NEW DEVELOPMENTS: RECENT CHANGES AFFECTING INTERNATIONAL TAX PLANNING

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My first question is, "Can we rely on double tax treaty provisions any more?" When I first started practising – a long time ago, we used to use Netherlands companies, Luxembourg companies or whatever, and we picked them off the shelf, and used them in tax treaties. That was fine in the 1970s and no-one complained. In the 1980s, when the United States woke up to the fact that there were quite a lot of territories outside the United States, and that tax treaties were being used to reduce US taxes, they decided to start to override the provisions of tax treaties – so much so that the current Swiss-US tax treaty actually states that no treaty override will be permitted unless both sides agree to it: this seems a fairly natural thing for two contracting parties to have as a matter of course, but as I will explain, this is not a matter of course.

The US Constitution states that the provisions of international agreements and those of domestic legislation have equal status. So, when the United States brought in the Foreign Investment in Real Property Taxes Act in 1981, it did not have to renegotiate the treaties in order to be able to enforce the provisions. There is no superior status given in the United States to treaty arrangements, whereas places like France and the Netherlands expressly state that international agreements do take precedence over subsequent domestic legislation. It seems to me obvious that if two contracting parties are agreeing something, really they should stick by their agreement, rather than being able – unilaterally – to override them. Constitutions such as those of Luxembourg and Belgium also limit the ability of subsequent domestic legislation to amend the provisions of those agreements. In the United Kingdom, we

have a little saying which is: "Parliament may take away anything that it has given." And, in fact, in the Finance Act 2008, there is probably a little-known section – section 59 – which states that UK residents cannot rely on certain elements of tax treaty provisions in order to override UK domestic legislation, and that is rather a trap for the unwary.

The United States brought in its Limitations on Benefits provisions for the first time with the US-Netherlands tax treaty in 1992. It was a two-page detailed article, which basically said that residents of the Netherlands cannot take advantage of the US tax reductions and exemptions offered by the treaty if 50% or more of the relevant income is paid out to non-residents. Since then, Limitation on Benefits provisions have been in all US treaties, but also in lots of other treaties as well: what they essentially say is that the treaties are fine for residents of the particular country, but they are not to be used in treaty shopping arrangements.

Some recent cases – *Indofoods v. JP Morgan* in the United Kingdom, the *Prévost* and *MIL Investments* cases in Canada – indicate the way that courts are thinking in relation to beneficial ownership. But there are very few cases which have looked at whether a treaty should apply at all. There have been some, however, which look at whether the object and the purpose of the treaty is being fulfilled. Article 31 of the Vienna Convention on the Law of Treaties states:

> "The treaty should be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."

With this in mind let us look at the title of a tax treaty. The wording says, "Agreement between X country and Y country for the Avoidance of Double Taxation and the Prevention

of Fiscal Evasion with respect to taxes on income." So the question one should really ask, when you are using a tax treaty, is "Are the taxes of just one country being avoided or, in fact, is double taxation being avoided?" And the second question is, "Am I creating something that actually assists with fiscal evasion rather than preventing it?" There was a case in the United Kingdom which could very well have used this argument – the *Smallwood* case – but which actually did not, but there have been cases in France, in 1999 and, I think, 2006, in which it was held that the entire treaty was inapplicable, because there was no double taxation involved, but on the contrary an assistance in fiscal evasion. In the Appendix below is an extract from the judgment in the *Yanko-Weiss* case, which was heard in Tel-Aviv in Israel, in December 2007. That held that a general anti-avoidance concept is implicit when you apply double tax treaties. I know there is a contrary argument, which is that you should look at the text of a treaty and, again, the Vienna Convention states that:

> "It must be presumed that the text of a treaty is the definitive intention of the contracting parties."

But I would say, in summary, that one should be aware that using a tax treaty to assist in fiscal evasion or to use for the ostensible prevention of double taxation when there is only one country's tax involved, may be negated, and I think that in the future we are going to see a lot more cases being decided where the courts hold the double tax treaty irrelevant. Generally, continental civil law jurisdictions will do that; maybe Anglo-Saxon countries might be a little bit less robust in that, but certainly I can say that automatic treaty shopping – as we have used it for the last forty years – needs to be thought of in a different light. Howard Rosen quite rightly says that without any substance involved, you should not be relying on a treaty.

The need for substance may be spelled out in the law. For example, the US Stop Tax Haven Abuse Bill says:

> "A transaction has economic substance only if the transaction changes in a meaningful way, apart from tax, the taxpayer's economic position and the taxpayer has a substantial non-tax purpose for entering into such a transaction."

The UK controlled foreign company rules require – for the exempt activities test – a company to be resident in a particular territory in order to be able to take advantage of the exempt activities test, and it must have a business establishment there, and it must be effectively managed there. The Revenue have shown, in INTM 205010 and 205030, that business establishment means premises which are or are intended to be occupied and used with a reasonable degree of permanence, from which the company's business in its territory of residence is wholly or mainly carried on. What does "effective management" mean? A company will not be regarded as effectively managed in its territory of residence unless the number of persons employed by the company in the territory is adequate to deal with the business, and any services provided by that company are not actually carried out in the United Kingdom.

Coming back to the question of whether tax treaties can be used at all, we can also look at the more recent EU Parent-Subsidiary Directive 1990, which says, under Article 2:

> "The Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse."

So here it is quite clear that, when trying to use the EU Parent-Subsidiary Directive, clients may consider that there is an automatic right to use that Directive if you have two EU

countries, but there is that provision that if it is used for the purposes of abuse, then it will not apply.

I have mentioned beneficial ownership briefly. I recently attended the OECD 50th Anniversary Conference of its first Model Treaty in 1958, and there they discussed beneficial ownership in quite a lot of detail. They said that it was first introduced in 1977, and the Commentary to the Treaty refers to the "economic entitlement" to the relevant income. Basically, would conduit companies involved in treaty shopping have economic entitlement to the relevant income? All but the French participant decided that conduit companies would generally have the economic entitlement to income, unless they were nominees or agents. Again, the cases that I have mentioned here look at that, and most of them have come to the conclusion that conduit companies themselves may indeed have the economic entitlement. That is why I have mentioned that it is fine to look at specific provisions and case law: looking at those specific provisions may apply the treaty, but the question should always be: is the treaty itself applicable?

Revenue authorities are looking increasingly at the concept of permanent establishment. I have been thinking for many years, "Why don't revenue authorities attack management and control issues more than they do?" It strikes me as being one of the simpler areas of attack, and yet very few revenue authorities really go that route. What they generally try and do is to say that they accept that a company might be managed and controlled outside of the particular territory, but that a domestic permanent establishment exists and therefore it is subject to domestic tax.

One of the areas that we have been advising on a lot over the last ten years or so is, of course, e-commerce. The question of permanent establishment in e-commerce is much more

esoteric than it is real – in terms of real estate, for example. Generally, a server operated by independent parties, leasing time for the operation of a website on the server, should not create permanent establishment issues. That is not the case in all countries. There are three cases which I can mention in the United States – the *Pedros Negros case*, the *North-Western States Portland Cement Co* and *Quillcorp v. North Dakota*. Those cases establish different things, but basically agreed that a server operated by independent people should not create a permanent establishment.

The UK Revenue is the only one that I know of that has actually pronounced, in INTM 266100, that in the United Kingdom we take the view that a server – either alone or together with websites – could not, as such, constitute a PE of a business that is conducting e-commerce through a website on the server. We take that view regardless (and this is interesting) of whether the server is owned, rented or otherwise at the disposal of the business. Most countries would say that if a server is owned by a business and it is located in another country, then that creates a permanent establishment there. The Revenue do not seem to take that view, and this was stated within Press Release No.84, published on 11th April 2000. Other OECD member states take the view that a server – as distinct from a mere website – could constitute a PE where the equipment is in fact fixed. So, again, if a company actually sites a server in a particular location, then it can be considered to be a permanent establishment there.

- "90-10" structure
- Anticipated revision of UK / Guernsey treaty
- Management and Control
- Permanent Establishment – HMRC attack
- Trading Profit vs Investment
- Speculative gains

Moving on to real estate, the diagram shows a very typical structure that I am sure many of you are familiar with if you have any land interests in the United Kingdom – the double Guernsey structure. It was put into existence over twenty years ago, with the Jersey or Guernsey 90:10 situation, where you try to take advantage of the tax treaty to say that the resident trading company – the lower one – was taxable in Jersey, could take advantage of the Jersey-UK or Guernsey-UK tax treaty in that, if it did not have a permanent establishment in the United Kingdom, it was only subject to 20% tax in Jersey or Guernsey. But, then a tax ruling with the authorities would allow 90% of that to be paid upstream and the tax recouped, effectively, so all that you were suffering was a 20% tax on 10% of the income.

I am not sure how many of you are aware that HMRC are now taking the stance that a development in the United Kingdom is itself a permanent establishment. That is quite a departure from how they have previously considered the concept of a permanent establishment. In the past, it has required a dependent agent to exist before a permanent establishment would be created. But now they are saying that a development owned by a foreign company is itself a permanent establishment. I believe that the Netherlands, and a few other countries like Luxembourg, may well consider that a foreign property is itself a permanent establishment abroad, and that is part of the benefits of using Dutch and Luxembourg companies in real estate transactions, as we will see shortly. But, in the United Kingdom, that has not been the stance. That creates some problems, because the first thing is that we do not think they are correct. We do not think that this is right in law, since there is no legal provision to say that a mere development on its own is a permanent establishment. The second thing – and this is now relevant to what I was saying earlier – is whether reliance can be placed on the Jersey and Guernsey tax treaties with the United Kingdom to say that a

permanent establishment does not exist? A development is a trade; there is no question about that. So, a foreign company trading in the United Kingdom is going to be subject to UK tax. The only reason why it might not be is because it does not have a permanent establishment and there is an appropriate tax treaty provision which says that. The argument is, you cannot tax the Guernsey company, because there is an appropriate tax treaty, but the next argument – and I do not think you are going to find tax counsel who are going to give a definitive opinion on this – is whether the treaty applies, because Guernsey has now reduced its tax rate for companies to zero – as has Jersey. Is double taxation being avoided? Look at the title of the Guernsey/Jersey-UK tax treaty and it is for the avoidance of double taxation, and the prevention of fiscal evasion. I think it is a perfectly logical argument for HMRC to run. At the moment, we have not had that argument being presented, but I would advocate a word of warning.

Hungarian companies are used for UK real estate investments as an alternative to Guernsey, because the Hungarian-UK treaty should apply since Hungary does have a taxation regime. There is a particular reason for using the Hungarian treaty, and there is a particular reason why I have not. The one in its favour is that there is a clause – the permanent establishment clause – which is the only one that the United Kingdom has with any other country which says that if you have a building site which lasts for less than twenty-four months (most of them are six months or twelve months), then you can have no permanent establishment under the terms of the treaty. I think that is a bit of a red herring, because a foreign company having a development in the United Kingdom may not actually be operating itself as a builder, and therefore the reference to building site should be in relation to the contractor, not the owner of the property. So I think that is a red herring, but a lot of advisers have been saying that the Hungarian treaty is the best treaty of all for this reason. The

problem I am concerned about is that I am not quite sure how it will be treated in Hungary, and I have had conflicting comments on that. The third issue is back to s.59 of the Finance Act 2008, which is that if there are UK people behind the Hungarian structure, they will not be able to rely on the tax treaty permanent establishment clause under s.59.

Many of you will be aware that the old France-Luxembourg tax treaty for investing in France has now been amended. Prior to the amendment, a Luxembourg company having property in France and selling it would not be taxed in France, because the business profits article of the treaty would apply. In other words, the tax administration would not treat the ownership of property as a separate concept or provision: they would actually apply the business profits article, and, because there might be no permanent establishment in France, the business profits article would say that profits are only taxable in Luxembourg. In Luxembourg the tax administration would say – as I said before – that the actual existence of a property in France is itself, as far as the Luxembourg authorities are concerned, a permanent establishment in France. So, there was a mismatch of how the two countries treated this, and, in fact, the Luxembourg Administrative Court of Appeal, in 2002, in the *Lacosta* case, said, "It doesn't matter that it's a mismatch. We'll apply the terms of the treaty." The authorities then got together and changed the treaty. They did not change it as radically as we thought they were going to. All they said was that if the Luxembourg company profits from real estate in France, it will no longer be considered to come within the business profits article, but instead it will be treated separately, and it will be subject to tax in France. What they did not do was to go further and say that a shareholding in the Luxembourg company owning the French real estate is itself defined as "real estate in France". A lot of countries do say that if you own property in a particular country, then the capital of the company that owns the property is considered real estate, just like the actual

property itself. They did not go further and say that the capital of the Luxembourg company would be considered akin to French real estate and therefore taxable, so you can still sell the shares of the Luxembourg company, and avoid French taxation. Actually, you can do even more than that. You can contribute the property from Luxembourg to a *société civile immobilière* ("SCI") and you could sell the shares of the SCI – also without being subject to French tax. So they did not really close that much of a loophole; it is quite easy to come outside of the amended treaty. You could even change the domicile of the Luxembourg company if you did not want to restructure, but that is another problem and probably the only place that you could change the domicile to, effectively, is the Lebanon under the Lebanese-French treaty.

Each treaty is quite individual. The UAE-France treaty has a particular article 11(1)(b), which says that if you own French real estate, but it is used for the purposes of the business then you can sell it without French taxation. I had a client that was involved in tourism in chalets in France, where we recommended that a Dubai company could be created to own all of the chalets which were being operated within the group, and to be able to sell any one of these chalets without French taxation.

Luxembourg has some changes in its dividend withholding tax regime from the 1st January 2009. I think this is a way that quite a lot of countries are going. We might not be too worried about treaty shopping if we do not have withholding taxes involved. In Luxembourg – from the 1st January 2009 – dividends paid by a Luxembourg company to a foreign parent company will be exempt from withholding tax provided that there is a tax treaty in place, and that the foreign country operates a similar system to Luxembourg.

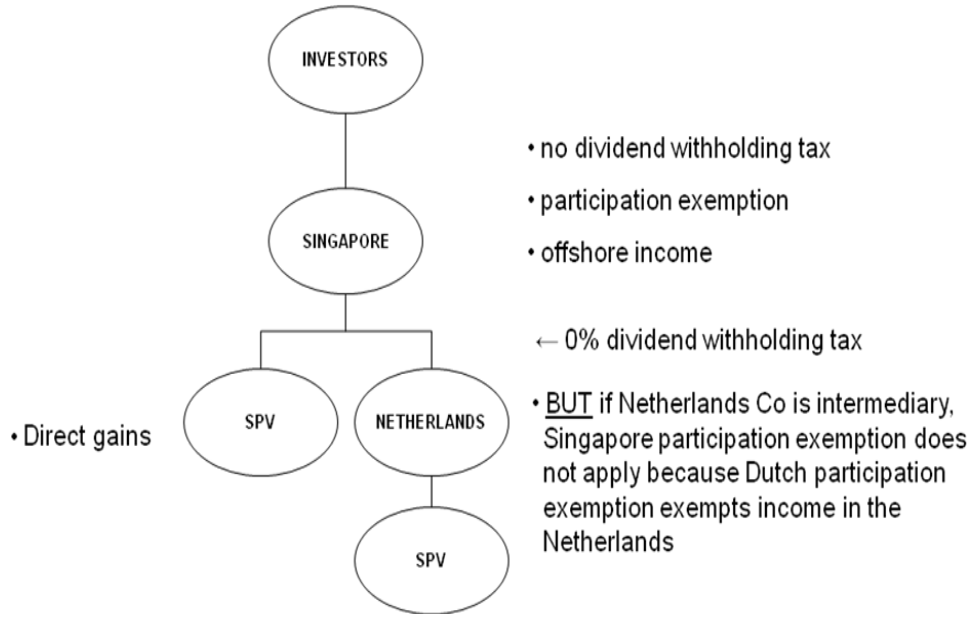
The next part of my presentation is talking about some of the more recent strategies of investing in the newer countries of interest for us – China, India and Africa. The new Luxembourg and Belgian tax treaties with Hong Kong are quite interesting. Until recently, of course, Hong Kong did not have any tax treaty arrangements; it now has them with Luxembourg and Belgium, and these can actually be very useful. Luxembourg – before now – in order to avoid the withholding tax, used to issue instruments like CPECs, for example. Now, under the new arrangements in Luxembourg, if a treaty exists – and Hong Kong is considered to have a similar tax to that of Luxembourg – then you do not need to do that. You can actually go straight out of Luxembourg into Hong Kong. Hong Kong has a legal system based on UK law, which is quite acceptable. It has no dividend withholding tax of its own and it operates a territorial system.

For investing into China for EU residents, a typical structure might be that the EU investor creates a Belgian or Luxembourg company to own a Hong Kong company, which then owns a Chinese company. As far as realising profits from a Chinese company is concerned, there is no capital gains tax in Hong Kong so that would be tax neutral, and also – under the internal treaty between Hong Kong and China – there would be no Chinese capital gains tax on the sale of a Chinese company. Dividends can come out of China subject to just 5% tax, with no tax in Hong Kong and – again – a pass-through from Hong Kong to Belgium; there is no tax in Belgium or Luxembourg and again out to the EU investor. Also, financing a Chinese company by way of loan is also very effective through Hong Kong, where there is no withholding tax, which would normally apply on interest coming out of a Chinese company.

We have recently had quite a few enquiries about investing into Africa. As many of you are aware, Mauritius is considered to be the most appropriate entity for doing that. It is part of

the African Union, it is part of the South African Development Community, and it is part of COMESA, which is the common market for Eastern and Southern Africa. In fact, African countries consider Mauritius as an African country, therefore it is far more acceptable than many other jurisdictions. Mauritius has about thirty-three tax treaties of which twelve are with African countries, where withholding tax rates can be reduced, and capital gains tax can be avoided on sale when you are trying to get out of the business that you are in. What is important about Mauritius – as far as Africa is concerned – is that it has Investment Promotion and Protection Agreements ("IPPAs"). We always talk about double tax agreements, but actually bi-lateral agreements for protecting one's investments – Bi-lateral Investment Treaties ("BITs") or IPPAs are very important in securing the best advantages: if you are investing in a country you want to make sure that your investment is not going to suddenly get hijacked. Mauritius is also very useful for investing into India. Again, there are other countries, e.g. Cyprus, which actually has a tax sparing clause on interest so it is quite a good treaty. Singapore is good for India – and is also good for China, but Singapore has a Limitation on Benefits provision in its India treaty.

Singapore is an interesting country, but one has to be very careful with it, and the authorities there do not really help to clarify the participation exemption. Here



is a simple diagram. You have a Singapore company and you have an SPV. You make direct gains in the form of dividends or capital gains. This is fine under the participation exemption in Singapore. If you come through the Netherlands – which might be a more appropriate route for particular reasons – and the Netherlands does not actually tax profits, income and gains under the participation exemption, Singapore says, "It hasn't been taxed abroad, therefore we're not going to exempt these profits, even though it's the same SPV and even though that SPV may well have been subject to tax in Denmark." So, a direct interest by a Singaporean company would be admitted and acceptable, but an indirect one would not be. They have relaxed some of the rules from the 21st January 2009, so Singapore can be useful for the next year or so, because they are trying to encourage the use of Singapore companies but, as I say, I think they should be a bit clearer with the provisions of their holding company regime. And Singapore trading companies, with branches in Labuan or Dubai might also be interesting.

The Italian law on trusts – just like the Israeli law on trusts – changes by the day. The Italian law now says that if you have a beneficiary that is in Italy, and if you have foreign trustees, the trustees are treated as Italian tax resident. If, however, the trustees are resident in a white-listed country such as New Zealand or Singapore, then these provisions will not apply, and – I think rather stupidly – if the trust is a discretionary trust, so the beneficiary is not certain that he is going to receive the income – although we all know he is – then, again, it comes outside these provisions.

The United Kingdom has introduced – in the Finance Bill 2009 under clause 34 and Schedule 14 – the reform to the taxation of foreign profits. Now it looks as though the United

Kingdom is going to have a participation exemption rather than the credit system that it has been before. It will be interesting to see whether or not that Finance Bill becomes a Finance Act: I am not taking that as a foregone conclusion at the moment.

The US exit tax, which was enacted in June 2008, means that a US citizen renouncing his citizenship is not necessarily going to avoid US tax. One thing I do want to talk about is s.409A: this was enacted as of 31st December 2005, but there were some transitional provisions. This involves another concept which might be new, but which I want to introduce at this stage, which is the idea of constructive receipt of income. Section 409A says that if you have a foreign trust but, actually, you are very likely to get the income, then it will be treated as a constructive receipt of income. The particular section is primarily aimed at deferred compensation for employees rather than foreign trusts, and it says that unless there is a substantial risk that the individual will not get his money, then it should be taxable immediately. This is an interesting concept for us all to take away – this constructive receipt of income.

Footballers are under investigation by UK and other authorities, and the typical arrangement is that they receive payments for their 'image rights' (it is in reality a diversion of the income they agreed for playing on the pitch). So out of an agreed £100,000 weekly salary, they receive £25,000 a week into a BVI company and – lo and behold – it comes back to them as a loan via the use of an EBT. It is of course the same amount as the income paid to the BVI company, but is referred to as a loan. When you think about whether there is a substantial risk that the individual is not getting that income – well he already has it in the form of a loan. Is he likely to pay it back? No. Therefore, this idea of constructive receipt of employment income is a very important one, which I think will become more and more important in the years to come.

With banks not lending any more, private equity funds are so important nowadays. We must have been involved in the creation of thirty to forty private equity funds over the past two years. It is very important for the investors to minimise tax leakage from the underlying investment, and for the fund managers as to how they are taxed.

Finally, Howard Rosen mentioned the word "scheme". Not many people nowadays would admit to creating schemes, but there are lots of them around. One of them which I always thought was an unlikely one, is the Dutch Co-operative. I have always thought that Dutch Co-operatives are unlikely to last. I think they were formed by farmers who pooled their wares together and then were not subject to a withholding tax on the receipt of income out of the Co-op. However it is now being used by foreigners particularly since one of the Big Four have been promoting Dutch Co-operatives extensively. I have always advised against it because for foreigners to be able to take advantage of a rule that was originally intended for farmers did not seem logical to me, but I was assured that people like the Royal Mail and other postal authorities around Europe have a Dutch Co-operative, and it is perfectly acceptable. So, when a recent client asked me about a Dutch Co-operative I said I did not like it. I spoke to a Big Four person. He said it was perfectly OK and told me about the Royal Mail. I then got an e-mail from him which said, "One of my colleagues told me of his recent experience with a Dutch ruling team when applying for a Co-operative ruling. He had submitted some weeks ago a ruling request for a structure in which – amongst others – two individuals were participating. In short, the answer was that the Dutch tax authorities refused the ruling because of the fact that there were two individual investors. Their arguments were technically incorrect but it makes no sense to argue with the tax authorities if one is asking for a ruling." It seems that corporate members would still receive a favourable tax ruling, but I wonder how long this will last.

APPENDIX

Yanko-Weiss v. Holon Assessing Office

DISTRICT COURT OF TEL AVIV-YAFO

HONOURABLE JUDGE MAGEN ALTUBIA

JUDGMENT DATE: 30 DECEMBER 2007

… The rise in the transformation of markets to global markets, the ease with which capital is moved, and tax regimes which have seen the interests of the State requiring incentives, including the attracting of foreign investments while creating tax shelters, all of these factors have created opportunities for assessees holding several residencies or citizenships, as well as to tax planners to transcend borders and to create holding structures which exploit contradictions and differences between different national tax regimes, in order to reduce their tax burden or that of their clients. …

In this context an excellent example is [in] the words of the philosopher Ludwig Wittgenstein as follows: "…there is no such thing as a literal meaning apart from the context that makes it meaningful." …

Wittgenstein gives the example: If it will be said to someone "Teach the children a game" and he will teach them to gamble in a game of dice, was it necessary to instruct expressly by saying that one should not teach children to gamble with dice? It is clear that the word "play" includes gambling with dice. However, it is clear that it was not intended that gambling will be presented to children. This example … has implications for the interpretation of treaties. It teaches that frequently the literal translation of a text may include a possible understanding that would never have crossed the minds of the drafters of a treaty. Therefore, one should read its provisions in the context of the intent of its drafters. We may add that the intent of the drafters is also connected to the present tax environment, to the tax administrations as they have developed and changed since the drafting of the treaty up to the time it is being interpreted, to the provisions of international law such as Article 31 of the Vienna Convention, and to the adoption of the doctrine that stands at the core of the legal system in Israel, the doctrine of good faith.

A tax treaty is designed, first and foremost, to create a situation in which an assessee, who is trapped in the tax networks of two contracting States, will not be exposed to double taxation. Tax treaties were not designed, nor can it be said that any such intent existed, whether they include express provisions or not, for use that will be made of them in a manner which is not in good faith and in an acceptable manner, or that use can be made of them which constitutes improper use of provisions set forth and the benefits which they grant. The States which conclude a treaty are entitled to raise arguments against such. They can do so by virtue of provisions of domestic law, which contain anti-avoidance provisions which are the basis for determining tax liability. The determination of liability is set forth first and foremost by domestic law. The domestic law gives effect to the treaty, whether with an equal status or a superior status, in order to set forth the scope of tax liability in a manner such that there will not be exposure to double taxation. To illustrate, if it will be determined, further to a claim of reclassification, or by virtue of the authority to claim on the basis of artificiality, that one must regard income as revenue income and not as capital income, thereafter it will be to apply treaty provisions. That is, first one determines the nature of the income, and thereafter

the provisions of the treaty will be applied. Not in every case where there is an argument of improper use, is the application of the treaty denied. Once the nature of the liability is determined, there should be an attempt, notwithstanding the use of anti-avoidance measures, to apply the main points which prevent double taxation, while at the same time using measures which the treaty provides, for example, the mutual agreement procedure, inter alia.

An additional justification for the use of anti tax-avoidance measures against treaty abuse is found in the implied condition which is to be read into every treaty, that they are not to be used for improper purposes. This is based in part on Article 31 of the Vienna Convention.

Article 31 of the Vienna Convention applies to the provisions of international treaties, including Conventions for the Prevention of Double Taxation:

> "1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its objects and purpose.
>
> …
>
> 4. A special meaning shall be given to a term if it is established that the parties so intended."

… The doctrine of "preventing improper use" is capable of including additional standards and anti-avoidance measures, in addition to that of artificial transactions: for example, substance over form, reclassification, the commercial essence of the transaction, etc. … One can say that the treaties for the prevention of double taxation to which Israel is a party are to be read as if they contain limitation on benefits provisions in cases where it is proven that there exists improper use of a tax treaty, according to standards of the domestic law and international law.

This approach is in line with the interpretation of the OECD of recent years (since 2003) from its Model Convention …

In the Commentary to Article 1 of the Model, in paragraph 7 it is stated:

> " The principal purpose of double taxation conventions is to promote, by eliminating international double taxation, exchange of goods and services, and the movement of capital and persons. **It is also a purpose of tax conventions to prevent tax avoidance and evasion."** (the emphasis does not appear in the original)

… The Commentary continues in paragraph 9.3 and clarifies:

> "This interpretation results from the object and purpose of tax conventions as well as the obligation to interpret them in good faith (see Article 31 of the Vienna Convention on the Law of Treaties)."

… para 9.4 of the commentary summarizes that, according to the two perspectives referred to above, benefits should not be granted by tax treaties when speaking of an arrangement which constitutes improper use of its provisions …