

United Nations

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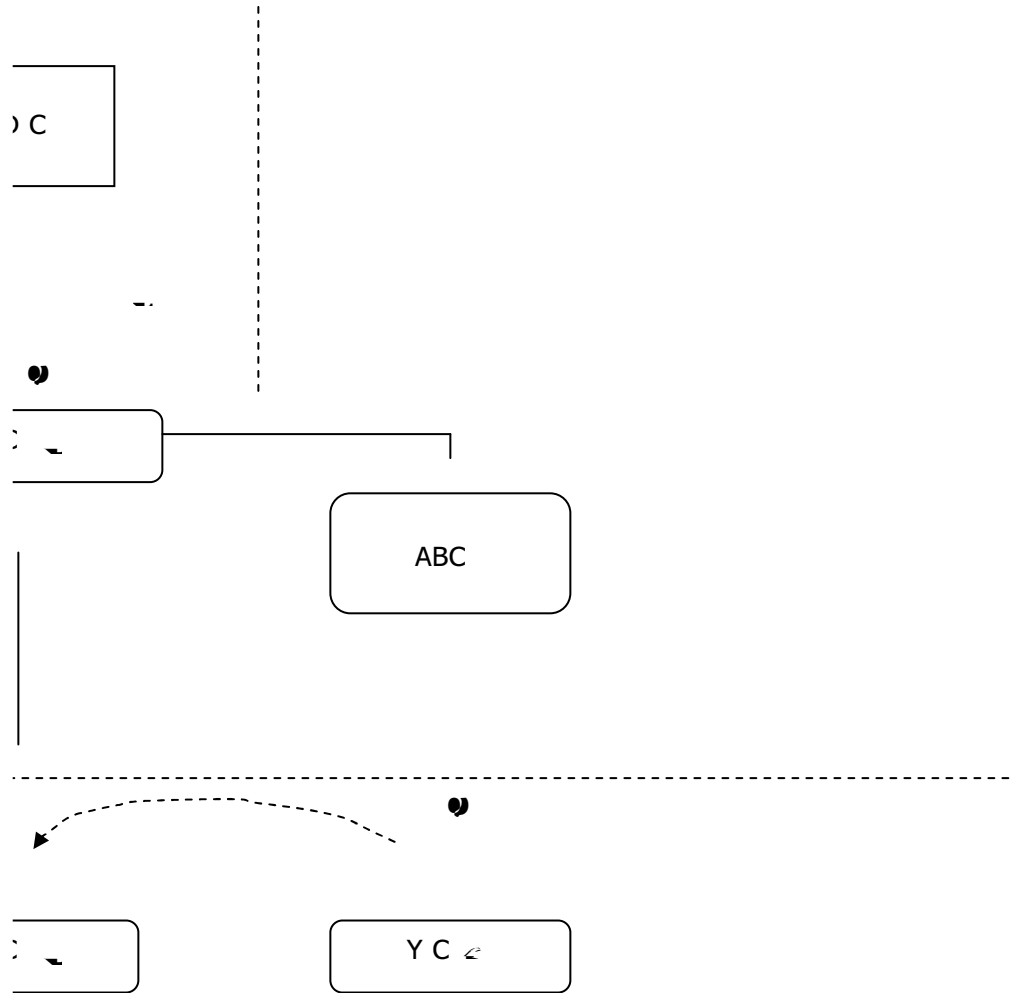
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I. Comments from Mr. Armando Lara Yaffar (Mexico)

Treaty shopping transactions deviate the main objectives of tax treaties by allowing people who are not entitled to the benefits of the conventions

to consolidate the group, AB Co sells the stocks to Y Co 1 at its market value.
o Article 9 between the tax treaty between country Y and country A this transaction
ot as well.



The parties involved in this scheme are taking advantage of the tax treaties in order to avoid paying taxes derived from the stock alienation. They are not paying taxes in Country X, Y or A.

The concept of residence is manipulated in both treaties (X-Y and Y-A)

or estate in its business activities.
(2)

III. Comments from Indonesia

Case of Indonesia : Treaty abuse.

OUTLINE

Firm XYZ in Indonesia is planning to divestate 41,94% of its share and to sell them to firm **ABC** (located in Country Z). **ABC**

Analytical consideration :

Suppose Firm XYZ (Indonesia) sells its shares direc

IV. Comments from Mr. McIntyre

the two Contracting States when claiming a treaty benefit.

(6) Treaties, including model treaties and commentaries, typically have not kept up with new business and investment methods or with new techniques for international tax evasion and avoidance.

(7) The holders of model tax treaties have sometimes sought to counter treaty abuses by inserting language in the commentaries to the model treaties. Those commentaries are afforded little or no weight by the courts of some countries. Given the widespread practice of treaty shopping, the overall effect of the commentaries in combating tax avoidance and evasion has been fairly small.

Any effective strategy for limiting abuse of treaties needs to address the root causes of the abuses. In my comments, I shall suggest techniques for dealing with abuses that would respond, to the extent feasible, with the causes of treaty abuse outlined above.

In particular, I believe an effective strategy for combating treaty abuse should contain the following elements:

(1) A clear understanding that no country relinquishes source jurisdiction by default or by

Article 1
Interpretation of this Convention

1. This Convention shall be interpreted by the competent authorities and instruments of government of the Contracting States in light of its two purposes. Those purposes are (1) to encourage productive economic activity and investment by reducing the risk of double taxation and (2) to eliminate opportunities for taxpayers to evade or avoid taxes otherwise due.

2. By entering into this Convention, the Contracting States agree on the following interpretive principles:

(a) A Contracting State does not intend to relinquish its right to tax income arising within its territory under this Convention unless it has explicitly expressed that intent in this Convention.

(b) In determining whether a taxpayer is entitled to a claimed treaty benefit, substance should prevail over form. A Contracting State, at its discretion, may decline to provide a benefit otherwise provided under this Convention if either the transaction (or set of related transactions) giving rise to a claim for that benefit lacks economic substance, or the transaction (or set of related transactions) was not motivated by a *bona fide* business or investment purpose.

(i) A transaction or set of related transactions shall not be considered to have a *bona fide* business or investment purpose if one of the substantial purposes for entering into the transaction or set of related transactions was the avoidance or evasion of taxes.

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instruments of government of the Contracting States in interpreting this Convention if the Competent Authority of one of the

stripping. In addition, developing countries should reserve the right to limit the deduction for royalty and interest payments in cases that appear abusive.

(3) Developing countries should clearly reserve the right to deal with tax avoidance through the use of new financial instruments.

c. *Hybrid Entities*. The OECD has done some useful work on dealing with hybrid entities — entities that pose, for example, as a partnership in one Contracting State and as a corporation in the other Contracting State. At a minimum, the UN Commentary should provide that a Contracting State may treat a hybrid entity for tax treaty purposes however it wishes as

g. *CFC Rules*. In recent years, several developing countries have adopted controlled foreign corporation (CFC) rules for dealing with tax avoidance and evasion through foreign entities. Those rules are common in developed countries. At a minimum, the UN Model Tax Convention should make clear that such rules are compatible with a country's treaty obligations and are a desirable feature of a country's domestic tax legislation. Rules also should be developed to deal with the potential double taxation of CFC income. A consideration of that issue, however, is outside the jurisdiction of this subcommittee.

h. *Income from Immovable Property*. Developing countries never should relinquish their right to tax income from immovable property or from the extraction of natural resources. Tax treaties have been interpreted, however, to limit source jurisdiction even over the extraction of natural resources. Companies involved in those industries tend to operate through many separate entities, some of which are held not to have a PE in the source country. The solution to this set of problems is to remove taxation of income from natural resources from Article 5 (the PE article) to Article 6 (Income from Immovable Property). Income classified as income from immovable property is taxable in the source state whether or not the taxpayer has a PE in that state.