaning conveyed by the text of the provision taking into account its context in the written law and the purpose or object underlying the written law; or*
>
> *(b) to ascertain the meaning of the provision when —*
>
> *(i) the provision is ambiguous or obscure; or*
>
> *(ii) the ordinary meaning conveyed by the text of the provision taking into account its context in the written law and the purpose or object underlying the written law leads to a result that is manifestly absurd or unreasonable.*
>
> *(3) Without limiting the generality of subsection (2), the material that may be considered in accordance with that subsection in the interpretation of a provision of a written law shall include —*
>
> *(a) all matters not forming part of the written law that are set out in the document containing the text of the written law as printed by the Government Printer;*
>
> *(b) any explanatory statement relating to the Bill containing the provision;*
>
> *(c) the speech made in Parliament by a Minister on the occasion of the moving by that Minister of a motion that the Bill containing the provision be read a second time in Parliament;*
>
> *(d) any relevant material in any official record of debates in Parliament;*
>
> *(e) any treaty or other international agreement that is referred to in the written law; and*
>
> *(f) any document that is declared by the written law to be a relevant document for the purposes of this section.*
>
> *(4) In determining whether consideration should be given to any material in accordance with subsection (2), or in determining the weight to be given to any such material, regard shall be had, in addition to any other relevant matters, to —*

(b) the desirability of persons being able to rely on the ordinary meaning conveyed by the text of the provision taking into account its context in the written law and the purpose or object underlying the written law; and

(c) the need to avoid prolonging legal or other proceedings without compensating advantage.

Annex D

A Comparative Analysis on Singapore's GAAR (s 33) and the PPT

Aspect	Comparative Analysis
The definition of arrangement	Similar. Both rules have broad definitions on arrangements so that counteracting measures can be applied in either composite schemes or on a single transaction.
The test for tax avoidance	Similar. Both rules rely on the purpose of an arrangement/transaction as the test for tax avoidance. The purpose is ascertained based on observable facts and circumstances. There is no requirement for subjective inquiry into the motives of the taxpayer for the rules to be triggered. In the author's opinion, there is little difference between "main purpose" in s 33 and "principal purpose" in the PPT.
Counteracting measures permitted	Different. The PPT is an annihilation provision to deny treaty benefit. It does not confer any right to the contracting states to re-construct or vary the facts or to impose domestic tax. On the other hand, s 33 provides the powers for the Comptroller to reconstruct the facts or to deem income to be present in the hands of the taxpayer. In this regard, s 33 has wider powers than the PPT.
Exclusion clause	Similar. Both exclusion clauses require an objective analysis of the evidence and circumstances of the arrangement to establish that the conditions in the exclusion clause are met. Under both rules, the onus is on the taxpayer to provide the objective evidence to rely on the exclusion clause. Both rules require the courts to reconcile their applications with the relevant specific statutory provision or treaty provision. The rules will not automatically apply simply because obtaining the tax / treaty benefit is one of the main purposes of the arrangement. The court is required to consider whether the grant of the benefit is consistent with the object and purpose of the provision. If so, the rules will not apply. Both exclusion clauses require the taxpayer to substantiate the motivation for entering into an arrangement are based on bona fide commercial reasons. In s 33, the requirement for bona fide commercial reasons is expressively provided in the exclusion clause. For the PPT, the principal purpose of a tax treaty is the link between the exclusion clause and the commercial reasons. Where the purpose of the specific treaty provision (e.g. developing economic relationship between two contracting states) can be upheld by the commercial reasons behind the arrangement, taxpayer may rely on the exclusion clause.

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