Tax Treaty Policy of Developing Countries post-BEPS

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1. Introduction

During the last 18 months, the attention of the international tax community has been keenly focused on the OECD's project on 'base erosion and profit shifting' (BEPS).[1] This collection of disparate measures includes a proposal intended to limit the potential for the abuse of bilateral income tax treaties to produce unacceptable tax reductions.

While an extensive treaty network is usually considered important in attracting foreign direct investment, the problem of the abuse of those treaties is well understood by countries in Asia. Indonesia, for example, terminated its tax treaty with Mauritius in 2004, in large part because that treaty was being inappropriately accessed by residents of third countries.[2] Mongolia has terminated or threatened to terminate its treaties with Luxembourg, the Netherlands, Kuwait and the UAE for similar reasons.[3] So, while income tax treaties are important economic instruments, the experience of developing countries, like developed countries, is that treaties can be misused as part of sophisticated tax planning to frustrate the tax claims of developing countries. As the OECD's project is directed at curtailing the circumstances where source country tax claims will be reduced by the operation of tax treaties, it should be especially valuable for developing countries.[4]

This paper examines the treaty practices currently adopted by several countries in Asia to see how those treaty practices might need to change if the countries were inclined to follow the OECD's recommendations. In other words, this paper asks how robust are the countries' current treaty practices against abuse, and actions what might they want to consider in order to make their treaty networks more robust? How might current treaty practices need

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1 OECD, *Action Plan on Base Erosion and Profit Shifting* (July 2013) http://www.oecd.org/ctp/BEPSActionPlan.pdf.

2 See generally, P Baker, 'UK: *Indofood International Finance*,' in M Lang, P Pistone, J Schuch, C Staringer & A Storck (eds), *Beneficial Ownership – Recent Trends* (Amsterdam, IBFD, 2013) at 29.

3 L Hoaglund, 'Mongolia Terminates Treaty with Luxembourg' (2013) 70 *Tax Notes International* 46; L Hoaglund, 'Mongolia Terminates Treaty with Kuwait, United Arab Emirates' (2013) 71 *Tax Notes International* 625.

4 The OECD notes that the impact of work on this Action Item should be to reinforce source country tax claims, 'tight treaty anti-abuse clauses coupled with the exercise of taxing rights under domestic laws will contribute to restore source taxation in a number of cases.' OECD, *Part 1 of a Report to G20 Development Working Group on the Impact of BEPS in Low Income Countries* 18 (July 2014) http://www.oecd.org/tax/part-1-of-report-to-g20-dwg-on-the-impact-of-beps-in-low-income-countries.pdf

to change in order to make treaty networks more resistant to abuse and avoid the need to have to terminate treaties?

The paper is constructed in two main sections: the first part of the paper outlines the current state of the OECD proposals with respect to curbing treaty abuse and the second part examines practices currently seen in the treaties of several countries in Asia and the extent to which they include specific anti-abuse provisions. It will become apparent that the tax treaties of the countries examined are not especially robust against abuse, and significant changes to treaty practice are probably called for if countries wish to enhance the integrity of their treaty networks.

2. The development of the OECD's proposals

The OECD's proposals to counter BEPS, including the abuse of tax treaties, were released in July 2013. They have evolved significantly in the 18 months since then.[5] The original proposals for protecting treaties, Item 6 of the BEPS Action Plan, required the OECD to –

> Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. Work will also be done to clarify that tax treaties are not intended to be used to generate double non-taxation …[6]

It thus focused on two specific actions: developing recommendations for changes to both the text of the OECD's Model Treaty and to domestic tax rules, and to clarify (perhaps within the text of the OECD's Model treaty or Commentary) that tax treaties were not intended to generate double non-taxation. Both of these objectives focus on non-residents inappropriately gaining access to a treaty in order to enjoy treaty benefits.[7]

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[5] OECD, above n 1. Action Item 6 also referred to measures to handle hybrid instruments and entities, to be co-ordinated with Action Item 2, and to outlining the considerations which should influence a country in deciding whether to enter a tax treaty with another country. These aspects of Action Item 6 will not be explored in this paper.

[6] OECD, above n 1, at 19.

[7] In another part of Action Item 6, the OECD examined arguments by residents that the existence of a treaty would defeat a domestic anti-abuse rule. This conception of 'treaty abuse' is thus rather more expansive than typical discussions of 'treaty shopping' which focus just on the issue of non-residents inappropriately accessing treaty benefits.

The July 2013 Action Plan was then elaborated by a public discussion draft, released in March 2014, soliciting comments on the proposals.[8] The March 2014 document proposed a combination of general approaches to treaty abuse and a number of specific measures directed at particular problems. The submissions received on the discussion draft (amounting more than 500 pages) were released in April 2014[9] and a set of recommendations, some of which were still tentative, was released in September 2014 ('*Recommendations*').[10] The *Recommendations* document added detailed commentary on the meaning and operation of some of the changes being advanced. However, it also proposed a less prescriptive approach, namely that countries should have some flexibility in how they implement measures to protect their treaties, so long as they achieve a set of 'minimum standards.' This idea of 'minimum standards' was advanced to allow countries to combine some or all of the multiple proposals made in the March 2014 discussion draft with any existing measures that the country might already have in place.[11]

Less than 2 months later, in November 2014, the OECD released *Follow-up Work,* a discussion document inviting responses on some of the elements of the *Recommendations* which had attracted negative reactions or were acknowledged to be incomplete (particularly the operation of the limitation of benefits clause for collective investment vehicles and other investment funds, the operation of the minimum standards and the meaning of the purpose-

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[8] OECD, *Public Discussion Draft BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances* (March 2014), http://www.oecd.org/ctp/treaties/treaty-abuse-discussion-draft-march-2014.pdf. The March document expended the discussion by addressing situations where a treaty is used as the pretext for an argument that a domestic anti-abuse rule is rendered ineffective and the authors took the opportunity to address a number of specific instances where the drafting of the OECD Model should be tightened or clarified to control identified abusive practices. Again, these aspects of Action Item 6 will not be explored in this paper.

[9] OECD, *Comments Received on Public Discussion Draft – BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances* (April 2014) http://www.oecd.org/tax/treaties/comments-action-6-prevent-treaty-abuse.pdf

[10] OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances – Action 6; 2014 Deliverable* (Paris, OECD, 2014) (available at https://www.reit.com/sites/default/files/OECD%20BEPS%20Action%206%20Deliverable%209-16-14.pdf)

[11] The September *Recommendations* put it this way, 'given the variety of approaches, a number of treaty provisions recommended in this report offer alternatives and a certain degree of flexibility. There is agreement, however, that these alternatives aim to reach a common goal, i.e. to ensure that States incorporate in their treaties sufficient safeguards to prevent treaty abuse, in particular as regards treaty shopping. For that reason, the report recommends a minimum level of protection that should be implemented.' OECD, above n 10, at 9.

based limitation test) and inviting comments on how these matters might be handled.[12] The *Follow-up Work* document did not amend or elaborate the *Recommendations* in any meaningful way; rather it formalised the process for a second-round of public discussions, focussed on various aspects of the *Recommendations* document. The comments sent to the OECD (more than 700 pages) on the November *Follow-up Work* paper were released by the OECD in January 2015 without analysis by the OECD of its reactions.[13] This is obviously not the end of the process as the OECD will need to address the comments made in respect of the *Follow-up Work*. The OECD expects the final recommendations to be released by September 2015.[14] The discussion in the remainder of this paper will focus on the *Recommendations* document as it remains (at the time of writing) the best indication of the steps that will ultimately be endorsed to give effect to Action Item 6.[15]

3. OECD measures addressing inappropriate access to treaty benefits

The most difficult part of any discussion of 'inappropriate' access to treaties lies in defining what is, and is not, appropriate. The Commentary to article 1 of the UN Model contains a long description of various forms of abuse of treaties and some mechanisms that countries may employ to counter these practices.[16] It is not always easy to identify when non-residents claiming to be entitled to the benefits of a treaty should be denied those benefits. Many different definitions and different terms are used to denote the inappropriate enjoyment of treaty benefits, the most common being 'treaty shopping.' Most of the definitions of treaty shopping or treaty abuse involve some notion of purpose or intention –

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12 OECD, *Public Discussion Draft – Follow-up Work on BEPS Action 6: Prevent Treaty Abuse* (November 2014) http://www.oecd.org/ctp/treaties/discussion-draft-action-6-follow-up-prevent-treaty-abuse.pdf.

13 OECD, *Comments Received on Public Discussion Draft – Follow-up Work on BEPS Action 6: Prevent Treaty Abuse* (January 2015) http://www.oecd.org/ctp/treaties/public-comments-action-6-follow-up-prevent-treaty-abuse.pdf

14 OECD, above n 10, at 10 ('the model provisions and related Commentary included in Section A of this report should therefore be considered as drafts that are subject to improvement before their final versions are released in September 2015').

15 The principal sources issued by the OECD on Action Item 6 are listed in the Appendix C to this paper.

16 See UN, *Model Double Taxation Convention Between Developed and Developing Countries* (2011) http://www.un.org/esa/ffd/documents/UN_Model_2011_Update.pdf, Commentary to art 1, paras 8-103. See also P. Baker, 'Improper use of Tax Treaties, Tax Avoidance and Tax Evasion' in A. Trepelkov, H. Tonino and D. Halka (eds) *Handbook on Selected Issues in Administration of Double Tax Treaties for Developing Countries* (2013) http://www.un.org/esa/ffd/documents/UN_Handbook_DTT_Admin.pdf

that is, the result of deliberate planning and conscious decision making, rather than a more objective set of facts and circumstances. Tests which rely upon notions of 'purpose' or 'intention' are notoriously difficult for tax administrations to administer and for taxpayers to comply with. It is not surprising, therefore, that other more mechanical tests are sought to. These tests, however, can create their own problems if they are triggered in inappropriate circumstances. It can, therefore, be important to have a further fall-back, allowing the competent authorities to deliver access to treaties that might otherwise be denied. As will be seen below, the approach being advocated by the OECD combines all three elements – a test based on the taxpayer's purpose, a test that is more mechanical and describes a state of affairs, and a safety-valve in the form of negotiations between the competent authorities.

The problem of inappropriate access to treaty benefits is not something that has taken the international community by surprise. The UN and the OECD have very detailed Commentary on the operation of their Model Treaties and each Commentary already outlines a number of strategies and approaches which might be invoked to counter treaty abuse. The Commentary to the OECD Model (endorsed in the Commentary to the UN Model) examines the notion of the abuse of a treaty as a doctrine of international law which might allow the benefits of a treaty to be denied; that is, a notion which already underlies the operation and interpretation of tax treaties as international instruments.[17] The Commentary on individual articles in each Model also contains many passages which draw attention to possible interpretations of the text which can buttress the arguments of tax officials seeking to deny treaty benefits.

The *Recommendations* document encourages some new approaches to the problem which will be incorporated in the OECD Model and Commentary. Some of these measures are in common use; others are not. Three separate strategies are proposed:

1. a general limitation of benefits article based on observable structural features – status, effective ownership and / or real economic activity occurring in the other State,
2. a general limitation of benefits article based on a purpose or state of mind, and

[17] The Commentary to the OECD Model says, 'a proper construction of tax conventions allows them to disregard abusive transactions, such as those entered into with the view to obtaining unintended benefits under the provisions of these conventions. This interpretation results from the object and purpose of tax conventions as well as the obligation to interpret them in good faith (see Article 31 of the *Vienna Convention on the Law of Treaties*).' OECD, *Model Tax Convention on Income and on Capital* (Paris: OECD, 2010), Commentary to art 1, para 9.3.

3. a change to the Preamble to the OECD Model to reiterate that the treaty is not intended to provide relief from tax to residents of third States.

The 'minimum standard' proposed in the *Recommendations* sets out a matrix of options for combining of these individual elements in conjunction with a country's existing anti-abuse measures.

3.1 A general limitation on benefits article based on status, ownership or activity

One of the measures likely to follow from the OECD's BEPS Project is the inclusion in the text of the OECD Model Treaty of a general 'limitation on benefits' ('**LOB**') article. (The text of the OECD's proposed LOB clause is reproduced in Appendix A.) A LOB article is already discussed in the Commentary to the OECD Model[18] and the Commentary to the UN Model[19] but the clause will be given much greater prominence if it is moved to the body of future treaties. The clause proposed in the *Recommendations* differs in some important respects from the texts in the OECD Model and UN Model, no doubt reflecting current thinking about how to design LOB clauses. Some other countries routinely employ LOB provisions (the clause being proposed resembles article 22 of the US Model) and making the article part of both Models will likely lead to more widespread adoption. As will be seen, a general LOB clause is not common in Asian countries.

At present, it is usually *prima facie* sufficient to attract treaty benefits that the taxpayer is a 'resident' of the other contracting State. Under an LOB clause, the taxpayer will have to meet extra tests.

3.1.1 Qualified person – para (2)

The first option will be if the taxpayer can demonstrate that it meets the definition of a 'qualified person.' The OECD's proposed clause says -

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18 A limitation on benefits article is already set out in the Commentary to article 1 of the OECD Model. See OECD, above n 17, Commentary to art 1, para 20.

19 UN, above n.16, pp 59-62.

> 1. Except as otherwise provided in this Article, a resident of a Contracting State shall not be entitled to the benefits of this Convention otherwise accorded to residents of a Contracting State unless such resident is a “qualified person” as defined in paragraph 2.

Where this test is met, the entity will enjoy all of the benefits of the treaty. Whether or not an entity is a ‘qualified person’ is re-assessed for each year -

> 2. A resident of a Contracting State shall be a qualified person for a taxable year if ...

The definition of ‘qualified person’ is drafted using a number of observable criteria. They are alternative means of satisfying the ‘qualified person’ test. The discussion below breaks down the OECD's proposed clause into a series of discrete clauses, and explains the kinds of entities and situations to which it is catering. The qualifications and limitations surrounding the rules are also examined.

Status. One set of tests focuses on the status of the foreign resident. So, an individual who is a resident of one of the contracting states will always be a ‘qualified person’ – para (2)(a). In the same way, the government of the other contracting state and some government-owned agencies will also be a ‘qualified person’ – para (2)(b). Thirdly, various types of charities, benevolent and cultural institutions will typically be a ‘qualified person’ if they are established and operated, ‘exclusively for religious, charitable, scientific, artistic, cultural, or educational purposes’ – para (2)(d)(i). Fourthly, paragraph (d) also extends the status of 'qualified person' to private pension funds (and entities which manage the investments of pension funds) established to provide pension and similar benefits principally to persons who are residents of either of the contracting states – para (2)(d)(ii) and (iii).

More complex issues arise for artificial entities that are not included as ‘qualified persons’ by reason of status alone. This group includes private companies, public companies and their subsidiaries, collective investment vehicles and other trusts and funds. For these kinds of entities, the tests focus on a number of different criteria – sometimes the residence of the owners of the entity, the place where it is managed, the place where its shares are traded, and so on.

Publicly-traded companies. First, a rule is created for a publicly-traded company – that is, a company in which the principal class of shares is regularly traded on a recognised stock exchange in either State (or in a third state if the competent authorities agree). These companies can be a 'qualified person' in one of two ways. The rule applies only to 'companies' – other entities which have interests that are listed on a stock exchange and regularly traded do not fall under this provision.

The option in paragraph (2)(c)(i)(A) for becoming a 'qualified person' is to demonstrate that the listed company's main class of shares is principally traded on the recognised stock exchanges of its state of residence -- that is, its shares are locally traded. This test looks to the location of the stock exchange rather than to the location of the ultimate shareholders. It is quite possible, therefore, that a company will qualify under this test even though a substantial proportion of its ultimate shareholders will not be residents of the state where the stock exchange is located. This test looks no further than the location of the stock exchange. Nor does the test expressly disqualify a listed company based on the degree of concentration of ultimate share ownership. It is quite possible, therefore, that a company could qualify under this test even though a significant parcel of its shares is held by a single shareholder resident in a third country. There is no express indication how many of the principal class of shares must actually be actively traded or how frequently.[20]

The test is applied to the company's 'principal class of shares' and any 'disproportionate class of shares' and it is these shares which must be 'primarily traded' on one of the appropriate stock exchanges. Other classes of shares which are insignificant will not count for the purposes of this test; minor trading even in the 'principal class of shares' on other exchanges will not disqualify the company. A special provision has been added to deal with dual-listed company structures.

[20] The US Model includes a similar phrase and the Technical Explanation takes the view that shares would be 'regularly traded' if trades in the shares occurred on at least 60 days per year and the aggregate number of shares which turned over during the year was at least 10% of all the shares on issue. This interpretation follows from US law but it gives an indication of the kind and level of activity that might satisfy a 'regularly traded' test. US Model, *Technical Explanation Accompanying the US Model Income Tax Convention of November 15, 2006*, Commentary to article 22, http://www.treasury.gov/press-center/press-releases/Documents/hp16802.pdf.

The second possibility in paragraph (2)(c)(i)(B) for publicly-traded companies is that the company's principal place of management and control is located in its state of residence - that is, it is locally managed. The definition of ' primary place of management and control' in paragraph 6 looks to where the 'executive officers and senior management employees exercise day-to-day responsibility for more of the strategic, financial and operational policy decision making for the company.' That is, the test focuses on the place where operating decisions are made, not for example where the company's directors meet nor where shareholder meetings occur.

Subsidiaries of publicly-traded companies. A second rule exists in paragraph (2)(c)(ii) for companies that are subsidiaries of publicly-traded companies – this type of company can be a 'qualified person' if it is at least 50% owned by a listed and publicly traded company that is resident in one of the States and a ‘qualified person.’ The test can extend to partly-owned subsidiaries and joint-venture companies: the test will be satisfied by tracing at least 50% of the shareholding in the relevant company to one or more publicly-traded companies resident in either state. And the test does allow for a significant portion of the company being examined to be owned by shareholders resident in a third state. The paragraph also allows a company to become a 'qualified person' by tracing through any intermediate companies to rely upon the status of the listed and actively traded parent company provided all the relevant companies (the parent, the intermediary and the company receiving the foreign source income). The clause also suggests a stricter test that in such cases all intervening entities must be resident in either contracting State.

Other entities. The final rule in paragraph (2) (e) is a residual test that applies to any ‘person other than individual.’ So, for example, paragraph (e) could apply to:

- an entity that is not a company – for example, a trust or partnership. The test extends beyond companies and refers to entities which issue ‘shares’ and those which issue other types of ‘beneficial interest.’ This may be relevant, for example, for investment funds and other collective investment vehicles if they are not structured as companies and no dedicated rule for these kinds of entities emerges from the process;

- an entity that is privately-held – ie, its shares are not listed on a stock exchange. Again, this may be relevant for funds where interests in the fund are issued and redeemed, rather than traded on a stock exchange;

- a listed company that is actively traded on a stock exchange but does not satisfy either the 'locally traded' or 'locally managed' elements of that test; and

- a subsidiary of a listed entity which, for example, is owned by the listed entity but through a third country intermediary.

In order for this type of entity to be a 'qualified person,' two tests must be satisfied:

- **an ownership test**: during at least half the year, more than 50% of the interests in it must be held by taxpayers which are (i) resident in the same contracting state and (ii) are themselves 'qualified persons;' and

- **a base erosion test**: less than 50% of its gross income can be paid in any year in the form of tax deductible payments either to non-residents or to persons who are not themselves 'qualified persons' (although this requirement is not enlivened for payments made to purchase goods, real estate or services at arm's length prices in the ordinary course of business).

There are several important aspects to the ownership test. First, given that the ownership of interests in the entity may change during the year, the test only needs to be satisfied for at least half the year. Secondly, the owners must be resident in the same state as the entity being tested. Thirdly, the owners must account for at least 50% of ownership which still permits a substantial portion of the ownership of the entity to be held offshore. Fourthly, ownership is measured by looking to the 'aggregate voting power' and to the 'value' of the interests being tested, and apparently both aspects must be satisfied. Finally, not all entities which are 'qualified persons' will suffice for this test: the list in paragraph (i) omits entities which are owned by listed entities. This means that a subsidiary of a listed entity is eligible to become a 'qualified person' by applying this section, but a subsidiary of that company cannot rely upon the status of its immediate owner; it must trace through to the ultimate listed parent.

The base erosion test focuses on the proportion of gross income that is paid to residents of third countries or to persons who are residents but are not ‘qualified persons.’ Again, up to 50% of the gross income of the tested entity can leak to residents of third countries without offending this rule. The reference to amounts flowing ‘directly or indirectly’ to such persons may prove very problematic in practice where income flows are supplemented or dissipated as they move through successive taxpayers.

The exception for payments for ‘services or tangible property’ will need some explanation in the Commentary. The obvious intention of the provision is to require that payments for interest and payments for the use of intangibles (eg, royalty payments for the use of intellectual property) must be examined; payment of arm’s length prices for inventory, equipment or real estate do not need to be examined. Developing countries may however be concerned that payments of management fees would not need to be tested provided they are at arm’s length prices – they are presumably payments for ‘services.’

Investment funds. The *Recommendations* also contemplate possible provisions for collective investment vehicles – para (2)(f). It was acknowledged in the *Recommendations* that the structural LOB clause could cause difficulties for collective investment vehicles and other investment vehicles such as sovereign wealth funds, multi-country pension funds and private equity funds. However, the drafters obviously felt that the identification of appropriate collective investment vehicles is not straight-forward and there was no serious attempt to articulate a coherent theory about how to handle the other kinds of investment funds. One important aspect of the *Follow up Work* document was to invite comments on how to define an appropriate LOB test for these entities. The result of that consultation process may not be known until September 2015.

3.1.2 Active business income – para (3)

A second way in which a taxpayer will be able to enjoy (some) treaty benefits is if the taxpayer satisfies an active business income test – para (3). This test can be satisfied regardless of the legal form of the taxpayer. While a 'qualified person' will enjoy all of the benefits of the treaty, satisfying the active business income test will only entitle the taxpayer to enjoy treaty benefits for 'an item of income.'

In order for the entity to be entitled to treaty benefits for a particular item of income, the taxpayer must meet two and sometimes three tests. It must be, ‘engaged in the active conduct of a trade or business in [its State of residence] (other than the business of making or managing investments …’

This test will clearly be satisfied for taxpayers that are exclusively engaged in manufacturing, assembly, extraction, production activities or the provision of professional services. Presumably a company merely holding shares in subsidiaries would not be engaged in the ‘active conduct of a trade or business’ and even if it were, this activity would fall into the exclusion for an entity that exists for ‘making or managing investments.’ The same analysis might apply to a company that exists to just hold intellectual property assets and receive royalty payments, or which is an in-house finance company for the corporate group and exists just to receive interest payments. On the other hand, a company which holds and manages a portfolio of investments for external clients would likely be regarded as engaged in ‘the active conduct of a trade or business’ and this business is not one which is carried on ‘for the resident’s own account.’

A more complicated question arises for companies that do more than engage in ‘active trade or business’ – for example, a single company which is both a manufacturer and which licenses intellectual property to related entities. The drafting of the clause suggests that such a company would satisfy this part of the test as long as its manufacturing operations were more than merely cosmetic.

The second part of the active business income test requires that, 'the income derived from the other Contracting State is derived in connection with, or is incidental to, that trade or business.' In other words, a company which satisfies the active income test based on its status as a manufacturer cannot rely on that status to enjoy treaty benefits for all items of income it earns from the source country – merely for income which is earned in connection with its manufacturing operations. Where a single company is both a manufacturer and licenses intellectual property to related entities, it may be argued that the royalties derived from the intellectual property that it licenses is income that is ‘in connection with, or is incidental to, that [manufacturing] trade or business.’ On the other hand, royalties derived from unrelated intellectual property are presumably excluded from enjoying treaty benefits.

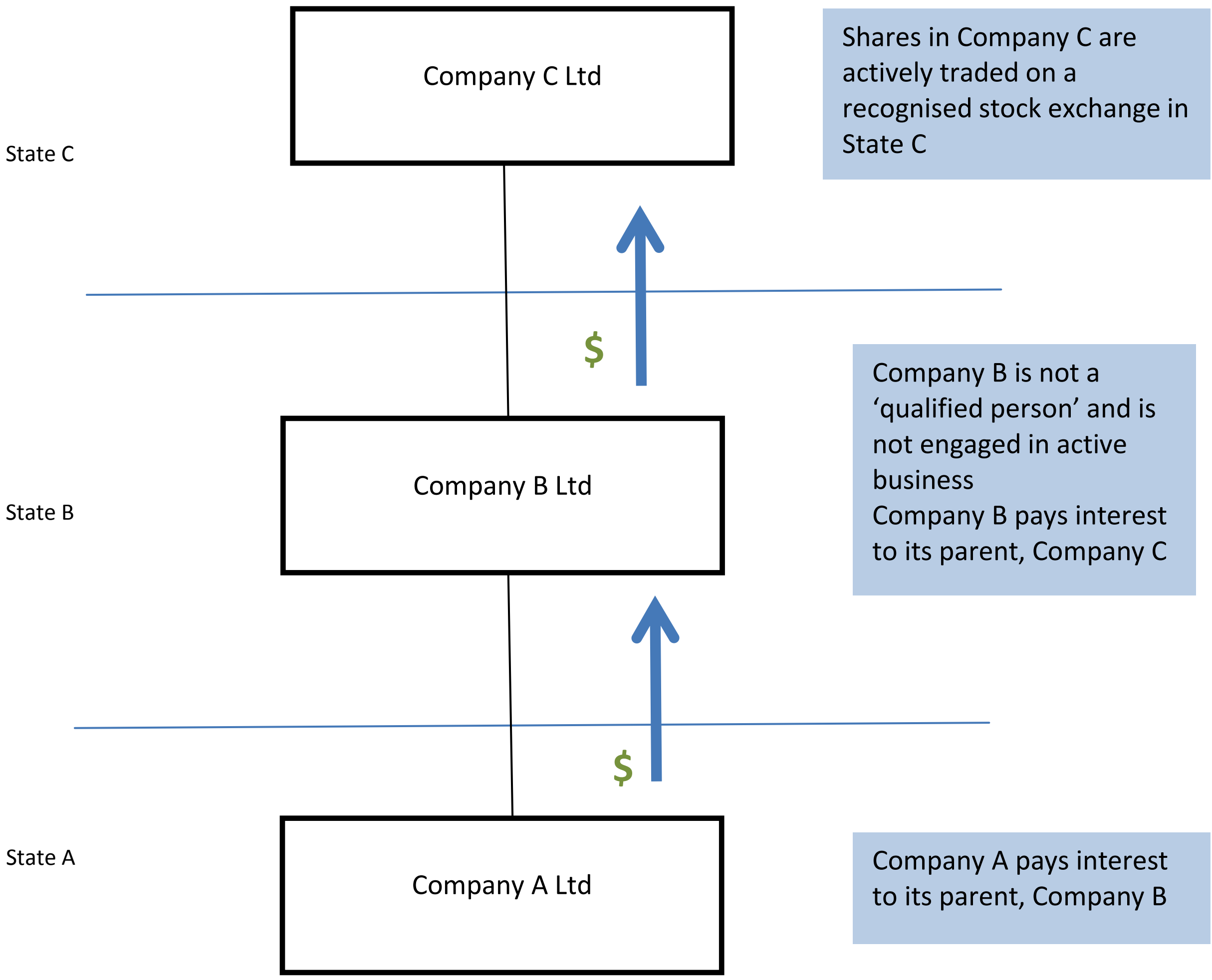
The third part of the active income test is an additional requirement which must be met if the resident is earning active business income through its offshore branch or from an associated enterprise in the source country. Where either situation exists, the added requirement is that the business operations of the recipient are regarded as 'substantial' when compared to the business operations conducted by the payer. In other words, income will not enjoy treaty benefits if it is being paid to an entity that is largely a wrapper around some modest business activities. In applying this test, the payer and the recipient are allowed (and required) to aggregate any 'activities conducted by persons connected to a person …' This aggregation occurs for any entity that shares 50% common ownership or more and may have significant effects in deciding whether activities conducted in the recipient state are substantial when compared to those conducted in the source state.

The active income test does not contain a restriction or qualification where base eroding payments are made. So, a company that conducts active business operations in the residence state faces no denial of treaty benefits even though most of its income leaks from the residence state to a third country. This creates a curious outcome. A privately-held company might not satisfy the tests to be a 'qualified person' under paragraph (2)(e) because a substantial portion of its income is eroded by deductible payments made to third countries. If however that same company conducts an active business, the ultimate destination of its income becomes irrelevant.

3.1.3 Equivalent benefits – para (4)

The *Recommendations* also include in paragraph 4 a third method for qualifying for treaty benefits. This option would deal with structures that appear to involve shopping between treaties (rather than into treaties). For example, a structure might exist which would not satisfy the objective LOB tests for a particular treaty, but the participants in that structure would all be entitled to similar benefits under other treaties. The obvious question is, should the source country simply apply the original treaty anyway, given that it would afford similar benefits if it applied the other relevant treaties instead?

In the example below, Company B may not be entitled to treaty benefits under the A-B treaty where its shares are not traded on a local stock exchange, its only shareholder is resident in State C, and its only activity is to collect and remit interest from Company A. While the structure may seem abusive, it is not obvious that State A has suffered any loss of revenue from applying the A-B treaty when the ultimate owner of the income is an entity that would be entitled instead to the benefits of the identical A-C treaty.



A tax treaty exists between State A and State B. The rate is article 11(2) is 10%
A tax treaty exists between State A and State C. The rate in article 11(2) is 10%

This issue is alluded to in the *Recommendations* and a possible clause is examined. The clause would reinstate the original treaty [in the example, the A-B treaty] in its entirety where a company (and only a company) is (predominantly) owned by an 'equivalent beneficiary.' The original treaty will be reinstated if both an ownership test and a base erosion test are met.

Both the ownership test and the base erosion test are framed around the term 'equivalent beneficiary.' The notion of 'equivalent beneficiary' relies upon the 'qualified person' tests just discussed and also to the rates prescribed in the treaty with the third state.

The first option for being an 'equivalent beneficiary' is for entities that are resident in a third state and again consists of two elements. The first element is that the company resident in the third state must be entitled to full benefits under that treaty, including being a 'qualified person' under that treaty where it contains an LOB clause. If there is no comprehensive LOB clause, the entity must qualify as 'qualified person' under the current treaty:

The second requirement is that, for dividends, interest and royalties, the rates stipulated in the treaty with the third state must be the same or lower than the rates in the current treaty.

The *Recommendations* document is ambivalent about recommending that such a clause be adopted noting that in some cases the clause might not work appropriately and that a better solution might lie in the discretionary power proposed in the general LOB clause which would permit the competent authorities to enjoy treaty benefits. The *Follow-up Work* document repeated the OECD's ambivalence and invited submissions on how to 'ensure that the inclusion of a derivative benefit provision would not raise BEPS concerns whilst providing that cases where intermediate companies are used for valid commercial reasons are not excluded from treaty benefits.'[21]

3.1.4 Residual power to cure problems – para (5)

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21 OECD, above n 12, at 9.

Because the LOB rule will be drafted using objective observable criteria there is a residual power in the competent authorities to overcome any unintended exclusion from treaty benefits. The OECD's proposal expresses the residual power in the competent authority to permit other entities to enjoy some or all treaty benefits in this way:

> 5. If a resident of a Contracting State is not entitled, under the preceding provisions of this Article, to all benefits provided under this Convention, the competent authority of the Contracting State that would otherwise have granted benefits to which that resident is not entitled shall nevertheless treat that resident as being entitled to these benefits, or benefits with respect to a specific item of income or capital, if such competent authority, upon request from that resident and after consideration of the relevant facts and circumstances, determines that the establishment, acquisition or maintenance of the resident and the conduct of its operations did not have as one of its principal purposes the obtaining of benefits under this Convention. The competent authority of the Contracting State to which the request has been made will consult with the competent authority of the other State before rejecting a request made under this paragraph by a resident of that other State.

3.2 A general limitation of benefits article based on purpose and abuse

A further recommendation contained in the *Recommendations* document is to include a purpose-based general LOB clause. The clause is intended to operate as a further and independent ground for denying treaty benefits, even where a taxpayer was able to satisfy the objective observable LOB clause just discussed. The proposed clause says –

> 7. 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.

The clause thus contains two distinct elements – a rule which would deny access to treaty benefits based on the 'purposes of any arrangement or transaction,' and an exception which would reinstate access to treaty benefits where doing so 'would be in accordance with the object and purpose' of the treaty provision. The second aspect of the clause is clearly very important: many taxpayers will undoubtedly undertake investments and transactions in the knowledge of the effects of the treaty and intending to enjoy the benefits of the treaty. Indeed, treaties are negotiated in order to induce taxpayers to change their behaviour and so denying treaty benefits simply on the basis that taxpayers have responded to that inducement is inappropriate. Rather, the clause is meant to focus on whether the way in which taxpayers have responded to that inducement – the way they structured their investment or transaction – has produced an outcome that is not in accordance with the object and purpose of the treaty provision being relied upon.

According to the *Recommendations*, this article would simply express in the text of the Model notions that are currently contained in the Commentary. Consequently, the new provision is not seen as a major departure from existing principles:

> 1. Paragraph 7 mirrors the guidance in … the Commentary on Article 1. According to that guidance, the benefits of a tax convention should not be available where one of the principal purposes of certain transactions or arrangements is to secure a benefit under a tax treaty and obtaining that benefit in these circumstances would be contrary to the object and purpose of the relevant provisions of the tax convention. Paragraph 7 incorporates the principles underlying these paragraphs into the Convention itself …; it also confirms the application of these principles for States whose domestic law already allows them to address such cases.[22]

The discussion in the *Recommendations* suggests that this is an objective enquiry to be undertaken based on the evidence of transactions which occurred. The subjective state of mind of the participants is not the focus of attention in this formulation. Instead, the investigation is meant to be about the purpose of 'the arrangement.' This formulation is intended to make the enquiry more objective and more focused on observable facts and circumstances than would be the case if the enquiry was directed to finding the state of mind of some taxpayer or their advisers.

[22] OECD, above n 10, at 66.

3.3 Changes to the Title and Preamble

The *Recommendations* also proposes changes to the Title and Preamble to the OECD Model to reinforce the notion that treaties are not meant to be exploited through inappropriate access to the treaty by residents of third countries.

The changes to the Title will re-instate the proposition that the treaty is being negotiated both to relieve double taxation and the prevent tax avoidance and evasion –

> Convention between (State A) and (State B) for the elimination of double taxation with respect to taxes on income and on capital and the prevention of tax evasion and avoidance

The preamble will also provide the two contracting states are entering the treaty –

> Intending to conclude a Convention 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 (including through treaty shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States)

The OECD suggests that the new Title and Preamble will have affect in the interpretation of treaty provisions because the Title and Preamble, should play an important role in the interpretation of the provisions of the Convention 'according to the general rule of treaty interpretation contained in Article 31(1) of the *Vienna Convention on the Law of Treaties*.'[23]

3.4 The 'minimum standards'

It was noted above that the *Recommendations* document proposed that countries should have some flexibility in how they implement measures to protect their treaties as long as they achieve 'minimum standards.' In part that recommendation is because there are a multitude of rules that might be invoked to counter the problem: statute and judicial

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[23] OECD, above n 10, at 99.

doctrines in domestic law including specific and general anti-abuse rules, existing structural rules inside treaties including targeted anti-abuse rules, as well as the proposed changes to the title and preamble, the proposed structural limitation of benefits article and the proposed purpose-based anti-abuse rule.

These ‘minimum standards’ are about how to combine the multiple proposals made in the *Recommendations* with the existing measures that countries might already have in place in legislation, judicial doctrines and treaty practice. The minimum standards are a matrix of combinations of these individual elements.

The *Recommendations* propose, first, that all countries could adopt all three proposals:[24] the proposed changes to the title and preamble, the proposed structural limitation of benefits article, and the proposed purpose-based anti-abuse rule.

However, the *Recommendations* document acknowledges that this ‘combination … may not be appropriate for all countries’ particularly ‘countries [with] domestic anti-abuse rules, or [where] the courts … have developed various interpretative tools (e.g. economic substance or substance-over-form), that effectively address various forms of domestic law and treaty abuses.’[25] For countries that do not wish to implement all three elements, the *Recommendations* proposes:

1. these countries should nevertheless still make the recommended changes to the title and preamble of their treaties; and

2. they should supplement that with either
   - (i) a purpose-based anti-abuse rule in the treaty, or
   - (ii) the structural limitation on benefits article, supported by some extra mechanism to deal with conduit arrangements not otherwise dealt with.

4. Changes to treaty practice

[24] OECD, above n 10, at 22.

[25] OECD, above n 10, at 23.

This part of the paper considers the recent treaty practice of selected ASEAN Member States[26] and compares their treaties against the 'minimum standard' being proposed by the OECD. The object of this part of the paper is to assess whether adopting the OECD's recommendations would entail significant changes to current treaty practice.

The ASEAN Member States reflect significantly different income tax treaty experience. Indonesia, Malaysia, Singapore, Thailand and Vietnam all have very extensive income tax treaty networks, each having more than 50 income tax treaties currently in force. At the other extreme Myanmar, Brunei Darussalam and Lao PDR have few income tax treaties; Cambodia has none currently in force although it is in the process of negotiating income tax treaties with several countries. The current status of the network of income tax treaties of the ASEAN Member States is reproduced in Appendix B to this paper.

Further, as with most countries, the income tax treaties of each individual ASEAN Member State do not express a single, unwavering model text. Rather, because income tax treaties are the product of negotiation with other Contracting States, and because approaches and concerns change over time, the individual treaties of a single country will vary to a greater or lesser extent, both from the other treaties of that country and from the OECD or UN models upon which a treaty will likely have been based. For the purposes of this part of the paper, a sample of recent treaties has been examined on the basis that they are probably the best indication of current practice, even though even recent treaties invariably diverge at some points.

The discussion below focuses just on the text of the treaties and the extent to which the current language would have to change if the Member State wished to adopt the new recommendations. It is important to note that this particular focus makes the discussion incomplete in at least two ways. First, many income tax treaties of ASEAN Member States already contain text of long-standing intended to constrains some of the more blatant types of abuse. Two obvious examples are the requirement that the 'beneficial owner' of dividends, interest or royalties be a resident of the other state before the reduced withholding tax rates are applied, and targeted purpose-based rules designed to protect the reduced tax rates on dividends, interest and royalties. Secondly, domestic statutory

[26] The Member States of ASEAN are Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam.

provisions or judicial doctrines may well exist which already buttress the integrity of each country's treaties.[27] A fuller examination of the robustness of the income tax treaties of ASEAN Member States against abuse would require an examination of text already used in the treaties and rules in domestic law.

4.1 Title and Preamble

As noted above, the *Recommendations* document proposes two ways which a country might meet the 'minimum standards.' One element is common to both options: all countries are encouraged to adopt the proposed changes to the Title (the treaty is being concluded for 'the prevention of tax evasion and avoidance') and to the Preamble (the treaty is not intended '[create] opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States)').

The practices of ASEAN Member States with respect to the Title and Preamble of the treaty tend to follow a common practice. Typically, both the Title and Preamble will refer to an agreement, 'for the avoidance of double taxation and the prevention of fiscal evasion.' This formula is typical in the treaties of many Member States.

While the Title of treaties might not need to change, the formula used in the Preamble would need to be expanded to include the specific reference to the treaty not 'creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States).'

4.2 Purpose-based test

While the changes to the Title and Preamble are recommended for all countries, they have a choice whether or not to adopt an over-arching purpose-based anti-abuse rule in the treaty

[27] There are examples in the treaties of ASEAN Member States of specific provisions intended to preserve the operation of domestic anti-abuse rules from challenge by reason of the treaty and such provisions are expected to play a role in protecting treaty networks. For example, Malaysia-Germany (2010) article 27, Indonesia-SAR Hong Kong (2010) article 27 and the Protocol to Singapore-Spain (2011) article 1(a)-(c) which preserves the right to apply 'domestic legal provisions on the prevention of tax evasion or tax avoidance' and specifically mentions CFC rules.

('a benefit under this Convention shall not be granted in respect of an item of income if it is reasonable to conclude ... that obtaining that benefit was one of the main purposes of any arrangement or transaction ... unless ... granting that benefit ... would be in accordance with the object and purpose of the relevant provisions of this Convention')

An over-arching purpose-based test is not a feature of the income tax treaties of ASEAN Member States. Article 27 of the 2008 Myanmar-India does contain a general denial of benefits provision if, 'a resident of a Contracting State [arranged its affairs] in such a manner as if it was the main purpose or one of the main purposes to take the benefits of this Agreement' but this is a rare example. And this formulation does not contain the 'escape clause' in the OECD proposal which retains the benefits of the treaty if 'obtaining that benefit in these circumstances would [not] be contrary to the object and purpose of the relevant provisions of the tax convention.'

This Article seems to be the standard practice of India which now appears to include a LOB clause in its treaties as a matter of course. One variant of the clause is this purpose-based approach. The clause typically denies treaty benefits to an entity, 'if its affairs were arranged in such a manner as if it was the main purpose or one of the main purposes to take the benefits of this Agreement’ and to 'any person including legal entities not having bona fide business activities.' This type of clause can also be seen in India's recent treaties with Fiji,[28] Latvia,[29] Malta[30] and Malaysia.[31]

There are, however, many examples of narrower purpose-based anti-abuse tests in the treaties of ASEAN Member States. For example, the 2011 Protocol to the Singapore-Spain treaty contains a specific exclusion from the benefit of reduced tax rates on dividends interest and royalties, 'if it was the main purpose of any person concerned with the creation or assignment of shares or other rights in respect of which the dividends are paid, the creation or assignment of the debt-claim in respect of which the interest is paid, the creation or assignment of rights in respect of which the royalties are paid, to take advantage of these Articles by means of that creation or assignment.'

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28 India-Fiji (2014) article 28.

29 India-Latvia (2013) article 28.

30 India-Malta (2013) article 27.

31 India-Malaysia (2012) article 28.

This kind of formulation, directed just to protecting the reduced rates on dividends, interest and royalties, can be seen in other treaties such as the 2013 Vietnam-New Zealand treaty,[32] the 2006 Laos-Brunei treaty,[33] the 2012 Singapore-Poland treaty[34] and the 2010 Indonesia-Hong Kong treaty[35] but it is not yet universal practice. In any event, its limited scope would not meet the OECD's paradigm.

4.3 Structural LOB clauses

The other option available to countries is to adopt the structural LOB article accompanied by some other measure directed against conduit arrangements.

Structural LOB clauses are very uncommon in the income tax treaties of ASEAN Member States. A handful exist – for example in the Protocol to the 2006 Malaysia-Spain treaty a very brief structural LOB clause protects Articles 10, 11, 12 and 13. It provides that benefits under those articles shall not be afforded to a company resident in a Contracting State if, 'persons who are not residents of that State hold, directly or indirectly, a participation of more than 50 per cent of the share capital ...' However, the provision is switched off and treaty benefits restored if the company, 'is engaged in substantive business operations, other than the mere holding of shares or property, in the Contracting State of which it is a resident' or 'if the competent authorities of the Contracting States agree ...'

Again, it is interesting to contrast this position with the practice of India. It has some instances of structural LOB clauses in treaties where a purpose-based general LOB clause does not appear. For example, India's treaty with Albania[36] contains a truncated structural LOB clause which bears a resemblance to portions of the US clause upon which the OECD proposal was based. Its treaty with Romania[37] is a curious blend of the two approaches. It denies treaty benefits if, 'the main purpose or one of the main purposes of the creation or

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32 Vietnam-New Zealand (2013) articles 10(6), 11(7) and 12(7).

33 Laos-Brunei (2006) articles 10(7), 11(8) and 12(8).

34 Singapore-Poland (2012) articles 10(8), 11(8) and 12(7).

35 Indonesia-SAR Hong Kong (2010) articles 10(7), 11(8) and 12(7).

36 India-Albania (2013) article 29.

37 India-Romania (2013) article 27.

existence of such resident or any person connected with such resident is to obtain the benefits under this Agreement ...' and then presumes that this will be the case where the level of ownership in the other State is inadequate or income leaks offshore, unless the entity carries on active business in its State of residence or the competent authorities agree.

The other piece of this option for meeting the 'minimum standards' is a supplementary rule designed to deal with conduit arrangements. It might be that such rules would be found in domestic law. The US, for example, has regulations against conduit financing arrangements in its domestic law,[38] but as noted above, this paper will not delve into domestic law. It is, however, worth pointing to the emerging practice noted above of preserving domestic statutory anti-abuse rules and judicial doctrines from challenge because of the existence of the treaty, a practice which ensures that the laws and doctrines will be able to serve as supplementary rules to deal with conduit arrangements.

There are examples of anti-conduit rules in the treaties of other countries. For example, Australia's recent treaty practice includes a specific denial of treaty benefits in circumstances where conduit financing is involved. Australia's recent treaties eliminate all source country tax where interest is paid to 'a financial institution which is unrelated to and dealing wholly independently with the payer'[39] but a specific limitation is added to protect the exemption from exploitation. For example, article 11(4) of the New Zealand treaty provides:

> 4. Notwithstanding paragraph 3, interest referred to in subparagraph (b) of that paragraph may be taxed in the State in which it arises at a rate not exceeding 10 per cent of the gross amount of the interest if:
>
> (b) it is paid as part of an arrangement involving back-to-back loans or other arrangement that is economically equivalent and intended to have a similar effect to back-to-back loans.[40]

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[38] See generally, O Marian & Y Brauner, 'United States' in G Maisto (ed), *Departures from the OECD Model and Commentaries* (Amsterdam, IBFD, 2014) at 562.

[39] Australia-New Zealand (2010) article 11(3)(b).

[40] Australia-New Zealand (2010) article 11(4)(b).

The clause combines an apparently objective criterion (a ‘back-to-back loan’ or an arrangement that is ‘economically equivalent’ to a back-to-back loan) with a purpose-based test (an arrangement intended to have a particular effect).

A clause like this may become more common in the treaties of developing countries if they decide to implement the minimum standard by opting for a LOB clause and anti-conduit rule.

5. Future treaty practice

As was noted above, the Commentaries to the UN Model and the OECD already offer some language to countries which are minded to add a LOB clause to their treaties. The experience of ASEAN Member States is that few have taken up this suggestion; LOB clauses are still very rare. The Commentaries also suggest other ways in which countries already have powers to protect their treaty networks against abuse. Again, the experience of ASEAN Member States is that few cases of abuse have been pursued and when they have, the experience seems to be that treaty benefits have proved difficult to deny in individual cases, and consequently the decision has reluctantly been made that terminating the treaty as a whole is the most appropriate remedy.

It remains to be seen whether the UN will adjust its Model income tax treaty in ways similar to the OECD proposals, but it is clear that the OECD’s work will give a significant impetus to LOB clauses and other mechanisms to protect treaty networks against abuse, giving countries options apart from the drastic solution of termination.

APPENDIX A

Draft Limitation on Benefits Article

1. Except as otherwise provided in this Article, a resident of a Contracting State shall not be entitled to a benefit that would otherwise be accorded by this Convention (other than a benefit under paragraph 3 of Article 4, paragraph 2 of Article 9 or Article 25), unless such resident is a "qualified person", as defined in paragraph 2, at the time that the benefit would be accorded.

2. A resident of a Contracting State shall be a qualified person at a time when a benefit would otherwise be accorded by the Convention if, at that time, the resident is:

a) an individual;

b) a Contracting State, or a political subdivision or local authority thereof, or a person that is wholly-owned by such State, political subdivision or local authority;

c) a company or other entity, if, throughout the taxable period that includes that time

   i) the principal class of its shares (and any disproportionate class of shares) is regularly traded on one or more recognised stock exchanges, and either:

      A) its principal class of shares is primarily traded on one or more recognised stock exchanges located in the Contracting State of which the company or entity is a resident; or

      B) the company's or entity's primary place of management and control is in the Contracting State of which it is a resident; or

   ii) at least 50 per cent of the aggregate voting power and value of the shares (and at least 50 per cent of any disproportionate class of shares) in the company or entity is owned directly or indirectly by five or fewer companies or entities entitled to benefits under subdivision i) of this subparagraph, [provided that, in the case of indirect ownership, each intermediate owner is a resident of either Contracting State];

d) a person, other than an individual, that

   i) is a [list of the relevant non-profit organisations found in each Contracting State],

   ii) was constituted and is operated exclusively to administer or provide pension or other similar benefits, provided that more than 50 per cent of the beneficial interests in that person are owned by individuals resident in either Contracting State, or

   iii) was constituted and is operated to invest funds for the benefit of persons referred to in subdivision ii), provided that substantially all the income of that person is derived from investments made for the benefit of these persons;

e) a person other than an individual, if

   i) on at least half the days of the taxable period that includes that time, persons who are residents of that Contracting State and that are entitled to the benefits of this Convention under subparagraph a), b) or d), or subdivision i) of subparagraph c), of this paragraph own, directly or indirectly, shares representing at least 50 per cent of the aggregate voting power and value shares) of the person, [provided that, in the case of indirect ownership, each intermediate owner is a resident of that Contracting State], and

   ii) less than 50 per cent of the person's gross income , as determined in the person's Contracting State of residence, for the taxable period that includes that time is paid or accrued, directly or indirectly, to persons who are not residents of either Contracting State entitled to the benefits of this Convention under subparagraph a), b) or d), or subdivision i) of subparagraph c), of this paragraph in the form of payments that are deductible for purposes of the taxes covered by this Convention in the person's Contracting State of residence (but not including arm's length payments in the ordinary course of business for services or tangible property);

f) [possible provision on collective investment vehicles]

3\. a) A resident of a Contracting State will be entitled to benefits of this Convention with respect to an item of income derived from the other Contracting State, regardless of whether the resident is a qualified person, if the resident is engaged in the active conduct of a business in the firstmentioned Contracting State (other than the business of making or managing investments for the resident's own account, unless these activities are banking, insurance or securities activities carried on by a bank or [list financial institutions similar to banks that the Contracting States agree to treat as such], insurance enterprise or registered securities dealer respectively), and the income derived from the other Contracting State is derived in connection with, or is incidental to, that business.

b) If a resident of a Contracting State derives an item of income from a business activity conducted by that resident in the other Contracting State, or derives an item of income arising in the other Contracting State from an associated enterprise, the conditions described in subparagraph a) shall be considered to be satisfied with respect to such item only if the business activity carried on by the resident in the first-mentioned Contracting State is substantial in relation to the business activity carried on by the resident or associated enterprise in the other Contracting State. Whether a business activity is substantial for the purposes of this paragraph will be determined based on all the facts and circumstances.

c) For purposes of applying this paragraph, activities conducted by persons connected to a person shall be deemed to be conducted by such person. A person shall be connected to another if one possesses at least 50 per cent of the beneficial interest in the other (or, in the case of a company, at least 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or another person possesses at least 50 per cent of the beneficial interest (or, in the case of a company, at least 50 per cent of the aggregate voting power and value of the company's shares or of the beneficial equity interest in the company) in each person. In any case, a person shall be considered to be connected to another if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same person or persons.

[4. A company that is a resident of a Contracting State shall also be entitled to a benefit that would otherwise be accorded by this Convention if, at the time when that benefit would be accorded:

a) at least 95 per cent of the aggregate voting power and value of its shares (and at least 50 per cent of any disproportionate class of shares) is owned, directly or indirectly, by seven or fewer persons that are equivalent beneficiaries, provided that in the case of indirect ownership, each intermediate owner is itself an equivalent beneficiary, and

b) less than 50 per cent of the company's gross income, as determined in the company's State of residence, for the taxable period that includes that time, is paid or accrued, directly or indirectly, to persons who are not equivalent beneficiaries, in the form of payments (but not including arm's length payments in the ordinary course of business for services or tangible property) that are deductible for the purposes of the taxes covered by this Convention in the company's State of residence.]

5. If a resident of a Contracting State is not entitled, under the preceding provisions of this Article, to all benefits provided under this Convention, the competent authority of the Contracting State that would otherwise have granted benefits to which that resident is not entitled shall nevertheless treat that resident as being entitled to these benefits, or benefits with respect to a specific item of income or capital, if such competent authority, upon request from that resident and after consideration of the relevant facts and circumstances, determines that the establishment, acquisition or maintenance of the resident and the conduct of its operations did not have as one of its principal purposes the obtaining of benefits under this Convention. The competent authority of the Contracting State to which the request has been made will consult with the competent authority of the other State before rejecting a request made under this paragraph by a resident of that other State.

6. For purposes of the preceding provisions of this Article:

a) the term "***recognised stock exchange***" means:
   - i) [list of stock exchanges agreed to at the time of signature]; and
   - ii) any other stock exchange agreed upon by the competent authorities of the Contracting States;

b) the term "***principal class of shares***" means the ordinary or common shares of the company, provided that such class of shares represents the majority of the voting power and value of the company. If no single class of ordinary or common shares represents the majority of the aggregate voting power and value of the company, the "principal class of shares" are those classes that in the aggregate represent a majority of the aggregate voting power and value of the company. In the case of a company participating in a dual listed company arrangement, the principal class of shares will be determined after excluding the special voting shares which were issued as a means of establishing that dual listed company arrangement;

c) the term "***disproportionate class of shares***" means any class of shares of a company resident in one of the Contracting States that entitles the shareholder to disproportionately higher participation, through dividends, redemption payments or otherwise, in the earnings generated in the other Contracting State by particular assets or activities of the company;

d) a company's "***primary place of management and control***" will be in the Contracting State of which it is a resident only if executive officers and senior management employees exercise day-to-day responsibility for more of the strategic, financial and operational policy decision making for the company (including its direct and indirect subsidiaries) in that Contracting State than in any other State and the staff of such persons conduct more of the day-to-day activities necessary for preparing and making those decisions in that Contracting State than in any other State;

e) [possible definition of "***collective investment vehicle***"];

[f) the term "***equivalent beneficiary***" means a resident of any other State, but only if that resident
   - i) A) would be entitled to all the benefits of a comprehensive convention for the avoidance of double taxation between that other State and the State from which the benefits of this Convention are claimed under provisions analogous to subparagraph a), b) or d), or

subdivision i) of subparagraph c), of paragraph 2 of this Article, provided that if such convention does not contain a comprehensive limitation on benefits article, the person would be entitled to the benefits of this Convention by reason of subparagraph a), b) or d), or subdivision i) of subparagraph c), of paragraph 2 of this Article if such person were a resident of one of the Contracting States under Article 4 of this Convention; and

B) with respect to income referred to in Articles 10, 11 and 12 of this Convention, would be entitled under such convention to a rate of tax with respect to the particular class of income for which benefits are being claimed under this Convention that is at least as low as the rate applicable under this Convention; or

ii) is a resident of a Contracting State that is entitled to the benefits of this Convention by reason of subparagraph a), b), subdivision i) of subparagraph c) or subparagraph d) of paragraph 2 of this Article;]

g) the term "***dual listed company arrangement***" means an arrangement pursuant to which two publicly listed companies, while maintaining their separate legal entity status, shareholdings and listings, align their strategic directions and the economic interests of their respective shareholders through:

i) the appointment of common (or almost identical) boards of directors, except where relevant regulatory requirements prevent this;

ii) management of the operations of the two companies on a unified basis;

iii) equalised distributions to shareholders in accordance with an equalisation ratio applying between the two companies, including in the event of a winding up of one or both of the companies;

iv) the shareholders of both companies voting in effect as a single decision-making body on substantial issues affecting their combined interests; and

v) cross-guarantees as to, or similar financial support for, each other's material obligations or operations except where the effect of the relevant regulatory requirements prevents such guarantees or financial support; and

h) with respect to entities that are not companies, the term "***shares***" means interests that are comparable to shares.

7. 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.

APPENDIX B

Treaty Network of ASEAN Member States (as at December 2014)

Brunei Darussalam 13 Treaties	Hong Kong (2010), Malaysia (2009), Kuwait (2009), Japan (2009), Pakistan (2008), Oman (2008), Bahrain (2008), Vietnam (2007), Laos (2006), Singapore (2005), China PRC (2004), Indonesia (2000), UK (1950)
Cambodia 0 Treaties	None currently in force
Indonesia 64 Treaties	Hong Kong (2010), Papua New Guinea (2010), Morocco (2008), Qatar (2006), Iran (2004), Suriname (2003), Portugal (2003), Bangladesh (2003), Mexico (2002), Korea DPRK (2002), Croatia (2002), Netherlands (2002), China PRC (2001), Thailand (2001), Slovakia (2000), Brunei (2000), Seychelles (1999), Russia (1999), Egypt (1998), Sudan (1998), Vietnam (1997), Belgium (1997), South Africa (1997), Syria (1997), Kuwait (1997), Venezuela (1997), Turkey (1997), Jordan (1996), Uzbekistan (1996), Romania (1996), Mongolia (1996), Ukraine (1996), United Arab Emirates (1995), Spain (1995), Algeria (1995), Taiwan ROC (1995), Czech Republic (1994), United Kingdom (1993), Sri Lanka (1993), Luxembourg (1993), Poland (1992), Tunisia (1992), Australia (1992), Malaysia (1991), Bulgaria (1991), Germany (1990), Pakistan (1990), Singapore (1990), Italy (1990), Hungary (1989), Sweden (1989), Korea ROK (1988), Switzerland (1988), Norway (1988), United States (1988), Finland (1987), India (1987), New Zealand (1987), Austria (1986), Denmark (1985), Japan (1982), Philippines (1981), France (1979), Canada (1979).
Lao PDR 8 Treaties	Belarus (2013), Luxembourg (2012), Malaysia (2010), Brunei (2006), Korea ROK (2004), China PRC (1999), Thailand (1997), Vietnam (1996)
Malaysia 77 Treaties	India (2012), Hong Kong (2012), Laos (2010), Germany (2010), San Marino (2009), Brunei (2009), Turkmenistan (2008), Qatar (2009), Syria (2007), Venezuela (2006), Kazakhstan (2006), Spain (2006), Saudi Arabia (2006), South Africa (2005), Singapore (2004), Chile (2004), Seychelles (2003), Kuwait (2003), Lebanon (2003), Luxembourg (2002), Sweden (2002), Croatia (2002), Morocco (2001), Kyrgyzstan (2000), Bahrain (1999), Japan (1999), Ireland (1998), Namibia (1998), Myanmar (1998), Uzbekistan (1997), Sri Lanka (1997), Egypt (1997), United Kingdom (1996), Taiwan ROC (1996), Czech Republic (1996), Fiji (1995), United Arab Emirates (1995), Malta (1995), Vietnam (1995), Mongolia (1995), Turkey (1994), Jordan (1994), Zimbabwe (1994), Albania (1994), Sudan (1993), Papua New Guinea (1993), Iran (1992), Mauritius (1992), Indonesia (1991), Austria (1989), Hungary (1989), Netherlands (1988), Ukraine (1987), Russia (1987), Moldova (1987), Georgia (1987), Belarus (1987), Azerbaijan (1987), Armenia (1987), China PRC (1985), Finland (1984), Italy (1984), Bangladesh (1983), Romania (1982), Pakistan (1982), Philippines (1982), Korea ROK (1982), Thailand (1982), Australia (1980), Poland (1977), Canada (1976), New Zealand (1976), France (1975), Switzerland (1974), Belgium (1973), Norway (1970), Denmark (1970)
Myanmar 7 Treaties	India (2008), Korea ROK (2002), Thailand (2002), Vietnam (2000), Singapore (1999), Malaysia (1998), United Kingdom (1950)

Philippines 39 Treaties	Kuwait (2009), United Arab Emirates (2003), Vietnam (2001), Bahrain (2001), Czech Republic (2000), China PRC (1999), Switzerland (1998), Sweden (1998), Nigeria (1997), Bangladesh (1997), Hungary (1997), Denmark (1995), Russia (1995), Romania (1994), Poland (1992), Israel (1992), India (1990), Spain (1989), Netherlands (1989), Norway (1987), Korea ROK (1984), Brazil (1983), Germany (1983), Thailand (1982), Malaysia (1982), Indonesia (1981), Austria (1981), Italy (1980), New Zealand (1980), Pakistan (1980), Japan (1980), Australia (1979), Finland (1978), Singapore (1977), Belgium (1976), United States (1976), United Kingdom (1976), Canada (1976), France (1976)
Singapore 76 Treaties	Barbados (2013), Liechtenstein (2013), Belarus (2013), Guernsey (2013), Poland (2012), Jersey (2012), Isle of Man (2012), Spain (2011), Switzerland (2011), Albania (2010), Ireland (2010), Panama (2010), Saudi Arabia (2010), Slovenia (2010), Georgia (2009), New Zealand (2009), Libya (2009), Uzbekistan (2009), China PRC (2007), Ukraine (2007), Morocco (2007), Qatar (2006), Belgium (2006), Kazakhstan (2006), Estonia (2006), Malta (2006), Fiji (2005), Brunei (2005), Israel (2005), Slovakia (2005), Malaysia (2004), Germany (2004), Bahrain (2004), Lithuania (2003), Oman (2003), Mongolia (2002), Russia (2002), Finland (2002), Romania (2002), Kuwait (2002), Austria (2001), Cyprus (2000), Denmark (2000), Latvia (1999), Portugal (1999), Turkey (1999), Myanmar (1999), Norway (1997), Czech Republic (1997), Hungary (1997), United Kingdom (1997), South Africa (1996), Bulgaria (1996), Egypt (1996), United Arab Emirates (1995), Mauritius (1995), Mexico (1994), Japan (1994), Vietnam (1994), India (1994), Pakistan (1993), Luxembourg (1993), Papua New Guinea (1991), Indonesia (1990), Taiwan ROC (1981), Bangladesh (1980), Korea ROK (1979), Sri Lanka (1979), Philippines (1977), Italy (1977), Canada (1976), Thailand (1975), France (1974), Netherlands (1971), Australia (1969), Sweden (1968)
Thailand 57 Treaties	Estonia (2012), Korea ROK (2006), Chile (2006), Hong Kong (2005), Thailand (2004), Oman (2003), Norway (2003), Kuwait (2003), Slovenia (2003), Turkey (2002), Myanmar (2002), Armenia (2001), Bahrain (2001), Indonesia (2001), Seychelles (2001), Bulgaria (2000), United Arab Emirates (2000), Russia (1999), Taiwan ROC (1999), Uzbekistan (1999), Cyprus (1998), New Zealand (1998), Denmark (1998), Nepal (1998), Spain (1997), Mauritius (1997), Laos (1997), Bangladesh (1997), United States (1996), Romania (1996), Luxembourg (1996), Switzerland (1996), South Africa (1996), Israel (1996), Czech Republic (1994), Vietnam (1992), Japan (1990), Australia (1989), Hungary (1989), Sri Lanka (1988), Sweden (1988), China PRC (1986), Austria (1985), Finland (1985), India (1985), Canada (1984), Philippines (1982), Malaysia (1982), United Kingdom (1981), Pakistan (1980), Poland (1978), Belgium (1978), Italy (1977), Singapore (1975), Netherlands (1975), France (1974), Germany (1967)
Vietnam 57 Treaties	New Zealand (2013), Serbia (2013), Tunisia (2010), Saudi Arabia (2010), Israel (2009), Qatar (2009), Hong Kong (2008), Morocco (2008), Venezuela (2008), Slovakia (2008), Austria (2008), Oman (2008), Ireland (2008), Brunei (2007), Sri Lanka (2005), Seychelles (2005), Pakistan (2005), Spain (2005), Bangladesh (2004), Cuba (2002), Iceland (2002), Finland (2001), Philippines (2001), Myanmar (2000), Taiwan ROC (1988), Indonesia (1997), Canada (1997), Czech Republic (1997), Belarus (1997),

	Italy (1996), Bulgaria (1996), Mongolia (1996), Switzerland (1996), Ukraine (1996), Uzbekistan (1996), Luxembourg (1996), Belgium (1996), Laos (1996), Germany (1995), Japan (1995), Malaysia (1995), Romania (1995), Norway (1995), Denmark (1995), China PRC (1995), Netherlands (1995), India (1994), Poland (1994), Hungary (1994), Korea ROK (1994), United Kingdom (1994), Sweden (1994), Singapore (1994), Russia (1993), France (1993), Thailand (1992), Australia (1992)

APPENDIX C

OECD Documents on Action Item 6 (as at 31 January 2015)

OECD, *Action Plan on Base Erosion and Profit Shifting* (July 2013) http://www.oecd.org/ctp/BEPSActionPlan.pdf.

OECD, *Public Discussion Draft BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances* (March 2014), http://www.oecd.org/ctp/treaties/treaty-abuse-discussion-draft-march-2014.pdf.

OECD, *Comments Received on Public Discussion Draft – BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances* (April 2014) http://www.oecd.org/tax/treaties/comments-action-6-prevent-treaty-abuse.pdf

OECD, *Part 1 of a Report to G20 Development Working Group on the Impact of BEPS in Low Income Countries* 18 (July 2014) http://www.oecd.org/tax/part-1-of-report-to-g20-dwg-on-the-impact-of-beps-in-low-income-countries.pdf

OECD, *Part 2 of a Report to G20 Development Working Group on the Impact of BEPS in Low Income Countries* 18 (August 2014) http://www.oecd.org/g20/topics/taxation/part-2-of-report-to-g20-dwg-on-the-impact-of-beps-in-low-income-countries.pdf

OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances – Action 6; 2014 Deliverable* (Paris: OECD, 2014) (available at https://www.reit.com/sites/default/files/OECD%20BEPS%20Action%206%20Deliverable%209-16-14.pdf)

OECD, *Public Discussion Draft – Follow-up Work on BEPS Action 6: Prevent Treaty Abuse* (November 2014) http://www.oecd.org/ctp/treaties/discussion-draft-action-6-follow-up-prevent-treaty-abuse.pdf

OECD, *Comments Received on Public Discussion Draft – Follow-up Work on BEPS Action 6: Prevent Treaty Abuse* (January 2015) http://www.oecd.org/ctp/treaties/public-comments-action-6-follow-up-prevent-treaty-abuse.pdf