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THE LIMITATION ON BENEFITS CLAUSES AND ITS INTERPRETATION IN COLOMBIAN TAX TREATIES AFTER THE OECD MULTILATERAL CONVENTION

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Abstract

The signature in 2017 of the MLC to implement Tax Treaty Measures to implement BEPS automatically modifies all the DTTs previously signed and ratified by Colombia. One of the principal consequences is the adoption of additional rules as the Limitation on Benefits Clauses that restrict the access to the benefits granted by any DTT through the subjective scope of the Treaty.

It is then crucial to be able to identify which are the beneficiaries of the DTTs. These purposes will be achieved through an appropriate interpretation and application of the L.O.B. clauses taking into account the nature, purposes, structure, and precedents of such instruments and the objects of DTTs.

This study will be divided in two parts: in the first, a brief review of the concept of treaty shopping and the proposed measures against it will be made, determining those agreed by Colombia in its DTT´s network. In the second part, the main L.O.B.s proposed in international conventions will be revised considering the different possible wordings and corresponding interpretations in order to make an appropriate analysis of the clauses included by Colombian DTTs on limitation of benefits. However, the limited detailed study of L.O.B. provisions around the world will lead us to rely and find guidance on Professor Félix Vega Borrego´s work from Spain, for the specific understanding of said clauses.

Content table

List of Abbreviations

MLC: Multilateral Convention
L.O.B.: Limitation on benefits clause
DTT: Double tax treaty
OECD:
U.S.: United States
B.O.: Beneficial Owner
UAE: United Arab Emirates
BEPS: Base erosion and profit shifting
C.S.: Contracting state
STR: Special Tax Regime
EU: European Union
CFC: Controlled Foreign Companies

I. The *Treaty shopping* phenomenon and the anti-avoidance mechanisms

In the context of international taxation, the regulation is no longer sufficient for audit purposes. One of the biggest challenges is the *Treaty shopping phenomenon,* consistent in the capture or avoidance of tax regimes by taxpayers through distortions in the determination of treaty subjects. Therefore, tax administrations around the world have taken measures for the adequate qualification of transactions and the corresponding application of law. This chapter will explain how the Double tax treaties (hereinafter DTTs) subjective scope is determined, the concept of Treaty Shopping, why there is a problem, what measures have been taken by different jurisdictions and which of them were adopted in Colombia.

A. The subjective scope of tax treaties

To determine when a DTT should be applied, two scopes have to be taken into consideration. The objective or substantive, relative to the taxes involved, and the subjective or personal scope, which allows to identify the individuals or companies that can benefit from the relief provided by DTTs.

The subjective scope is determined by Article 1 of DTTs following the Organization for Economic Co-operation and Development model convention (hereinafter OCED MC) which demands the persons involved to be residents of the contracting states, or in other terms (if) "*worldwide tax liability exists in at least one of the two states*". Persons for these purposes are defined in Article 3 of the OECD MC as any individual, company or any other body of persons, excluding P.E.s. (OECD, 2014) (Lang, 2013).

Residence on its turn, its determined in Article 4 of the same model convention according with domestic law, following criteria as domicile, place of management, residence or any other of similar nature. However, situations of double residence can occur, and the convention foresees it, giving relief to the taxpayer in the terms in which the contracting states determine by mutual agreement. (OECD, 2014)

Even though this might seem simple, the economic reality has exceeded the terms in which international tax law was formulated in the first place, and the flexibilization of business value chains have given a power of choice never seen before. (Vega Borrego, 2017) Therefore, taxpayers have taken actions trying to capture the most favorable tax regimes and to exclude themselves from the most severe ones, having in consideration not only domestic but international rules, and specially DTTs reliefs. (Pistone&others, 2010)

The mentioned tax planning is object of qualification daily, either if its considered to be legitimate or within the terms and purposes in which treaties where formulated, or if its catalogued as outside of the contracting states aim, an improper use of tax treaties. (HIJ Panaji, 2007)

B. The concept of *Treaty shopping*

Treaty Shopping gets involved as an undesired setting of conditions, following which, taxpayers have made its way into normative systems according to its needs. Generally, *Treaty shopping* issue is not directly addressed as it comprehends various situations that can be object of very dissimilar qualifications.

This phenomenon "*expands materially the personal scope of the double tax treaties"* (Vega Borrego, 2017) and is commonly explained through the history of the term, according to which, the expression was used for the first time in the United States to express that litigants tried to "shop" the forum or "borrow" tax jurisdictions through the constitution of a company in a country with a most favorable tax regime (usually because of the existence of a DTT or its terms). (HIJ Panaji, 2007) (Pistone&others, 2010)

Different definitions have been drawn since the appearance of the concept, but all of them converge in two necessary elements: the lack of an initial legal structure to access the treaty and the search for a conduit company that allows it. (Morales-Arias, 2010) A good example is the written by Stef van Weeghel that explains it as "*a situation in which a person who is not entitled to the treaty benefits uses – in the widest meaning of the word- an individual or a company to obtain the treaty benefits not directly available".* (van Wheeghel, 1998)

In consequence, determining the scope of what is called *Treaty Shopping* might not be an easy task, taking in consideration that the contours of countries jurisdiction may not always be completely determined, less would it be the labor of stablishing the scenarios where the taxpayers conduct will consist in capturing or excluding a domestic regime.

C. The problem of *Treaty shopping*

Treaty shopping is commonly named only in order to explain the measures to address or fight against it. At least that is the situation in the OECD documents and scholar´s explanations. Since any subject in a situation that can be qualified as *Treaty shopping*, as explained above, is taking advantage of regulations, and in consequence, benefits that *prima facie* wouldn´t be entitled to. (OECD, 1986)

The disparity between the value of the activity developed by the subject in such situation and the benefits obtained by him from the corresponding government, generates unkind regards that might be consider natural, taking in consideration the intricate relationship that taxes and public policies have and their impact on justice and quality of life.

However, the discussion of whether aggressive tax planning should be rejected remains, considering in any case that those structures are assembled according to law. It is why, the light of legality might cover these conducts as some defend, but the debate of morality takes its place and the reference to abuse of law seems as a commonplace.

The question, as some scholars have pointed out, is if *Treaty shopping constitutes* itself an *improper use* of tax treaties, having in mind the wide universe of scenarios described with such expression. Thus, this phenomenon can be fought against as long as it is found contrary to *bona fide,* and in consequence, when that is the result after a subjective analysis. (HIJ Panaji, 2007)

In the end, *Treaty shopping* seems to be questioned as the concept stands as a threat to principles of international tax law and to the purposes by which DTTs are signed in the first place. States tax their resident´s worldwide income and all income and gains arising in their jurisdiction as part of the sovereignty conferred by the people´s votes, at least in democracies. (Graetz, 2003)

Yet, the main issue of international taxation is the distribution of countries' rights to tax. (Gupta, 2015) The reason behind it relies on the search for worldwide economic efficiency that accompanies tax policies around the globe, which makes "*indifferent both about whose well-being is increased and which nation´s treasury collects the income taxes that are assessed".* (Graetz, 2003)

The terms in which countries have gave up some of its sovereign power to tax in order to promote international commerce and development can be mainly found in the principles of tax law. Arm´s length and neutrality principle are very good examples of this. Since it is considered taxes shouldn´t interfere with economic decisions, is essential for any country to warrantee a competent environment with conditions that constitute a market where taxes do not influence a taxpayer decision to invest in one country or another and where all taxpayers will be treated equally disregarding their nationality. (Gupta, 2015)

Keeping coherence with other dispositions as the non-crimination principle and most favored nation clauses, which are also deeply connected with other goals as avoiding the tax obstacles for international commerce and ensuring respect for taxpayer's rights and legal certainty. (Falcon&Tella, 2010) Therefore, the abuse in this specific context consists on making beneficiary of a treaty an individual or company in a third country that otherwise wouldn't be subject of the DTT. (Yoshimura, 2013)

D. Anti-avoidance mechanisms

With that said, it´s not rare that countries have tried to assess this issue. And many approaches have been found for those purposes. Some of them where measures taken directly, and in cases, unilaterally by states, and others are part of what is called "*the minimum standard*" settled by the OECD after the final reports on action 6 of the Base Erosion and Profit Shifting (hereinafter, BEPS) project, which aimed at avoiding an improper use of tax treaties consisting in three measures:

A. An express statement of states intention of avoiding the creation of opportunities for non-taxation or reduced taxation as a result of evasion or avoiding conducts of taxpayers, including *treaty shopping.*
B. Inclusion of Limitation on benefits clause
C. Inclusion of a Principal purpose test in order to cover other *treaty shopping* scenarios not covered by the LOB. (OECD, 2014)

Taking into account the common purpose, considerations regarding one of the mechanisms are possibly and very probably applicable to the others in given situations.

1. Definition of residence:

   Considering residents are the beneficiaries of DTTs, countries have tried to narrow DTTs personal scopes through modifying their domestic definition of who can be considered resident as a first step. This, considering interpretation of treaty terms must be done according to domestic law following art. 3.2. (OECD, 2014).

   Elaborate discussions of whether residence or source state domestic law must be applied have taken place – starting from the distinction between monist an dualist systems-, but the debate appears to be solved with Avery Jones´ studies on possible conflicts between domestic and treaty provisions, where he concludes source state law must be preferred since it is the first one to apply the treaty (Avery Jones, 2006). Certainly, other questions will take place as to whether source country must apply the treaty in accordance with source state conduct and the possible double taxation situations deriving from a negative answer (Morales-Arias, 2010).

A good example of conditions set by states in order to delimitate a narrower universe of residents is the 183-day threshold determined by countries like Australia, USA, China, Colombia and others, which, following OECD recommendations determined this period of time as minimum permanence criteria for the state to consider there is a sufficient connection with the individual.

2. Beneficial Owner

Beneficial Owner (hereinafter, B.O.) is a concept that has become of high relevance for international tax law, appearing for the first time in mid-1960s UK treaties and in 1977 OECD MC. Being traditionally included in the wording of articles 10, 11 and 12, without a proper meaning inside DTTs.

Regardless, OECD commentaries on article 10 and scholarship have fulfilled the term of a special connotation, considered implicit in any DTT in order to explain the terms "*paid… to a resident*", or in other words, to ensure only residents, persons with a real link with the state, are beneficiaries of the conventions. (Baker P. , 2012) (Jain, 2013) (Pijl, 2003)

Differentiating beneficial ownership of the recipient of the payment -without actually benefiting from it and with the obligation of transferring it to a third party[1]-, and excluding any company or individual interposed between the payer and the beneficiary (OECD, 2014). That is, "*counter treaty shopping by channeling of the relevant income through a resident of a state with a suitably attractive treaty provision"*[2] (Baker P. , 2007).

However, identifying the meaning of B.O. hasn´t passed without discussion, three main positions try to explain it, the first, as a specific legal notion of common law taken as an international notion in which "*the beneficial owner is the person whose ownership attributes outweigh those of any other person"* and rules on this regard imply an investigation on ownership attributes itself. (VCLT, 1969) The second, more aligned with civil law systems, considers B.O.s are not agents, nominees or other subjects acting as such, as for example conduit companies would (OECD, 1986). Finally, the third identifies the B.O. if he would be subject to tax in any event. (Oliver&VanWeeghel&others, 2001)

3. Limitation on Benefits clause:

This instrument born in United States treaties demands for a qualified subject in order to grant treaty benefits for any transaction. LOBs are applied

[1] See also Re v. SA (Swiss Federal Comission of Appeal in Tax Matters 2001) and Maxwell, S. &. (2011). Indofood international finance Ltd v JP Morgan Chase Bank NA London Branch.
[2] On a more radical posture, demanding economic benefit for the intermediary to exist in order of considering it the B.O., Danish interpretations (Bundgaard&Winther-Sorensen, 2008)

to subjects other than individuals -since individuals can´t move directly it´s residence so easily- that have a business purpose or a sufficient nexus to the state of residence. With this objective, LOBs require taxpayers to overcome legal tests for having access to treaty reliefs on double taxation, usually granted at source. Withal if the taxpayer does not comply with the requirements to be considered a "*qualified resident"* LOBs consider a saving clause through which, benefits can still be provided if an additional test is fulfilled. These concepts will be reviewed in more detail on Chapter II. (Vega Borrego, 2017)

4. Principal Purpose Test:

   The principal purpose test (hereinafter, PPT) is a mechanism that operates at a treaty level and intents to exclude any transaction or operation developed guided by taxing purposes. Therefore, this mechanism looks for economic substance as not only one of the reasons for the transaction to take place, but as the principal. Otherwise, benefits should not be granted unless the granting of treaty benefits would be in accordance with the object and purpose of the convention. (Ranz, 2017) (OECD, 2015)

   The inclusion of a PPT rule in the OECD MC is one of the measures suggested by action 6 in order to determine the applicability of the convention to the concrete taxpayer situation. And more deeply, it gives coherence to DTTs system of law and guarantees equality.

However, it represents significant difficulties regarding its subjective character and the uncertainty as to the reach of its dispositions, taking in consideration the inexistence of objective referents to establish or prove the taxpayer intentions and which is exactly the object and purpose of DTTs. Even though, specific preparatory documents may be at hand and the context of existence of any DTT explained above can be a common place, this, following Vienna Convention on Law of Treaties rules of interpretation. (VCLT, 1969)

5. General and Specific Anti-Avoidance Rules:

General anti-avoidance rules (hereinafter, GAARs) and Special anti-avoidance rules (hereinafter, SAARs) are commonly domestic law mechanisms that look for determining the real economic transaction developed in the concrete situation, allowing tax administrations to re-characterize it and give it the corresponding taxing consequences to that qualification notwithstanding the formal appearance given by the parties. Nonetheless, general clauses (GAARs) act as subsidiary instruments of an open nature being able to apply in a wide sphere of situations, while SAARs have an independent applicability in order to attack specific conditions and therefore specific avoiding structures.

The domestic origin of GAARs and SAARs is not an obstacle for its application in situations covered by a DTT, normally justified by an extensive interpretation of Art. 2.3. of the OECD MC as long as it does not oppose to the treaty´s object and purpose following VCLT guidelines. Even when this explanation is not accepted, a long-time explanation has been drawn, the *factual approach* considers this type of rules have a previous domestic level application by determining the facts that constitute the factual situation to which the DTT will be applied and therefore not affecting the convention hierarchy. (Pistone&others, 2010) (Morales-Arias, 2010)

The use of these instruments, as very clearly has been stated by OECD doctrine and scholarship is not exclusive among anti-abusive instruments including anti-avoidance rules. Meaning, GAARs, SAARs and the above-mentioned mechanisms, as other that may exist, can be applied to the same factual situation as long as the terms of each instrument allow it. As Blum & Pinetz explain "*more specific anti-avoidance rules should not exclude the application of the general anti-avoidance rule*". (Blum & Pinetz, 2016) (OECD, 2014).

E. The anti-avoidance mechanisms in Colombian tax treaties

In accordance with Colombian´s chancellery and press reports at the present time Colombia have signed 13 DTTs, 9 of which are already in force, and another 5 are in negotiations[3] (Ministerio de relaciones exteriores, 2018;

[3] Nonetheless, according to Colombia´s chancellery, Colombia have signed treaties to eliminate double taxation since 1961 but only regarding specific areas, usually for air and maritime transport, not constituting proper DTTs.

Portafolio, 2018) (Portafolio, 2018) (Embajada de Colombia en Bélgica, 2016). The fastly increasing country´s receptiveness to this kind of international commitments is evident. However, the derived implications in the national tax system might not seem so clear bearing in mind the weight of the international tax doctrine and the outdated national legislation, or the lack of scholar and judicial development. Although, most Colombian DTTs do include recent anti-avoidance mechanisms, as follows:

Date	**Country**	**Actual status**	**Preamble**	**PPT**	**B.O.**	**L.O.B**
26/01/18	Italy	Signed	(expressly mentions treaty shopping)	x (Art. 29)	x (Arts. 10, 11, 12)	Not included
	USA	Negotiations				
31/07/2006, Law 1082	Spain	In force since 23/10/2008	Not in the terms of action 6, only intends to avoid "double taxation and prevent tax-evasion"	Not included	x (Arts. 10, 11, 12)	Not included
23/12/2008, Law 1261	Chile	In force since 22/12/2009	Not in the terms of action 6, only intends to avoid "double taxation and prevent tax-evasion"	x (Art. 27)	x (Arts. 10, 11, 12)	x (Art. 27)
31/07/2009, Law 1344 --> Renegotiated in 2012	Switzerland	In force since 01/01/2012	Not included	x (Art. 21) with objective criterias to apply it	x (Arts. 10, 11, 12)	Not included
2011, Law 1459	Canada	In force since 30/06/2011	Not in the terms of action 6, only intends to avoid "double taxation and	x (Art. 26) Only for articles 10, 11 and 12	x (Arts. 10, 11, 12)	Not included

			prevent tax-evasion"			
25/06/15	France	Signed	x (expressly mentions treaty shopping)	x (Art. 26)	x (Arts. 10, 11, 12) and in Art. 26 for all the treaty	Not included
02/08/2012, Law 1568	Mexico	In force since 11/07/2013	Not in the terms of action 6, only intends to avoid "double taxation and prevent tax-evasion"	x (Art. 26) Included within the L.O.B.	x (Arts. 10, 11, 12)	x (Art. 26)
17/12/2013, Law 1692	Portugal	In force since 30/01/2015	Not in the terms of action 6, only intends to avoid "double taxation and prevent tax-evasion"	x (Art. 26)	x (Arts. 10, 11, 12) and in Art. 26 for all the treaty	Not included
2/11/16	UK	Signed	x (expressly mentions treaty shopping)	Not included	x (Arts. 10, 11, 12)	Not included
	Netherlands	Negotiations				
	Belgium	Negotiations				
17/12/2013, Law 1690	Czech republic	In force since 06/05/2015	Not in the terms of action 6, only intends to avoid "double taxation and prevent tax-evasion"	x (Art. 25) As "the purpose", not "one of" or the "principal" purpose.	x (Arts. 10, 11, 12)	Not included
	Israel	Negotiations				

16/07/2013, Law 1667	South Korea	In force since 03/07/2014	Not in the terms of action 6, only intends to avoid "double taxation and prevent tax-evasion"	x (Art. 26) Included within an anti-abuse provision that denies benefits also in situations of control	x (Arts. 10, 11, 12)	Not included
12/11/17	United Arab Emirates	Signed	x (expressly mentions treaty shopping)	x (Art. 22) Included within the L.O.B.	x (Arts. 10, 11, 12)	x (Art. 22)
2017	Japan	Negotiations				
2013, Law 1668	India	In force since 07/07/2014	Not in the terms of action 6, only intends to avoid "double taxation and prevent tax-evasion"	x (Art. 28) It has to be "the" principal purpose and is equivalent to good faith	x (Arts. 10, 11, 12)	Not included

Source: Own preparation based on the information provided by Colombia´s chancellery web page.

As can be observed, many of Colombian DTTs already include an anti-avoidance mechanism, the B.O. expression can be found in the wording of all of them, the PPT is commonly introduced and some, as United Arab Emirates (UAE) and Czech Republic DTTs include an express authorization to apply domestic provisions against elusion or avoidance in situations conventionally covered.

This would be the actual panorama, if it was not because of the results on BEPS Action 15, which became a Multilateral Instrument (hereinafter, MLI) signed and ratified by states in order to modify automatically the previously signed DTTs among them of their choice (OECD, 2016). The MLI implies the introduction of the measures suggested by some of BEPS project actions, and for the purposes of this work, of the L.O.B. clause in Colombia´s covered DTTs -Art. 7 of the MLI-. Entailing a modification of most of them, noting only three of them (UAE, Mexico and Chile) have agreed on it. In accordance with the OECD Matching database, Colombia´s DTTs that would be covered by the MLI, in conformity with both corresponding countries´ statements, are:

Country	Actual status	Simplified L.O.B. apply
Spain	In force since 23/10/2008	No
Chile	In force since 22/12/2009	Yes
Canada	In force since 30/06/2011	No
France	Signed	No
Mexico	In force since 11/07/2013	No
Portugal	In force since 30/01/2015	No
Czech republic	In force since 06/05/2015	No
South Korea	In force since 03/07/2014	No
India	In force since 07/07/2014	Yes

Source: Own preparation based on the information provided by OECD´s match database.

As can be seen, even within covered DTTs where Art. 7 MLI is applied, L.O.B. provisions are not very popular between states. Giving as a result for Colombian DTTs, being applicable only in such treaties with UAE and Mexico -in the terms of the treaty-, and with Chile and India in the wording of the MLI.

II. The given answer: The Limitation on Benefits clause (L.O.B. clause)

So far, the situation faced by tax administrations around the world seems to be clear in general terms - at least for not getting tangled between the various existing treaty shopping modalities- and in response many measures have been suggested and directly tried out by states. L.O.B. clauses appear in the picture among the multiple options, but most importantly, become relevant as they are directly designed for addressing treaty shopping issues and are part of the minimum standard provided by OECD.

Therefore, in this chapter the attention will be focused in understanding where they come from, to get into its logic; what are this kind of clauses in order to comprehend its nature, and, how do they work in the MLC according with its final wording, considering they can become automatically applicable in given scenarios. Finally, the L.O.B.s included in Colombian DTTs will be analyzed according with the previous considerations in order to understand how they should be interpreted and applied.

A. The MLC L.O.B. precedents

L.O.B. clauses imply not a formal but a substantial modification of treaties´ subjective scope, which means that after any subject fulfills article 1 requirement and is considered resident following domestic law, additional conditions will have to be met for treaty benefits to be granted.

The settlement of L.O.B. clauses, and its content, determine which conditions will be demanded from taxpayers. As a general rule, L.O.B.

clauses implement tests which, if approved, will grant access to treaties' application, and subjects who manage to pass those tests are considered "qualified residents". However, subsidiary tests may be settled for taxpayers to have limited treaty access.

L.O.B. clauses appeared for the first time, as such, in 1996 U.S. DTT Model[4], and since then, its inclusion by the U.S. have not only changed the way in which states interact and taxpayers involve in business, but also have influenced the treaties negotiated by European countries and directly the OECD MC. First, through the mention in Article 1 commentaries of the possibility of including these clauses, and very recently, by conforming part of the BEPS Action 6 minimum standard, and of the MLI with the L.O.B. simplified version. (Vega Borrego, 2017)

The U.S. have a new version of the Model DTT every ten years, and through them is possible to understand better the changes developed in L.O.B. clauses. In 1996, the first L.O.B.s included four main clauses to grant treaty access -with a previous discount of the subjects who automatically were classified as qualified residents- which were: stock-exchange clause, ownership and base erosion clause, activity clause and good faith (bona fide) clause. 2006 and 2016 U.S. DTT MC maintain these structures with more

[4] 1986 OECD Report on conduit companies also proposed some measures against the use of these kind of vehicles that were then included in 1992 commentaries to article 1 of the OECD MC, and which are substantially the same of the U.S. 1996 DTT MC. However, this last model was the first to introduce a complete set a of L.O.B. clauses and therefore it is going to be used as baseline for this work purposes.

complex wordings and some additional dispositions as will be reviewed in this chapter.

B. Functioning of the LOB clauses:

To understand better how the L.O.B.s and the corresponding changes have grown into international tax law, each L.O.B. clause will be analyzed through a comparative between the U.S. models' different versions and the OECD Action 6 and MLC wording, as reflected in the following table (the X represents the presence of the clause in the corresponding instrument):

<table>
<tr><th rowspan="2"></th><th rowspan="2"></th><th rowspan="2"></th><th colspan="3">U.S. Model</th><th rowspan="2">OECD Action 6</th><th rowspan="2">MLC Simplified version</th></tr>
<tr><th>1996</th><th>2006</th><th>2016</th></tr>
<tr><td rowspan="6">Qualified Residents (Full treaty access)</td><td rowspan="4">Automatic Qualified residents</td><td>Individuals</td><td>X</td><td>X</td><td>X</td><td>X</td><td>X</td></tr>
<tr><td>Public authorities and subdivisions</td><td>X</td><td>X</td><td>X</td><td>X</td><td>X</td></tr>
<tr><td>Tax-exempt organizations</td><td>X</td><td>X</td><td>X</td><td>X</td><td>X</td></tr>
<tr><td>Pension Funds</td><td>X</td><td>X</td><td>X</td><td>X</td><td>X</td></tr>
<tr><td></td><td>Stock-exchange clause</td><td>X</td><td>X</td><td>X</td><td>X</td><td>X</td></tr>
<tr><td></td><td>Ownership and base-erosion clause</td><td>X</td><td>X</td><td>X</td><td>X</td><td>X</td></tr>
<tr><td>Non-Qualified residents</td><td></td><td>Activity Clause</td><td>X</td><td>X</td><td>X</td><td>X</td><td>X</td></tr>
</table>

(limited treaty access)		**Headquarters Company clause**	-	-	X	-	-
		Derivative benefits clause	-	-	X	X	-
	Exclusion clauses	**Permanent establishment clause**	-	-	X	X	X
		Bona fide clause	X	X	X	X	X

Source: Own preparation based on the clauses provided by U.S. MC, BEPS Action 6 and MLC.

1. **Qualified residents:**

   As first step, residents who face the L.O.B. filter are divided into those who are not considered of high risk of developing a treaty shopping structure and those who are, therefore some subjects are deemed as automatic qualified residents (Vega Borrego, 2017). Withal, it becomes noticeable that the definitions of the terms in which provisions express who are going to enjoy said quality turn into tests themselves.

All U.S. Models, BEPS Action 6 and the MLC determine as **automatic qualified residents:**

a. **Individuals:**

	U.S. Model			**OECD Action 6**	**MLC Simplified version**
	1996	2006	2016		
Individuals	X	X	X	X	X

Source: Own preparation based on the clauses provided by U.S. MC, BEPS Action 6 and MLC.

As general rule, and following Art. 4 definition of the beneficiaries of the treaty -as reviewed before-, residents of either contracting states will be entitled to treaty access. For companies, additional requirements will have to be met in order to such entitlement to be sustained.

However, individuals are not required to comply with any other conditions since the risk of treaty shopping development through an individual is substantially less, considering for example that its residence shifting may respond to other than business criteria and there is no doubt on the substantial purposes of its existence. f.ex. there are no shell individuals. (OECD, 2015) (OECD, 2014)

Nevertheless, U.S. Models article 4(1) consider residents all U.S. citizens even without any factual nexus, increasing double residence cases and triangular situations, because residence determinations with disregard for reality generate a mismatch for tax purposes between the facts and the assumptions made by law. Yet, there is one exception, in U.S.- Spain DTT for U.S. citizens to be considered residents, a substantial presence (of over 31 days) was demanded, also in case there was a residence conflict with a third state it was necessary to be resolved in U.S. favor. (International revenue service, 1996) (Internal Revenue Service, 2016) (Internal Revenue Service, 2006) (Vega Borrego, 2017)

Another special situation would be the Collective Investment Vehicles (hereinafter, CIVs) which, after the analysis that some states wish to make over the treaty shopping risk of the different class of CIVs, are considered of low risk, and in consequence, states determine a provision that expressly entitles those entities to treaty benefits under article 1. In such cases, the CIVs will be treated as individuals, therefore, will also be qualified residents under this provision (OECD, 2015).

b. Governmental entities and other public authorities:

Public authorities are also directly classified as qualified residents since it is not to be expected that states itself are going to engage in treaty shopping. U.S. Models and OECD Action 6 and MLC give them this qualification through different wordings as will be seen below:

U.S. Model			**OECD Action 6**	**MLC Simplified version**
1996	2006	2016		

Public authorities and subdivisions	Qualified governmental entity	Contracting state, political subdivision or local authority thereof	Contracting state, political subdivision or local authority thereof <u>and any agency or instrumentality</u>	A contracting state, or a political subdivision or local authority thereof, the central bank thereof or a person that is wholly owned, directly or indirectly, by them	Contracting state, political subdivision or local authority thereof <u>and any agency or instrumentality</u>

Source: Own preparation based on the clauses provided by U.S. MC, BEPS Action 6 and MLC.

1996 U.S. Model determines "*qualified governmental entities"* will be deemed as automatic qualified residents. Is not substantially different from the other versions since this term is defined as either:

a. A governing body of a C.S. or political subdivision or local authority
b. A person owned by any of the persons in literal a. if:
    i. Is organized under the C.S. law
    ii. Its earnings are for its own (no privates)
    iii. Its assets vest in any of the persons in literal a. upon dissolution.
c. A pension fund or trust of persons in literals a. or b. which complies with conditions of article 19 of Model Conventions

Literals b. and c. persons are required to not carry on commercial activities as a condition to being considered public authorities. This makes sense since the model is demanding these persons not to act as privates, otherwise their interests and conducts may change. (International revenue service, 1996) (Vega Borrego, 2017)

2006 version does not use the same terms, but it does maintain access for persons in the mentioned literal a. And 2016 version, contains a very similar definition, keeping the wording of 2006 and adding "*any agency or instrumentality of any such contracting state, political subdivision or local authority"* which could be identified as very similar to literal b. in 1996 version, but for the 2016 model there is no definition provided. (Internal Revenue Service, 2006) (Internal Revenue Service, 2016) (Vega Borrego, 2017). Action 6 also includes situations that are included in 1996 literals a. and b., and the MLC follows 2016 U.S. Model wording. (OECD, 2014) (OECD, 2016)

In any case, it can be very difficult to determine the subjects who fit into these wordings, therefore some states have mentioned directly in the treaty the respective authorities in each case- as U.S.-Italy DTT- , but as Vega recommends, another option could be the mutual agreement procedure (M.A.P.) between states (Vega Borrego, 2017).

c. Non-profit entities (exempt entities):

This kind of organizations are usually tax-exempt or beneficiaries of special tax regimes (hereinafter, STRs) because of their altruistic purposes and the social benefits arising from them. It makes sense that they are considered automatically qualified residents under all versions of L.O.B.s:

	U.S. Model			**OECD Action 6**	**MLI Simplified version**
	1996	2006	2016		
Tax-exempt organizations	Established and maintained exclusively for a religious, charitable, educational, scientific or other similar purpose, that have been organized under the laws of a contracting state and that are generally exempt from tax on the income obtained			Charitable organizations (Only in the detailed version)	Non-profit organisation of a type that is agreed to by the Contracting Jurisdictions through an exchange of diplomatic notes

Source: Own preparation based on the clauses provided by U.S. MC, BEPS Action 6 and MLC.

As observed, all U.S. Models present the same wording for these entities, naturally their purpose it's a determinant criterion accompanied by the characteristic of usually being subjects of STRs -which normally implies administrative controls-. Also, U.S. regime demands for these factors to be complied to at the moment of being applied the treaty. (Internal Revenue Service, 2006) (Internal Revenue Service, 2016) (International revenue service, 1996)

Some U.S. treaties add the condition of more than 50% of the beneficiaries of the organisations to be qualified residents, however, this requirement is very similar to a base erosion test and can be considered anti-technique to include it in the definition of these subjects. (Vega Borrego, 2017)

MLC on its turn, leaves the characterization of non-profit organisations considered qualified residents to contracting states through the exchange of diplomatic notes on each case, leaving an open space for non-uniform answers at international levels. (OECD, 2016) And finally, the action 6 simplified version does not include such provision, but the detailed version foresees a wording to be completed by each state with a list of the "*non-profit organisations found in each contracting state*". (OECD, 2015)

d. Pension funds:

Pension funds are the last kind of subjects usually considered automatic qualified residents. In many occasions are considered in the same provisions as charitable organisations since these are also generally tax-exempt. Given this condition, usually states seek to tax funds´ shareholders since double taxation is prevented. However, in addition to be considered a pension fund, provisions also demand for a minimum of beneficiaries of the fund who are residents or somehow give it connection with the state in which it resides:

U.S. Model	OECD Action 6	MLC Simplified

	1996	2006	2016		**version**
Pension Funds	Generally exempt entities organized, under the laws of a contracting state to provide pensions or other similar benefits to employees pursuant to a plan	Any person established in a contracting state that is generally exempt and operated principally: a. to administer or provide pension or, b. to earn income for the benefit of a.	Any person established in a contracting state that is generally exempt and operated exclusively or almost exclusively funds or funds of funds	Any person established in a contracting state that is generally exempt and operated exclusively or almost exclusively funds or funds of funds	Is a recognized pension fund or was constituted and is operated to invest funds for the benefits of the pension fund
	>50% of the beneficiaries, members or participants are individuals residents in a contracting state	>50% of the beneficiaries, members or participants are individuals residents in a contracting state	>50% of the beneficiaries, members or participants are individuals residents in a contracting state	> 50% of the beneficiaries, members or participants are individuals residents of a contracting state or of a 3rd state if: source state signed a DTT with the 3rd state in which it would be entitled or, b. regarding dividends and interest source state provides a tax rate at least as low as the applicable rate in the DTT.	> 50% of the beneficial interest is owned by residents of a C.S. or > certain % of the beneficial interest of those persons is owned by a resident of a contracting state if: source state signed a DTT with the 3rd state in which it would be entitled or, b. regarding dividends and interest source state provides a tax rate at least as low as the applicable rate in the DTT.

Source: Own preparation based on the clauses provided by U.S. MC, BEPS Action 6 and MLC.

Pensions funds are described in all versions as generally exempt, in 1996 the scope of the concept was narrower as it referred to as entities that "*provide pensions or other similar benefits to employees"*, which highly limited the modalities and subjects who could enjoy a pension for treaty terms. Also, the threshold of more than 50% beneficiaries who are individuals and residents in a C.S. implied for Multinational Enterprises (hereinafter, MNEs) the need to create a fund in each country they functioned. (International revenue service, 1996)

2006 Model considered new scenarios as entities dedicated to “*earn income*” for the benefits of funds (funds of funds) and put special emphasis in shareholders through the characterization of entities with activities like “*operate*” and “*administer*”, and not in the provision of funds itself, and did not mentioned the condition of beneficiaries to be “*employees pursuant to a plan*”. 2016 Model kept 2006 wording in general but added the requirement of being operated “*exclusively or almost exclusively”* which have been observed as an attempt to limit the activities developed by such entities and maintained the possibility of funds that own other funds. (Internal Revenue Service, 2006)

Action 6 followed 2016 redaction, but in reference to the beneficiary’s threshold, allowed third country residents as long as:

a. There is a DTT between source state and the third country and, under its provisions the entity is entitled to treaty benefits.
b. Regarding dividends and interest, the tax rate at source is at least as low as the applicable in the DTT between source state and the country in which the fund resides. Which is very similar to a special derivative benefits clause. (Vega Borrego, 2017) (OECD, 2015)

Finally, MLC is not as descriptive and only requires it to be a recognized pension fund, who complies with the beneficiary´s threshold or a percentage determined by states for owners of the owners of the beneficial interest, and not the number of beneficiaries, if the a. and b. action 6 conditions are met, or, as a second possibility, to be funds of funds as long as substantially all income derives from investments for benefiting the pension fund. (OECD, 2016)

Nevertheless, other clauses can give the qualified resident status. As explained before, four clauses usually are agreed by states: Stock-exchange clause, Ownership and base-erosion clause, Activity clause and the Bona fide clause. But, only by overcoming the test of the first two of them a subject will be considered "qualified resident" and will enjoy full treaty benefits -for all the income obtained from the state in question-. (Vega Borrego, 2017)

e. Stock-exchange clause:

Formally, this is the first L.O.B. clause reviewed in this work so far, as the other categories seen yet, are only definitions of subjects who are considered relieved from taking the tests. In general terms, this clause demands for companies´ participation to be traded in stock markets in order to obtain access to full treaty benefits. However, the clause seeks for this requirement to be complied in a substantial way and many tools may be used for those purposes. The versions of this clause are:

U.S. Model	OECD Action	MLC

	1996	2006	2016	6	Simplified version
Stock-exchange clause	All shares of the class(es) that represent more than 50% of the voting power and value of the company are regularly traded on a recognized stock exchange	The principal class of its shares (and any disproportionate class of shares) is regularly traded on one or more recognized stock exchanges, and either: A. the stock exchange is located in residence contracting state or, B. the company´s primary place of management and control is in residence contracting state			The principal class of its shares is regularly traded on one or more recognised stock exchanges

Source: Own preparation based on the clauses provided by U.S. MC, BEPS Action 6 and MLC.

As underlined, in 1996 the U.S. demanded three characteristics of the trade of shares in a stock market to grant benefits from a treaty:

a. That all the shares of the class or classes that represented more than 50% of the voting power and value of the company are traded:

   In the case there is only one class of shares it will be very easy to know the percentage. But, if not, it will be necessary to identify how many classes of shares are, which one represents more than 50% of the voting power and value and then all shares from that class must be traded regularly on a recognized stock exchange.

   In other cases, this requirement can arise complex issues, for example if neither of the classes of shares represent that percentage, it have been questioned if the proportion can be reached through the aggregate of various classes of shares.

For the U.S.-Luxembourg DTT the answer has been affirmative, and some other treaties have also been very flexible. (Vega Borrego, 2017) (International revenue service, 1996)

b. That such shares were regularly traded:

This condition has not been defined by any U.S. Model, nor by the action 6 or the MLC. But, as the requirement was introduced by 1996 U.S. Model, rules of interpretation will lead us to domestic law for fulfilling these terms with meaning. U.S. branch tax legislation determines two criteria:

i. Trading frequency: shares must be traded in a minimum number of days over the usual minimum for 60 days during the tax period.
ii. Trading volume: the shares traded must correspond to the number of issued and fully paid shares of each class plus 10% of each class of shares.

Off course these elements will not be binding for treaties and countries that do not include U.S. rules in its regulation but is useful as a guidance of why the term exists.

Additionally, a problem has been pointed out in scholarship, taxpayers will only know if they complied with this requirement at the end of the taxable year. (Vega Borrego, 2017) (International revenue service, 1996)

c. That the trade was realized on a recognized stock exchange:

The main question for this requirement is what defines a stock exchange as recognized. For all U.S. Models, the answer is that the stock exchange is located in one of the contracting states, in U.S. case it would mean NASDAQ system and those registered in the U.S. securities and exchange commission, these systems usually demand serious listing requirements, broad ownership and a significant amount of trading.

On the other hand, most tax treaties have opted to directly recognize other stock exchanges and to allow competent authorities of contracting states to agreed on additional stock exchanges. Though, it is common to limit recognition of stock exchanges where shares of closely held companies are traded to those located within the state´s territory. Closely held companies are defined for:

i. Being owned in more than 50% for non-qualified residents or residents of the EU

ii. Each of those residents beneficially owns more than 5% of the shares

iii. The shareholders own the percentage of shares for more than 30 days in a taxable year. (Vega Borrego, 2017)

It is not a surprise that companies with these characteristics being traded on stock exchanges, see themselves restricted since its capital is not widely distributed and the treaty shopping risk directly increases. (OECD CIV, 2010) (Blum & Pinetz, Treaty Entitlement of Investment Funds in Light of BEPS Actions 2 and 6, 2016)

In 2006, new terms were added to the definition of the clause. First, it referred to the "*principal class*" of shares, which, as defined by 2006 and 2016 models it will substantially correspond with the definition of 1996 and the three characteristics explained above.

Besides, the scope gets wider and covers "*any disproportionate class of shares*", that means situations where the profit does not correspond with the value of the share, and the difference in charged to income obtained by the company in the other C.S. For the counting of the trading requirement, models demand these shares to be added with the principal class of shares. But, for the calculation of tax reductions in treaties before 2006 it would be as if the disproportion did not exist. (Vega Borrego, 2017)

Lastly, two alternative conditions were included by 2006 and 2016 models, one of which must be met in addition to the definition already reviewed:

A) The Stock exchange have to be located in the C.S. were the company is resident.
B) The company´s primary place of management and control is in the C.S. where the company is resident.

The first condition seems to be pretty clear since it corresponds to the general most limited rule, but the second, gives the option for companies whose shares are traded in recognized stock exchanges located in third countries to access the treaty if its "*primary place of management and control"* is in its residence country.

Still, the concept is differentiated from the Place of effective management (POEM) where the board of directors meet to make key decisions, and its defined as the place where "*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"* and clarifies it includes subsidiaries of any kind and the preparatory day-to-day staff activities. Normally headquarters location is a big indicator to establish de primary place of management and control, and its necessary to take into account any special voting arrangements to understand the decision-making process within the company. (Vega Borrego, 2017) (Internal Revenue Service, 2016) (Internal Revenue Service, 2006)

Finally, all U.S. Models include the possibility of subsidiaries to access treaty benefits if their parent companies do comply with the stock exchange clause, it is known as <u>Indirect Access:</u>

In 1996, the concept of control was viewed as the possibility of influencing other companies' decisions, thus, for indirect access was necessary that entitled companies owned directly or indirectly more than 50% of the shares of the subsidiary, being all intermediate owners residents as well. Though, Vega commentary seems very adequate, if the intermediate owners are all qualified residents becomes unnecessary and burdensome to review all the ownership chain being sufficient to verify the compliance of the first company directly owning the taxpayer. (International revenue service, 1996)

For 2006, the indirect access phrasing was adjusted in accordance with the stock exchange new terminology, in consequence, the 50% threshold is over the voting power and value of the shares and of any disproportionate class of shares in the company, being directly or indirectly owned by 5 or fewer companies entitled to treaty benefits under the stock exchange clause. Although, this version was more flexible into demanding only residence from intermediate owners. But it is not explained why the subsidiary should be owned by 5 or fewer companies as the dispersion of the capital would low the risk of treaties improper use. (Internal Revenue Service, 2006)

Other U.S. treaties have adopted similar but wider definitions, in Luxembourg-U.S. DTT its only demanded to "*be controlled",* in the treaty with Switzerland the percentage is over the "*predominant interest"* not necessarily being related with the ownership of shares, and in Ireland´s DTT with the U.S. the indirect access is not only given under the stock exchange clause but also for qualified residents under the governmental entities clause.

In addition, membership of some states to international organizations have made more flexible the recognition of stock exchanges, mainly two conditions have been settled:

a. The shareholder´s state of residence should count with a comprehensive tax treaty with the source state.

b. The taxpayer must be a qualified resident under an L.O.B. in the treaty between the source state and the residence state of the shareholders:

   A commentary has arisen over this requirement since not all DTTs include L.O.B. provisions. In response, a fiction has entered into the determination of compliance with the requirement. The tax administration will consider whether it will be a qualified resident under the L.O.B. provisions if the shareholders were residents of the company´s state of resident, in other words, of the treaty between the source state and the country in which the company resides. (Vega Borrego, 2017)

Finally, 2006 model integrates two elements in this clause:

a. Intermediate owners must be:
   i. Residents of the source state or,
   ii. Qualifying intermediate owners:

      This concept was described as residents of third states who are either:

      - Residents of the same state of the company applying the test
      - Resident of a country that has a comprehensive DTT with rules addressing STRs and notional interest deductions.

This model includes new possibilities for companies to access indirectly the stock exchange clause and whose intermediate owners are neither qualified residents or residents of either contracting states, in despite of the new conditions required. Vega critizes the new provisions as they take the effective liability of taxpayers in order to grant treaty benefits. (Vega Borrego, 2017) (Internal Revenue Service, 2006)

b. Inclusion of a base erosion prong:

   This provision states:

   i. income different from dividends (which are not excluded from any of the other clauses)

   ii. paid directly or indirectly as deductible payments for taxes covered by the DTT, excluding:

      - Arm´s length payments in the ordinary course of business for services and tangible property.
      - Intra-group transactions

   iii. And paid to:

      - Persons not residents entitled to treaty benefits
      - Connected persons to the company who benefit of deductible payment STRs.
      - Company connected persons regarding interests.

   iv. must represent less than 50% of the gross income:

- of the company and,
- of the corporate group – as a whole and with each entity-. Are considered to be part of the group, entities with tax consolidation, fiscal unity or other regimes that require to share profits or losses. (Vega Borrego, 2017) (Internal Revenue Service, 2006)

f. Ownership and base erosion clause:

The ownership and base erosion clause is the second to establish a test that, if approved, grants full treaty access to taxpayers. Specifically, the manner in which is written may vary: the ownership clause can be provided by itself, also called the transparency clause, called "*the isolated approach*". But, if provided companied by a base erosion clause, as the U.S. always do, it's the "*channel approach*". The OECD contemplates both possibilities. (OECD, 2015) Now we will proceed to examine how these two complementary provisions have been foreseen in the habitual instruments:

U.S. Model			**OECD Action 6**	**MLC Simplified version**
1996	2006	2016		

<table>
<tr><td>Ownership</td><td>A minimum of 50% of each class of shares should be directly or indirectly owned by qualified residents (of the same C.S. of the taxpayer) during min. A 50% of the days in the tax period.</td><td colspan="2">The shares (or disproportionate class of shares) or beneficial interests representing at least 50% of the aggregate voting power and value are owned, directly or indirectly, by qualified residents during min. A 50% of the days in the tax period.</td><td rowspan="2">a person other than an individual, provided that persons who are residents of that Contracting State and are qualified persons own, directly or indirectly, more than 50% of the beneficial interests of the person</td><td rowspan="2">On at least half the days of a twelve-month period that includes the time when the benefit would otherwise be accorded, persons who are qualified residents of that Contracting Jurisdiction and that are entitled to benefits of the treaty own, directly or indirectly, at least 50 per cent of the shares of the person.</td></tr>
<tr><td>base-erosion clause</td><td>Less than 50% of the gross income in the taxable year is paid, directly or indirectly, to persons who are not residents of either contracting state (unless attributable to a P.E. in either C.S.) as deductible payments for tax purposes in residence states.</td><td>Less than 50% of the gross income in the taxable year is paid, directly or indirectly, to persons who are not residents of either contracting state as deductible payments of the taxes covered by the DTT in residence state (excluding arm´s length payments in the ordinary course of business for services or tangible property)</td><td>Less than 50% of the gross income (of the company and of the tested group) in the taxable year is paid, directly or indirectly, to persons who are not residents of either contracting state (unless attributable to a P.E. in either C.S.) or some qualified residents, as deductible payments of the taxes covered by the DTT in residence state (excluding arm´s length payments in the ordinary course of business for services or tangible property)</td></tr>
</table>

Source: Own preparation based on the clauses provided by U.S. MC, BEPS Action 6 and MLC.

a. Ownership test:

This test aims at ensuring that the taxpayer have a real nexus with the territory of the state by asking that half or more of the owners of the taxpayer are qualified residents of either C.S. All versions of this clause demand a minimum holding period of the 50% of the taxable period.

Habitually, these provisions are accompanied by regulation on the minimum holding period, nonetheless, when that is not the case, questions arise on the moment in which compliance will be confirmed.

Checking the requirements each time income is obtained seems to be very burdensome, therefore Vega suggests it should coincide with the final date of the taxing period in residence state, when also taxes become due, as it's the moment where taxpayers can know if were able to comply and it would facilitate the application of the provisions since treaty shopping risk will decrease. (Vega Borrego, 2017)

Another relevant issue is related to the percentage of the company that have to be owned by qualified residents. All versions referred above, demand for a minimum of 50%, but some tax treaties ask for more than 50% to be owned by qualified residents, an apparently little difference in the wording may be causing major effects into international transactions because some business structures are divided in half's by different investors who would not remain if their counterpart owned even a 1% additional as it would give them predominant voting power.

Main differences between models regard the qualified residents accepted to own the company for clause purposes and the addition of terms “disproportionate class of shares” and “beneficial interests” as also valid in 2006 and 2016 versions. 1996 version demanded qualified residents to reside in the same contracting state of the taxpayer and for indirect owners to all indirect owners to be qualified residents as well -which, as noted before would made unnecessary verifying indirect compliance since the direct owner would be a qualified resident already-.

In that matter, 2006 version only requested residence from intermediate owners, and 2016 considered they must be qualifying intermediate owners -in the terms explained before-. Additionally, 2006 version excluded entitled companies trough indirect access of the stock exchange clause, and some U.S. treaties even deny entitlement by not counting shares of qualified residents of the ownership and base erosion clause without apparent foundation. The seemly arbitrary position of the U.S. becomes stronger when looking at the practice of counting shares or beneficial interests owned by U.S. Citizens for the 50% percentage effects.

Lastly, many issues may arise of the positive or negative wording of the test as may count or not indirect participation of companies within others. A positive manner would be more flexible and provide a wider scope. (Vega Borrego, 2017) (Internal Revenue Service, 2006) (Internal Revenue Service, 2016) (International revenue service, 1996)

b. Base erosion test:

Base erosion have signified major issues for states as the BEPS project can evidence, therefore, countries around the world have searched for a ceiling of allowed indirect transfers of income to non-qualified residents upon which treaty access will be denied, taking into account that income obtained by the taxpayer transforms to an expense levied by an intermediary company on a third state -usually of non or low tax imposition- making entities able to pay minimum or no tax at all in either state (residence and source). Unless, the income is attributable to a Permanent Establishment in either C.S.

In consequence, the wording of U.S. Models requires for an amount of deductible payments (over gross income) made to determined subjects for treaty benefits to be denied. A first element to consider is the definition of gross income (i). For 1996 and 2006 this term was not defined by treaties, which led to domestic definitions not contributing to a unified criterion. (International revenue service, 1996) (Internal Revenue Service, 2006)

2016 model defines it for the first time as "*gross receipts*" -according to the residence C.S.- "*for the taxable year (included the time when the benefit would be accorded)",* excluding:

- In business for manufacture, production or sale of goods, reducing the costs of the goods sold.
- In non-financial services, reducing the direct costs for rendering such services.
- In dividend transactions, not including the portion of exempt dividends and the intra-group transactions.

Besides, some treaties have determined a rule for remedying the situation of subjects only being able to determine whether they complied with the requirements of the clause at the end of the taxable year, the rule provides to take the higher amount between the aggregate gross income of the previous taxable year and the average gross amount of the previous four years. (Internal Revenue Service, 2016) (Vega Borrego, 2017)

Secondly, beneficiaries (ii) of the clause have changed during the evolution of U.S. Models. For 1996 version beneficiaries could be either residents of a C.S. or a P.E. situated therein. 2006 version becomes more rigid and demands for them to be qualified residents, under any provision but the ownership and base erosion clause, of a C.S. and eliminates de P.E. exception, thus, payments to said entities are not eligible for benefitting from the convention. (International revenue service, 1996) (Internal Revenue Service, 2006) 2016 keeps the wording so far and also limitate which qualified residents are admissible, being rejected those who:

- Benefit from a STR regarding deductible payments.
- Benefit from notional deductions regarding interests. (Internal Revenue Service, 2016)

Thirdly, the character of deductible payments (iii) is essential in the configuration of the hypothesis foreseen by the rule. The standard dictates payments have to be deductible from the tax base according to residence state rules in order to be considered. The only variations introduced by 2006 and 2016 version have been a couple of exclusions:

- Payments made in the ordinary course of business for services or tangible property, as long as made at arm´s length (Internal Revenue Service, 2006)
- Intra-group transactions (Internal Revenue Service, 2016)

2. Non-qualified residents:

So far subjects that aimed to obtain tax treaty benefits had to be residents of a C.S. and, in the case of not being an automatic qualified resident, to take the stock exchange clause test. In case of not overcoming the mentioned test, residents will check if requirements for access under the ownership and base erosion clause were met, if the answer was negative, they will come to the following clauses which will provide benefits for an item of income in special, therefore providing them limited treaty access and implying a verification of the requirements every time income is obtained.

a. Activity Clause:

The objective of this clause is to verify the development of a business activity from which the income derives, or in other words, prevents shell companies who do not count with a real factual nexus to the territory from benefitting from DTTs.

U.S. Model	OECD	MLC Simplified

	1996	2006	2016	**Action 6**	**version**
Activity Clause	The entity must engage in a substantial active trade or business in the contracting state of residence from which the income is obtained and is directly related				

Source: Own preparation based on the clauses provided by U.S. MC, BEPS Action 6 and MLC.

Two elements are consistently required in all versions of this clause, the development of an active trade or business and the obtainment of income directly related to the mentioned activity. The OECD BEPS Action 6 followed completely 2006 U.S. MC, hence characteristics regarding that version of the model would be also applicable to the action wording. (OECD, 2015)

a. Substantial active trade or business:

   This concept is not actually defined by treaties. The only reference made by all instruments is regarding the substantial character of the activity developed as it should be determined "*based on all the facts and circumstances*".

   By the contrary, exclusions have been expressly introduced within the treaties wording. 1996 and 2006 clauses excluded "*making or managing investments*" from being an active trade or business. 1996 version provided that to be the case, except for activities of banking, insurance or securities conducted by banks, insurance companies or registered securities dealers. (International revenue service, 1996)

2006 kept that exception, with a modification of the exclusion itself to limited only to investments made for the "*resident´s own account",* this limitation from Vega´s point of view does not make sense as this kind of activities and the companies that develop them are subject of strict administrative control (Vega Borrego, 2017). (Internal Revenue Service, 2006)

Nonetheless, the consideration made in the stock exchange clause could be applied here by analogy, referred to fails in the systems and their regulations in some countries, where state controls are not as reliable as they should.

2016 version turned to directly mention the scenarios excluded, widening the activities not considered to be an active trade or business:

i. Operating as a holding company
ii. Supervision or administration of a group of companies
iii. Group financing
iv. Making or managing investments, unless carried out by banks, insurance companies or registered securities dealers within its ordinary course of business as such.

In any case, as will be seen afterwards, the headquarters company clause was created to give the entities excluded in these cases, access to the convention. (Internal Revenue Service, 2016)

U.S. Domestic law does include a definition for the concept of active trade or business: "*a unified group of activities that constitute or could constitute an independent economic enterprise, which are carried on for profit*". This definition becomes relevant not only for rely on it in U.S. DTTs interpretation, but also as it gives guidance and foundation on how the clause was structured in its origins.

A second aspect necessary to review, is by who should be carried out the active trade or business. It is not essential for none of the versions of the clause, that the trade or business is developed by the same subject as the one requesting the application of benefits (the taxpayer). (Vega Borrego, 2017)

Indirect access is contemplated in all U.S. Models. 1996 did not required the activity to be executed by the taxpayer, and some treaties included cases of indirect access in the memorandum of understanding. For 2006 version, the wording became more specific, explaining the active trade or business would include those of "*persons connected*" to the taxpayer. (International revenue service, 1996)

2006 defined connected persons as those who:

- Have 50% or more of the ownership of the other company
- Have control over the other person
- Are under the control of the same person who control the other taxpayer. (Internal Revenue Service, 2006)

For 2016 and the OECD MC, this definition is now included on article 3 of conventions. In consequence, headquarters and parent companies in general could also benefit from DTTs if one of their subsidiaries effectively engages in an active trade or business, only being necessary to prove compliance with the second requirement regarding the direct relation of the income obtained with the activity developed. (Internal Revenue Service, 2016)

<u>Substantiality test:</u>

As third element, the volume of activity in residence state is determinant in the evaluation for granting treaty benefits as it is compared with the generating income activity at source state. Some treaties ask for a direct relation between both of them, and as higher is the activity at source, the suspicions increase.

The comparison of three factors: asset values, gross income and payroll expenses in each state give as a result three corresponding ratios that can be obtained from the factors of the previous taxable year or of the three previous taxable years. The safe harbor is defined in all treaties to be over 7,5 per each ratio, and over 10 in average.

This test is applied to all cases in 1996 Model, and only for income derived from related persons in 2006 and 2016 as it is deemed to be fulfilled otherwise. (Internal Revenue Service, 2006) (Internal Revenue Service, 2016) (International revenue service, 1996)

b. Activity related income:

The relation of the income with the activity that provides the nexus between the company and the C.S. can be direct or indirect. Direct relation will be deemed in situations where the income generating activity in the other state is "*in a line of business that forms part of or is complementary*" the trade or business. (International revenue service, 1996)

The U.S. do not accept the option of being "*complementary*" and understand the relationship as the activity being part of the overall industry, implying a more difficult standard to meet as the activity and trade or business must be related to the same industry but developing conducts in different industries. (Vega Borrego, 2017)

For 1996 version it means the activity that generates income is "*in connection with*". 2006 model added the need for the trade or business to be conducted in residence state. And 2016 version replaces "in connection with" for "*emanates from*". (Internal Revenue Service, 2016) (Internal Revenue Service, 2006)

These expressions are better understood when taking into consideration the 3 forms, or levels, of integration: upstream (where residence company supplies goods for the company in source state), downward (when company in source state sells and distributes goods manufactured by company at residence state -the parent company-) and parallel (when both companies are engaged in the same trade).

Indirect relation of the income is considered to exist in situations where the income generating activity is "*incidental to*" the trade or business. The definition of said term for 1996 model and the technical explanation of 2006 model refers to activities that "*facilitate*" the trade or business in resident state. 2016 Model does not define it at all. (Vega Borrego, 2017) (International revenue service, 1996) (Internal Revenue Service, 2016) (Internal Revenue Service, 2006)

b. Headquarters company clause

This is a recent clause introduced by 2016 U.S. MC, that by its assembly can be considered a special activity clause for the reason that the granting of benefits over an item of income depend on the activities carried on by the subject. (Vega Borrego, 2017)

	U.S. Model			OECD Action 6	MLC Simplified version
	1996	2006	2016		
Headquarters Company clause	-	-	headquarters company for a multinational corporate group consisting of such company and its direct and indirect subsidiaries	-	-

Source: Own preparation based on the clauses provided by U.S. MC, BEPS Action 6 and MLC.

Following the wording of the clause, the main requirement to obtain treaty benefits over interest and dividend payments made by other companies of the same multinational corporate group is to be the headquarters company of said group. In U.S. DTTs 6 requirements have to be met to count with such qualification, for these purposes we will follow Vega´s classification into 4 groups making the corresponding commentaries regarding 2016 Model structure:

Group 1

a. Provide a substantial portion of the overall supervision and administration of the group (including financing).
b. Having and exercising independent, discretionary authority to carry out its functions (mentioned in literal a.)

Vega considers this shows how these companies must exercise primary management and control functions in residence state. In fact, 2016 MC includes as a requirement *"such company's primary place of management and control is in the Contracting State of which it is a resident"* instead of the two literals mentioned above. (Vega Borrego, 2017) (OECD, 2016)

Group 2

c. The group must consist in trade or business developing corporations residents in at least five countries (or groups of countries), and the aggregate income derived therein represents at least 10% of the group´s gross income.
d. The income derived from countries different from residence country do not represent 50% or more of the group´s gross income.
e. Maximum a 25% of the headquarter company´s gross income can be obtained from the state of source.

These three requirements with respect to location of income together would imply income derived from countries different from residence state must variate between 40 and 50 percent, taking into account at least 10% must originate in residence state -both values as part of the group´s gross income- and only up to 25% of the headquarters' gross income must derive from source state. 2016 MC contains three provisions in the same lines.

In case these percentages are not met with the amounts for the taxable year, calculation can be made with amounts of the average of the 4 previous years. (Vega Borrego, 2017) (OECD, 2016)

Group 3

f. The headquarters company is subject to the same income tax regime in residence state as activity clause subjects. (Not being subject of a STR).

Group 4

g. Income derived from source state must be obtained *"in connection with" or* is *"incidental to"* the active trade or business regarding which calculations of Group 2 requirements was done.

The last requirement in U.S. treaties make reference to both specific expressions of the activity clause while 2016 MC includes a complete base erosion test limited to interest and dividends which also excludes financial obligations with banks who are not connected persons and whose payments are not deductible. (OECD, 2016) (Vega Borrego, 2017)

c. Derivative benefits clause

The derivative benefits clause is also a special clause, but in this case, of the ownership and base erosion provision, which aims at giving an alternative relief usually regarding dividends, interests and royalties. The rationale of this rule is to compare taxation at source for each item of income with the conditions settled by the DTT with the shareholders´ residence state and with the treaty being applied. Benefits are thus conditioned to the DTT with the shareholders' residence state not laying out a less favorable regime, that is, in absence of the treaty being applied.

Off course, this kind of procedure generated all sorts of questions and inconveniences for countries applying U.S. treaties prior to the 2016 Model convention, as not all countries counted with a DTT between source state and shareholders´ residence state, shareholders may be residents of more than one country and third states may be cautious to provide information as the clause may be favoring income accumulation in intermediate states. (Vega, 2002)

In consequence, a modified clause was structured and introduced in 2016 U.S. MC, BEPS Action 6 and MLC with requirements that allowed ownership not only from qualified residents but from equivalent beneficiaries:

- Resident in a qualifying state (usually members of an international organization -solving possible conflicts with EU law)
- The third state must have a DTT with source state and comply with some additional conditions. The equivalent beneficiary should be then entitled to treaty benefits under a ownership and base erosion L.O.B. clause, or at least, similar to that.

However, equivalent beneficiaries are not eligible if they are connected persons who: benefit from a STR at residence regarding deductible payments or, benefit from interest notional deductions. In the same way, certain qualified persons are treated as equivalent beneficiaries as they do not own in aggregate more than 25% of the company. (Internal Revenue Service, 2016) (OECD, 2015) (OECD, 2016)

U.S. Model			**OECD Action 6**	**MLC Simplified version**
1996	2006	2016		

Derivative benefits clause	-	-	On at least half of the days of a twelve-month period commencing or ending on the date when the benefit otherwise would be accorded : a) at least 95 percent of the aggregate vote and value of its shares (and at least 50 percent 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 a qualifying intermediate owner ; and b) less than 50 percent of the company's gross income, (...)	A resident of a Contracting State that is not a qualified person shall nevertheless be entitled to a benefit that would otherwise be accorded by this Convention with respect to an item of income if persons that are equivalent beneficiaries own, directly or indirectly, more than 75 per cent of the beneficial interests of the resident.	A resident of a C.S. that is not a qualified person shall also be entitled to a benefit that would otherwise be accorded by the DTT with respect to an item of income if, on at least half of the days of any twelve-month period that includes the time when the benefit would otherwise be accorded, persons that are equivalent beneficiaries own, directly or indirectly, at least 75 per cent of the beneficial interests of the resident.

Source: Own preparation based on the clauses provided by U.S. MC, BEPS Action 6 and MLC.

Hence, 2016 wording as some treaties do, additionally inserted an ownership threshold -of 95% while in the OECD is 75%- and kept the ownership and base erosion test in literal b. This treaty even extends benefits to business profits, capital gains and other income category and makes possible for not qualified residents to be eligible if they are liable at residence with respect to foreign source income only on a remittance or similar or, if their tax at residence is determined on a fixed-fee, forfait, or similar basis. (OECD, 2016) (OECD, 2015) (Internal Revenue Service, 2016)

d. Permanent establishment clause:

The Permanent Establishment is an exclusion clause and therefore is different from the rest, because it does not grant, but on the contrary it denies, treaty access. However, it is very restricted given all the conditions that must concur.

First, it is necessary for the application of the clause that the state of residence applies the exemption method since it takes this condition as existing to not incur into double taxation issues. This requirement makes not possible to apply the clause for residents of the U.S. because that country does not provide for such method. (Vega Borrego, 2017)

OECD commentaries on article 24 para. 71 make evident this condition when determining benefits will apply only over P.E. income if its "*taxed normally"* at source state. Likewise, MLC convention conditions the application of the clause to income being "*effectively taxed"* at source. (OECD, 2016) (OECD, 2014)

In a broader perspective, the rationale of the P.E. clause responds to tax income at source -where the P.E. is located- and residence, being in a specific percentage less, than the taxation it would have been subject to in residence state if income was not attributed to a P.E., in order to be applicable.

The percentage for 2016 U.S. MC and OECD Action 6[5] and MLC has been settled in 60%. Nevertheless, in U.S. DTTs with Luxembourg and Ireland was of 50%. (Internal Revenue Service, 2016) (OECD, 2015) (OECD, 2016)The wording is as follows:

	U.S. Model			OECD Action 6	MLC Simplified version
	1996	2006	2016		
Permanent establishment clause	-	-	Where an enterprise of a C.S. derives income from the other C.S., and the residence state treats that income as attributable to a P.E. situated outside of that C.S., the benefits of this Convention shall not apply to that income		Where: a) (...) The residence C.S. treats such income as attributable to a P.E. of the enterprise situated in a third jurisdiction; and b) the profits attributable to that P.E. are exempt from tax in the residence C.S., the benefits of the DTT shall not apply to any item of income on which the tax in the third jurisdiction is less than 60% of the tax that would be imposed in the residence C.S. on that item of income if that P.E. establishment were situated in the residence C.S. In such a case, any income to which the provisions of this paragraph apply shall remain taxable according to the domestic law of the other Contracting Jurisdiction (...). 2. Paragraph 1 shall not apply if the income derived from the source C.S. described in paragraph 1 is derived in connection with or is incidental to the active conduct of a business carried on through the P.E. (other than the business of making, managing or simply holding investments for the enterprise's own account, unless these activities are banking, insurance or securities activities carried on by a bank, insurance enterprise or registered securities dealer, respectively).

Source: Own preparation based on the clauses provided by U.S. MC, BEPS Action 6 and MLC.

[5] BEPS Action 6 did not directly include the Permanent Establishment clause, it was included within the provisions that

2016 Model sets two situations for the clause to be applicable (after the cited extract):

a. If the state where the P.E. is located does not have a DTT in force, with exception of situation were the income is included in the tax base of P.E. owner.
b. If profits attributed to the P.E. are subject to a combined aggregate effective tax that is less than the lesser of 15% or, 60% of the general statutory rate.

For this model purposes, the rates taken into consideration are the settled by general income corporate tax law at residence state. While in OECD provisions the percentages taken into account are the effective tax rates to which the taxpayer will be subject to.

The consequence hence will be for all the cited provisions that all P.E. income will be affected by the limitations established by the clause. In case the thresholds are exceeded, source state will be able to tax without treaty limitations. Some variations may be found in U.S. tax treaties which establish a higher ceiling when the clause is applied -anyway smaller than the applicable rate if treaty was not applied. Also, some treaties limitate the application to some items of income as interest, royalties and dividends. (Internal Revenue Service, 2016) (Vega Borrego, 2017)

Finally, some exceptions are contemplated by both 2016 MC and OECD MLC:

a. If the P.E. is engaged in an active trade or business (similar to the activity clause), as long as the P.E. and its owner comply with a L.O.B. clause
b. If royalties received by the P.E. are a compensation for the use or the right to use intangible property produced or developed by the P.E.
c. If the affected income by the clause is subject to tax in either C.S. according to CFC rules.

Lastly, a saving clause is included by all versions of the clause, through which, tax administrations can grant treaty benefits for the specific income to residents who were not able to overcome the L.O.B. tests if solid business reasons are given to justify the attribution of income to the P.E. It can be considered a special bona fide clause within the P.E. exclusion. (Internal Revenue Service, 2016) (OECD, 2016)

d. Bona fide clause:

At last, the bona fide clause appears in all versions of the L.O.B. clauses. Is a subsidiary nature clause which aims at giving a last chance to taxpayers to file a petition until tax authorities of either C.S. requesting for tax treaty benefits for a specific item of income. Depending on the claimed benefit, the application must be presented until source or residence state.

No clear rules or criteria have been settled to orientate tax administrations decisions, leading to high level of discretion and correlative uncertainty in compliance regards. Thus, even without dispositions on that matter, the degree of motivation to such administrative decisions is assumed to be high. (Vega Borrego, 2017)

	U.S. Model			**OECD Action 6**	**MLC Simplified version**
	1996	2006	2016		
Bona fide clause	A resident of a Contracting State not otherwise entitled to benefits may be granted benefits of the Convention if the competent authority of the State from which benefits are claimed so determines.	If a resident of a C.S. is neither a qualified person (...) nor entitled to benefits with respect to an item of income (...) the competent authority of the other C.S. may, nevertheless, grant the benefits of this Convention, or benefits with respect to a specific item of income, if it determines that the establishment, acquisition or maintenance of such person and the conduct of its operations did not have as one of its principal purposes the obtaining of benefits under this Convention.	If a resident of a C.S. is neither a qualified person (...), nor entitled to benefits (...), the competent authority of the other C.S. may, nevertheless, grant the benefits of this Convention, or benefits with respect to a specific item of income, taking into account the object and purpose of this Convention, but only if such resident demonstrates to the satisfaction of such competent authority a substantial nontax nexus to its C.S. of residence and that neither its establishment, acquisition or maintenance, nor the conduct of its operations had as one of its principal purposes the obtaining of benefits	A resident of a C.S. that is neither a qualified person nor entitled (...) to a benefit that would otherwise be accorded by this Convention with respect to an item of income shall nevertheless be entitled to such benefit if the competent authority of the C.S. from which the benefit is being claimed, upon request from that resident, determines, in accordance with its domestic law or administrative practice, that the establishment, acquisition or maintenance of the resident and the conduct of its operations are considered as not having as one of its principal purposes the obtaining of such benefit. The competent authority of the Contracting State to which such request has been made by a resident of the other C.S. shall consult with the competent authority of that other State before rejecting the request.	If a resident of a C.S. is neither a qualified person (...) nor entitled to benefits (...), the competent authority of the other C.S. may, nevertheless, grant the benefits of the DTT, or benefits with respect to a specific item of income, taking into account the object and purpose of the DTT, but only if such resident demonstrates to the satisfaction of such competent authority that neither its establishment, acquisition or maintenance, nor the conduct of its operations, had as one of its principal purposes the obtaining of benefits under the DTT. Before either granting or denying a request made under this paragraph by a resident of a Contracting Jurisdiction, the competent authority

			under this Convention. The competent authority of the C.S. to which the request has been made shall consult with the competent authority of the other C.S. before either granting or denying a request made under this paragraph by a resident of that other C.S.		of the other C.S. to which the request has been made shall consult with the competent authority of the first - mentioned C.S.

Source: Own preparation based on the clauses provided by U.S. MC, BEPS Action 6 and MLC.

As observed, all provisions -except for the very widely written 1996 version- consider as previous conditions that the residents are neither qualified residents or subjects entitled to treaty benefits (subsidiary character) for the possibility of tax authorities to grant them.

The main criteria that can be extracted from the clauses is the inexistence of a tax purpose in the development of its conduct, as one of its principal motivations. Bearing similarities and almost identical wordings with the Principal Purpose Test (PPT) explained in the first chapter. Notwithstanding that the standard of proof of such aims is left to the tax authorities themselves. In 1996, said characteristic was only found in the technical explanation of the model. (Internal Revenue Service, 1996)

For 2006, and thus in Action 6 and MLC version, it can be found directly in the model and an additional requirement regarding the previous inform by the competent tax authority to its corresponding counterpart in the other C.S. before rejecting (in Action 6) or granting the taxpayer´s application. (Internal Revenue Service, 2006) (OECD, 2016) (OECD, 2015)

Models only refer to take into consideration the taxpayer´s circumstances for determining the existence of the mentioned subjective element, however, U.S. domestic law has developed some criteria that can be helpful for other scenarios to be considered when deciding over a taxpayer situation:

- The date of the company´s incorporation in relation with the date of the entry in force of the treaty (it can be positive or negative according with the establishment of more favorable or disadvantageous conditions by the treaty
- Continuity of historical business and ownership of the corporation (being a positive indicator)
- Extent to which the corporation is claiming STR benefits in the state of residence (as higher more negative will be viewed)
- Business reasons for choosing that country as state of residence (and no others)
- Contracting state membership in international organizations (which creates opportunities of resolving EU law conflicts)
- Entitlement to treaty benefits in comparison with those it would have been entitled in case the company was incorporated at shareholders majority state of residence

- Dependence of the business activity at source of the capital, assets and personnel at company´s residence state
- Degree or margin to which L.O.B.s were not complied with. (Vega Borrego, 2017)

C. The effect of the LOB clauses in the DTCs signed by Colombia:

After the review made so far of the types of L.O.B. clauses that are commonly negotiated and the possible effects it can have on the extent to which subjective scope of DTTs may have, it is the purpose of this work to determine how those provisions may be included within the apparently distant Colombian context.

As concluded from the analysis made in chapter 1 above, L.O.B. clauses would be contemplated in four of the DTT network of Colombia. With respect to those treaties, the wording of each of them will now be studied with the purpose of understanding which sort of L.O.B. provisions include and how should they be interpreted.

1. Chile and India:

Chile and India DTTs with Colombia are examined together as they both follow the structure developed by the MLC by virtue of the mutual inclusion between Colombia and the corresponding country in each other´s list of Covered DTTs.

Therefore, Conventions with both countries would have as automatic qualified residents to individuals, public authorities and its subdivisions, tax-exempt organizations and pension funds; as qualified residents those who manage to overcome stock exchange and the ownership and base erosion clause; only granting limited treaty benefits to subjects under the activity and bona fide clause, and excluding from benefits income attributed to P.E.s, within the terms and conditions explained above. The following chart represents the situation:

			MLC Simplified version
Qualified Residents (Full treaty access)	Automatic Qualified residents	**Individuals**	X
		Public authorities and subdivisions	X
		Tax-exempt organizations	X
		Pension Funds	X
		Stock-exchange clause	X
		Ownership and base-erosion clause	X
Non-Qualified residents (limited treaty access)		**Activity Clause**	X
		Headquarters Company clause	-
		Derivative benefits clause	-
	Exclusion clauses	**Permanent establishment clause**	X
		Bona fide clause	X

Source: Own preparation based on the clauses provided by U.S. MC, BEPS Action 6 and MLC.

It is clearly an example of stronger anti-treaty shopping measures for Colombia in its relationship with Chile and India, taking into consideration that before the application of the MLC modifications those treaties only foresee:

a. India: DTT with India only provided for a clarification of the possibility of applying domestic anti-avoidance and anti-abuse measures notwithstanding the treaty extent, a PPT rule and an explicit good faith consideration (different from bona fide clause specific meaning) as a determinant factor for granting treaty benefits. Clearly, even though article 28 of said convention is named "Limitation on benefits", no proper L.O.B. clause was included in its structure. (Colombia-India Double Tax Treaty, 2011)

b. Chile: DTT with Chile included a stronger structure, having a similar provision to a ownership test, where beneficial interests, represented as shares or in any other way, owned by residents and non-residents of the other C.S. or, those subjects exercising direct or indirect control or managing powers over the company, may result in a limitation of any treaty recognized tax reduction or deductible payments only to dividends, interests and royalties. It´s interesting though, that the following paragraph contains as an exemption said rule a PPT with an inversed burden of proof, giving a last resort to taxpayers before treaty benefits being completely denied.

This DTT, also states an ordinary PPT and the possibility for tax administrations to recommend and apply modifications to the treaty trough MAP´s procedure. (Colombia-Chile Double Tax Treaty, 2007)

2. Mexico:

Colombia-Mexico DTT´s article 26 states "*anti-abuse rules",* making clear the qualification both states give to treaty shopping scenarios. Within said article, article 4 is restated, confirming residents or either contracting state are entitled to treaty benefits. However, it determines at least one of the following two conditions must be met for persons different from individuals (implicitly considered, in consequence, qualified residents for DTT purposes):

a. "*(i) That more than 50% of the ownership over the person (or in the case of company, more than 50%of each class of shares)"*, following the wording of the 1996 ownership and base erosion clause, *"is held, directly or indirectly, by any combination of one or more:", here, is also reaching to a higher extent the term "held" instead of "owned"* as can be in power of subject under different titles than property. The article follows:

"*(A) individuals resident of one or both contracting states"* confirming individuals as automatic qualified residents and considering a new scenario of persons being resident of both C.S.

"*(B) companies under literal b) of this paragraph"* (regarding stock exchange traded companies)

"*(C) one of the Contracting states, its political subdivisions or local authorities"* adding as automatic qualified residents to contracting states and its political subdivisions.

The second paragraph of this provision includes a special base erosion clause for dividends, interests and royalties for which "*no more than 50% of the person´s gross income is paid to persons different to those described in (A) and (C) previous clauses"*.

It is a simpler wording than the established for1996 U.S. MC as it does not condition payments to be made in the form of deductible payments in any C.S., but it does define the payments being counted for the 50% threshold will be those made to automatic qualified residence, in other words, individuals and public authorities and its political subdivisions.

It is worth to mention that defining residents subject to the L.O.B. provisions as "*different from individuals"* is a clever strategy through which a wider scope can be defined, by not only covering companies in proper terms, but also all kind of intermediate instruments or vehicles that may be used. This interpretation is confirmed by the wording of the first element of literal a., where ownership of persons and companies is differentiated.

b. The second possibility is to be a "*company resident in a contracting state which principal class of shares",* following 2006 stock exchange clause terms, "*is regular and substantially traded in a recognized stock market"*, a difference of the U.S. MC is observed since the clause requires for *"substantial"* trading of the shares and it does not include the additional requirements of the mentioned model.

   A very positive aspect is that later in the treaty (numeral 3 of the same article) directly identifies the recognize stock exchanges, even if the third one listed opens the possibility for states authorities to recognize subsequently other stock markets.

Finally, a PPT with the inverse burden of proof is included, in addition of the requirement for tax authorities to "*consult*" and not "*inform*" its correlative in the other C.S. before denying treaty benefits under either the ownership and base erosion clause (which applies a "*channeling approach")* or the stock exchange clause, and leaving open the possibility for states authorities to recommend and modify the provisions of the treaty within MAP´s procedure. (Mexico-Colombia Double Tax Treaty, 2009)

3. **Unites Arab Emirates:**

The DTT between Colombia and the UAE is very unusual since the L.O.B.s are worded in such a way that only residents of the UAE will obtain benefits from the treaty. This situation nonetheless does not represent disbalance between the states noting that the UAE do not count with an ordinary income tax regime.

Paragraph 1 of Article 22 of the DTT determines as qualified residents:

"*a) The United Arab Emirates*

b) a person, different from an individual, of the United Arab Emirates" as defined in article 4 -considering persons different from companies and individuals as in the Mexico´s DTT-

“c) an individual

d) a company as long as it can prove that at least 51% of the benefits are owned, directly or indirectly, from the United Arab Emirates, and/or from a governmental institution of the United Arab Emirates, and/or from an individual resident in the United Arab Emirates, and that such company is controlled by said residents”

In general, the definition of qualified residents may look ordinary as it includes, individuals, Public authorities, other persons and companies that comply with the ownership test. However, not full treaty benefits will be granted with such qualification, the wording of the article limitate benefits to those provided in articles 8 (shipping and air transport), 10 (dividends), 11(interest), 12 (royalties) and 13 (capital gains).

Other particularities are that the ownership test does not refer to the shares of companies but solely to the benefits and is stricter as it demands for the 51% of them to be of either public authorities and its subdivisions (even trough indirect access) or from residents of the EUA. In any case, the wording is very clear with compliance not being a formal but a substantial issue when demanding to be controlled by those residents even if the percentage is not met.

This treaty also applies the “*channeling approach”* by including a base erosion test in addition to the mentioned ownership test. The base erosion test demands for taxpayers to prove that “*no more than 50% of the gross income are used, directly or indirectly, to comply with obligations (including interests and royalties) with persons not entitled to the treaty”.*

Is evident the relevance that has for states that third country residents do not engage in treaty shopping to benefit from this treaty as it does not only demand in the base erosion test solely for the qualified residents to be recipients of the income (not having to be deductible payments in any state in specific and not providing for P.E. exemptions) but also, a special burden is imposed to taxpayers, who have to proof the purpose of the developed conduct is not obtaining any of the treaty benefits in favor of a non-resident of the UAE. This last requirement traduces into an open declaration of taxpayers against treaty shopping.

The final provisions determine anti-abuse and anti-evasion measures established in the Colombian domestic law will be applicable, that a confirmation of the fulfillment of the requirements must be availed by tax authorities of either C.S. -a real novelty- and a PPT rule accompanied by the reassurance of the exchange of information as the basis to fight against abusive and evading conducts. (United Arab Emirates-Colombia Double Tax Treaty, 2017)

Conclusions

The object, as explained at the beginning of this work, was to bring some light into the interpretation of Limitation on benefits clauses within the Colombian double tax treaties network. For those purposes, a revision of the treaty shopping issue was made in order to provide elements from the context in which these provisions arise, acknowledging other possibilities proposed for tax administrations around the world to face such practices and for a better understanding of the panorama regarding the relation between tax regimes and international commerce.

There, the beneficial owner, the principal purpose test, general and specific anti-avoidance rules appeared among with the concept of residence and the definition of DTT´s subjective scope, over which L.O.B. provisions apply. Lastly, for a wider view of Colombia´s situation, the presence of anti-avoidance measures was verified in each DTT, giving as a result -for this work purposes- that only conventions with Chile, Mexico and the UAE included L.O.B. provisions. However, the MLC replaced the agreed L.O.B. and included these kind or rules in convention signed with India.

Then, in the second part of the work, the conformation and interpretation of the L.O.B. clauses were review through a comparison between the U.S. MC for 1996, 2006 and 2016 and the OECD Action 6 and MLC. The U.S. development of these rules was highly taken into consideration since was in that legal framework that L.O.B. provision had its origins, and in a broad sense, modification made to its wording have responded to the north American experience. As was noted during the study, the influence of the U.S. MC was not minor and even in some tax treaties as the Mexican and even the convention with the UAE -in some respects- the technical expressions were maintained.

In general, L.O.B. clauses determine additional conditions for residents of either contracting state for the obtainment of benefits, widening or reducing the subjective scope of DTTs. It is important to note that they do not only reduce it, as might be though, because even if formulated in strict terms, the real effect of some clauses combined, and the creation of new clauses can give treaty access to a larger extent of taxpayers as have happened with the headquarters companies.

These clauses can be considered to be 4: stock exchange, ownership and base erosion, activity and bona fide clause, with a previous automatic qualification of some residents: individuals, public bodies and their political subdivisions, tax-exempt organizations and pension funds. In any case, the additional inclusion and exclusion clauses (permanent establishment, headquarters companies and derivative benefits) keep variating the scenario, which among with the complex definitions of prongs within the clauses and the ambiguous terms create a constantly changing and uncertain panorama, that as bona fide clearly states, gives the final vote back to tax administrations. In the process, the reasonable and legitimate expectations of taxpayers get lose on the way and the defense right against it becomes a burden for those who decide to chase -and not pursue- treaty benefits.

Finally, the Colombian situation characterized for its undefinition at last starts to determine some lines for taxpayers to move within, not getting yet to the further situation of disbalance that developed countries seem to have reached, in this matter can be conclude that:

1. Even tough very few DTTs include L.O.B. provisions, the soon entry in force of the MLC creates a Colombian anti-avoidance politic with stronger anti-treaty shopping measures- at least for 2 of the conventions-. In general, it conforms a better structured overview for the affected Colombian tax treaties.

2. Treaties signed by Colombia including L.O.B. provisions are mainly integrated by ownership and base erosion clauses, which always keep a channeling approach. It is still necessary for Colombia to define stronger lines regarding the state´s tax policy for higher advantages to be obtained from the country´s DTT network.

3. There are yet many unexplored possibilities regarding L.O.B. provisions for Colombia. The activity and permanent establishment clauses have never been included, and surprisingly neither have the bona fide clause. Furthermore, the clauses considered by DTTs as the stock exchange clause and the ownership and base erosion tests have been structured in rather simple terms, leaving room for additional requirements regarding the qualification of subjects intervening in transactions, holding periods, classes of shares, category of payments and rules for the accounting of the required thresholds.

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