

The interaction of domestic anti-abuse and income attribution rules with the guiding principle in the OECD Commentary and anti-abuse rules in DTTs

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1. Introduction and Scope

Over the past few decades, the increasing complexity of international transactions and the globalization of economies have heightened the importance of robust anti-abuse measures serving as critical mechanisms within tax systems, both domestically and internationally, to prevent taxpayers from exploiting loopholes in tax laws to minimize their tax liabilities unfairly. The thesis explores the interplay between domestic anti-abuse measures and income attribution rules in light of

international standards, analysing – through a comparative approach – diverse legislative schemes and case law to explore their harmonization for effective cross-border income taxation.

Chapter 2. outlines the core concepts of anti-abuse and income attribution rules in domestic and international contexts; it also analyses the OECD guiding principle and its codification in double tax treaties through anti-abuse provisions such as the Principal Purpose Test (PPT) and Limitation on Benefits (LOB) clauses. Chapter 3. delves into domestic anti-abuse frameworks while Chapter 4. focuses on income attribution rules in cross-border transactions. Finally, Chapter 5. evaluates the interaction of domestic rules with international standards, highlighting synergies and conflicts.

2. Introduction to the concept of anti-abuse rules

2.1. General Overview

Historically, tax avoidance was a domestic issue with authorities focusing on practices that eroded local tax bases. However, the globalization of commerce and the rise of multinational corporations have introduced significant challenges, prompting a shift towards coordinated international anti-abuse frameworks. The Organisation for Economic Co-operation and Development (OECD) has played a crucial role in this, particularly through its Base Erosion and Profit Shifting (BEPS) Project¹ that aims to close gaps in international tax rules that facilitate profit shifting to low- or no-tax jurisdictions.

Effective anti-abuse measures are essential to ensure taxes are paid where economic activities and value creation occur, preserving revenue integrity. However, the absence of a clear definition of tax avoidance complicates the design of general anti-avoidance rules (GAARs). These broadly drafted provisions target abusive practices but vary widely across jurisdictions.² Despite their importance, no system has yet perfected the balance between curbing avoidance and ensuring clarity for taxpayers.³

Domestic anti-abuse rules often include GAARs, “catch-all” provisions that empower tax authorities to deny benefits from transactions lacking genuine economic substance or a legitimate business purpose. For example, the UK’s GAAR, introduced in 2013, targets abusive arrangements deemed unreasonable⁴ while

1 OECD Action Plan on Base Erosion and Profit Shifting (OECD Publishing, 2013), <http://dx.doi.org/10.1787/9789264202719-en>.

2 Paulo Rosenblatt, Manuel E. Tron in: IFA Cahiers 2018-Volume 103A, ‘Anti-avoidance Measures of General Nature and Scope – GAAR and Other Rules’ General Report, Online Books IBFD, p. 5. In the context of tax treaties, see H.D. Rosenbloom, ‘Tax Treaty Abuse: Problems and Issues’, *Law & Policy in International Business* (1983), Vol. 15, p. 766. See also Robert J. Danon, ‘The PPT in Post-BEPS Tax Treaty Law: It Is a GAAR but Just a GAAR!’, *Bulletin for International Taxation* (2020) p. 245.

3 Rosenblatt, Tron in: IFA Cahiers 2018-Volume 103A, p. 7.

4 UK Finance Act 2013 (c. 29), Part 5 – General anti-abuse rule, Chapter – Other provisions.

Canada's GAAR, established in 1988, addresses misuse or abuse of tax provisions.⁵ Specific anti-avoidance rules (SAARs), such as controlled foreign corporations (CFC) rules, may complement GAARs by targeting specific transactions. Domestic anti-abuse rules are essential in the fight against aggressive tax planning. However, overly broad or ambiguous measures can lead to compliance burdens and disputes, undermining their effectiveness.

Income attribution rules also exist that are critical for determining tax liability and countering tax avoidance strategies that exploit the tax rules on global business operations. They aim to align taxation with the location of actual economic activity and value creation, preventing multinational enterprises (MNEs) from shifting profits to low- or no-tax jurisdictions through mechanisms like transfer pricing manipulations, CFCs, or hybrid mismatches. These rules are bolstered by initiatives such as the OECD's BEPS Project that provides global guidelines for tackling profit shifting and tax avoidance. However, applying these rules consistently across borders remains challenging. Recent measures, such as the Pillar Two's global minimum tax⁶, signal a shift toward stricter income attribution standards. The rise of the digital economy further complicates these efforts as traditional tax concepts of physical presence are increasingly outdated.

2.2. The guiding principle in the OECD Commentary and anti-abuse rules in DTTs

Cross-border tax avoidance leads to BEPS and is problematic for every state because it adversely affects a tax system. Indeed, tax avoidance practices are contrary to "*fiscal equity, have serious budgetary effects and distort international competition and capital flows*"⁷. Under international law, the anti-abuse doctrine is a recognized legal principle, and it can be argued that a similar inherent anti-abuse essence also exists for treaties.⁸ The OECD Model Convention (OECD MC)⁹ and OECD Commentary (Commentary) are key tools for interpreting double taxation treaties (DTTs), offering courts and anybody who needs to apply or interpret the law a unified framework for understanding international tax rules.¹⁰ The

5 Canada, IC88-2 General Anti-Avoidance Rule – Section 245 of the Income Tax Act, para. 3.

6 OECD (2021), 'Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS', OECD Publishing, Paris, <https://doi.org/10.1787/782bac33-en>.

7 OECD (1987), 'International Tax Avoidance and Evasion: Four Related Studies, Issues in International Taxation', No. 1, OECD Publishing, Paris, para. 10, <https://doi.org/10.1787/g2ghgbf6-en>. See also Vikram Chand, *The Interaction of Domestic Anti-Avoidance Rules with Tax Treaties (with special references to the BEPS project)*, (Geneva/Zurich: Schulthess, 2018) p. 3.

8 Chand, *The Interaction of Domestic Anti-Avoidance Rules with Tax Treaties (with special references to the BEPS project)*, pp. 469-472.

9 OECD (2017), Model Tax Convention on Income and on Capital: Condensed Version 2017, OECD Publishing, Paris, https://doi.org/10.1787/mtc_cond-2017-en.

10 Werner Haslechner, 'Introduction' in: Ekkehart Reimer/Alexander Rust (eds.), *Klaus Vogel on Double Taxation Conventions*, 5th edition (The Netherlands: Kluwer, 2022), m.no. 116.

Commentary particularly provides critical insights into applying anti-abuse provisions. In 2003¹¹, paragraph 9.5 of the Commentary on Article 1 introduced a “guiding principle” asserting that DTTs should not facilitate non-taxation or reduced taxation through abusive arrangements. This principle was reaffirmed in the 2017 update now found in paragraph 61:

A guiding principle is that the benefits of a double taxation 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. That principle applies independently from the provisions of paragraph 9 of Article 29, which merely confirm it.

Treaty benefits should thus not be available when two conditions are met. First, the primary purpose of a transaction is to secure a more favorable tax position and, second, this benefit contradicts the treaty’s object and purpose.¹² The primary difference between the 2017 version and the original 2003 Commentary is the reference to Article 29(9). The guiding principle sets forth a general standard that states are required to adhere to when denying treaty benefits based on either a domestic or treaty GAAR. The PPT outlined in Article 29(9) of the OECD MC is simply a codification of this guiding principle as clarified in the last sentence of the 2017 update.¹³

Treaties should be interpreted in good faith¹⁴ based on Articles 26 and 31(1) of the Vienna Convention on the Law of Treaties (Vienna Convention).¹⁵ The guiding principle aligns with this approach, emphasizing substance over form in treaty interpretation. When a treaty excludes Article 29(9), the guiding principle confirms the inherent anti-abuse essence of DTTs. If included, Article 29(9) defines the principle’s scope, reinforcing purposive treaty interpretation. However, some scholars question the necessity of a guiding principle, arguing that treaty limits should be determined by their inherent object and purpose. This renders paragraph 61 of the Commentary on Article 1 of limited standalone interpretative value.¹⁶

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- 11 OECD (2003), ‘Model Tax Convention on Income and on Capital: Condensed Version 2003’, OECD Publishing, Paris, https://doi.org/10.1787/mtc_cond-2003-en.
 - 12 Chand, *The Interaction of Domestic Anti-Avoidance Rules with Tax Treaties (with special references to the BEPS project)*, pp. 186-187.
 - 13 Robert J. Danon, ‘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* (2018) p. 37.
 - 14 John F. Avery Jones, ‘The Relationship Between Domestic Tax Systems and Tax Treaties’, *Bulletin Tax Treaty Monitor* (2002), p. 270.
 - 15 Vienna Convention on the Law of Treaties, 23 May 1969. Entered into force on 27 January 1980. United Nations, Treaty Series, vol. 1155, p. 331.
 - 16 Alexander Rust/Valentina Emanuele, ‘Domestic GAARs and Their Impact on Tax Treaties’ in: Georg Kofler/Michael Lang/Pasquale Pistone/Alexander Rust/Josef Schuch/Karoline Spies/Claus Staringer/Rita Szudoczky (eds.) *Anti-Abuse Rules and Tax Treaties*, 1st edition (Alphen aan den Rijn: Kluwer Law International B.V., 2024) pp. 11-13. See also Michael Lang, ‘The Signalling Function of Article 29(9) of the OECD Model – The ‘Principal Purpose Test’’, *Bulletin for International Taxation* (2020) Vol. 74 Issue 4/5, p. 268.

2.3. BEPS Action 6: the PPT and the LOB clause

As mentioned, the OECD's BEPS Project highlights the critical need for coordinated international anti-abuse measures to address loopholes enabling artificial profit shifting to low-tax jurisdictions. Through 15 Action Points¹⁷, it targets corporate tax reform areas focusing on preventing less-than-single taxation and double non-taxation.¹⁸ Notably, BEPS Action 6¹⁹ addresses treaty abuse, identifying it as a significant concern and proposes several strategies to combat it. First, it recommends including anti-abuse provisions in DTTs explicitly stating that treaties should not create opportunities for non-taxation or reduced taxation through evasion or avoidance. This approach expands treaty purposes to encompass both the elimination of double taxation and the prevention of tax avoidance. The 2017 OECD MC update reflects this intent through a revised title and preamble. Second, BEPS Action 6 advocates for specific anti-abuse rules such as the LOB provision, and a GAAR or PPT outlined in Article 29. Recognizing the limitations of treaty-based measures, BEPS Action 6 also encourages countries to adopt complementary domestic anti-abuse rules²⁰, ensuring treaties do not hinder their application through recommended Commentary amendments.²¹

The PPT is one of the most important anti-abuse mechanisms in DTTs, a treaty-based GAAR that denies treaty benefits if one of the main purposes of a transaction is to obtain those benefits in a way that contradicts the treaty's objectives. The PPT includes both a subjective and an objective element. Subjectively, a treaty benefit is denied if the taxpayer's primary purpose was to obtain it which is assessed using a reasonableness criterion based on facts and circumstances.²² Objectively, benefits may still be granted if their allocation aligns with the treaty's purpose. The PPT applies to treaty benefits including taxation limitations, double taxation relief, and non-discrimination protections.²³

The PPT is a complex provision, typical of GAARs, with inherent vagueness.²⁴ Its inclusion in the OECD MC as part of the OECD's BEPS Project may have in-

17 OECD BEPS 2015 Final Reports <https://www.oecd.org/ctp/beps-2015-final-reports.htm>.

18 Susi Hjorth Bærentzen, *The Effectiveness of General Anti-Avoidance Rules – Their Limits, Challenges and Potential in EU and International Tax Law* (IBFD: 2022), p. 47.

19 *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances*, Action 6 – 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project (Paris: OECD Publishing, 2015) <http://dx.doi.org/10.1787/9789264241695-en>.

20 *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances*, Action 6 – 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project (Paris: OECD Publishing, 2015) <http://dx.doi.org/10.1787/9789264241695-en>, Executive Summary, p. 10; Section A, paras. 16, 22, 56, 58-59.

21 Bærentzen, *The Effectiveness of General Anti-Avoidance Rules – Their Limits, Challenges and Potential in EU and International Tax Law*, pp. 37-41. See also Rust/Emanuele in: Kofler *et al.* (eds., Kluwer Law International, 2024) pp. 3-4.

22 Danon, *Bulletin for International Taxation* (2018) p. 44.

23 *Id.*, p. 42.

24 Danon, *Bulletin for International Taxation* (2020) p. 242.

creased its actual application's complexity, as – one might sustain that – it may appear to serve more to strengthen the institutional power of the OECD rather than to implement an effective reform in preventing treaty abuse.²⁵ The PPT would thus potentially undermine one of the main functions of DTTs to ensure certainty for taxpayers involved in international trade, granting tax authorities extensive discretion.²⁶ Under Article 7(2) of the Multilateral Instrument (MLI)²⁷, the PPT shall replace existing treaty GAARs in covered agreements and be added to those lacking a treaty GAAR, offering clearer interpretation by prioritizing written provisions over unwritten anti-abuse rules.²⁸

The LOB clause is another key anti-abuse provision aimed at restricting treaty benefits to entities with a genuine connection to a contracting state. The OECD MC's structure exposes the source state to treaty shopping as Article 4 only requires a resident entity to be incorporated or managed in the residence state. The U.S. addressed this vulnerability with LOB clauses²⁹, ensuring that treaty benefits are granted only to taxpayers with substantial connections to their residence country and legitimate economic activities. Incorporated into Article 29(1)-(7) of the 2017 OECD MC, LOB clauses mirror provisions in the 2016 U.S. Model Convention.³⁰ They prevent treaty abuse by denying benefits to entities that lack substantial ties to their place of incorporation, such as letterbox companies. LOB clauses impose additional requirements to prevent abuse of the residence criteria thus altering the concept of treaty residence itself; they require taxpayers to meet one of several alternative tests to qualify for treaty benefits.³¹

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- 25 Błażej Kuźniacki, 'The Principal Purpose Test (PPT) in BEPS Action 6 and the MLI: Exploring Challenges Arising from Its Legal Implementation and Practical Application', *World Tax Journal* (2018), p. 286. See also Philip Baker, 'The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting', *British Tax Review* (2017) Issue 3, p. 283.
 - 26 Kuźniacki, *World Tax Journal* (2018), pp. 285-287. See also Andrés Báez Moreno, 'GAARs and Treaties: From the Guiding Principle to the Principal Purpose Test: What Have We Gained from BEPS Action 6?', *Intertax* (2017) Vol. 45 Issue 6/7, p. 435.
 - 27 Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, entered into force on 1 July 2018.
 - 28 Chand, *The Interaction of Domestic Anti-Avoidance Rules with Tax Treaties (with special references to the BEPS project)*, p. 472. See also Rust/Emanuele in: Kofler *et al.* (eds., Kluwer Law International, 2024) p. 7.
 - 29 Danon, *Bulletin for International Taxation* (2020) pp. 246-247.
 - 30 United States Model Income Tax Convention (2016), United States Model Income Tax Convention 2016 (treasury.gov). The U.S. has a long history of incorporating anti-abuse rules in DTTs with some of the strictest LOB clauses worldwide. The first version of the U.S. Model Convention that incorporated an LOB clause was that of 1981, *U.S. Treasury Department's draft Model Income Tax Convention*, published on 16 June 1981, and withdrawn as an official U.S. Model on 17 July 1992. See also the Technical Explanation to the 1996 U.S. Model Convention, that at Article 22 includes the 'Purpose on Limitation on Benefits Provisions', www.irs.gov/pub/irs-trty/usmttech.pdf (accessed 2 March 2025).
 - 31 Rust/Emanuele in: Kofler *et al.* (eds., Kluwer Law International, 2024) p. 8.