Examination of the Anti-Avoidance Measures to Counter Tax Treaty Abuse/Shopping

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Abstract
A Double Tax Treaty (DTT) is a bilateral agreement between two countries aimed at eliminating double taxation to encourage international trade and investment. Usually, the benefit of relief of double taxation provided under a DTT is only available to taxpayers who are resident in both or one of the countries that is a party to DTT. The implication of this is that, taxpayers who are not resident in either of the country that is a party to DTT are ineligible to enjoy the benefit of relief of double taxation provided by DTT. However, in recent years, through the ingenuity and assistance of accountants, lawyers, tax consultants and advisors, taxpayers are now able to set up structures which makes it possible for them to enjoy the benefit offered by a DTT even though they are not resident in either of the country that is a party to DTT. This constitute an improper use of tax treaty to gain a tax advantage which is now generally referred to as 'tax treaty abuse/shopping'. 'Tax treaty abuse/shopping' is considered as a form of tax avoidance or evasion that can negatively impact on government's revenue generation. It is in this regard that the Organisation for Economic Co-operation and Development (OECD) introduced certain anti-avoidance measures to counter treaty abuse/shopping. The objective of this article is to examine the various anti-avoidance measures introduced by OECD to counter treaty abuse/shopping. The article also examines the current position of the Nigerian government on tax treaty abuse/shopping.
Keywords: Taxation, Double Tax Treaty, Tax Treaty abuse/shopping, Tax avoidance or evasion

Introduction

A Double Tax Treaty (DTT) is a bilateral agreement entered into between two countries for the purpose of preventing harmful double taxation and for removing obstacles to cross-border trade in goods and services and movements of capital, technology and persons.[1] This is with a view of protecting taxpayers resident in both or either of the country that is a party to DTT from having their income and capital taxed twice (double taxation). Thus, DTTs provides an essential benefit to taxpayers as it prevents double taxation problems that could occur when two sovereign countries seek to tax the same income and capital of taxpayers under their domestic tax laws in their respective jurisdiction.[2] The main purpose of DTT is therefore to eliminate and prevent double taxation by ensuring that taxpayers do not pay tax on the same income and capital in two countries.[3] Examples of relief from double taxation provided by DTT include exemption from tax in one or both of the countries[4] and reduced withholding taxes on dividends, interest and royalties.[5]

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1 Organisation for Economic Co-operation and Development (OECD) 'Prevention of Treaty Abuse - Peer Review Report on Treaty Shopping: Inclusive Framework on BEPS: Action 6, OECD/G20 Base Erosion and Profit Shifting Project' (2019) <https://doi.org/10.1787/9789264312388-en> accessed on 8 May 2021.

2 Andersen Tax, 'A Review of the Nigerian Double Taxation Treaty Network' (2019) <https://www.andersentax.ng/a-review-of-the-nigerian-double-taxation-treaty-framework> accessed on 8 May 2021.

3 Baker P., 'Improper Use of Tax Treaties, Tax Avoidance and Tax Evasion' (2013) <http://www.un.org/esa/ffd/tax/2013TMTTAN/> accessed on 8 May 2021.

4 OECD's Model Tax Convention on Income and on Capital 2017, art. 23A and 23B

5 OECD's Model Tax Convention on Income and on Capital 2017, art. 10, 11 and 12.

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The elimination of double taxation provided by DTT is an important benefit meant to eliminate any barrier that double taxation could create to cross-border trade, investment and movement of persons and goods. This will go a long way to facilitate cross border trade and increase Foreign Direct Investments (FDI) which could have been impeded, if there was no relief of double taxation.[6] DTT is therefore an important policy tool to promote international trade and economic activities.[7]

Usually, the benefit of relief of double taxation provided under DTT is enjoyed only by taxpayers who are resident of both or one of the country that is a party to DTT.[8] This is in line with the principle of reciprocity in international relation which requires that favours, benefits or penalties granted by one country to the citizens or legal entities of another country should be returned in kind.[9] Accordingly, a DTT serves as a reciprocal agreement which provides double taxation relief to taxpayers residents in both or one of the country that is a party to DTT. The implication of this is that, taxpayers who are not resident in either of the country that is a party to DTT are not eligible to enjoy the benefit of relief from double taxation provided by the DTT.[10]

However, in recent years, through the ingenuity and assistance of accountants, lawyers, tax consultants and advisors, taxpayers are now able to set up structures and arrange their affairs in a way that enable them enjoy the benefit of relief of double taxation even though they are ineligible to such benefit due to the fact that they are not resident in either of the country that is a party to DTT.[11] This constitute an improper use of DTT for the benefit of ineligible taxpayers who are not genuinely entitled to enjoy the benefit of relief of double taxation thereby resulting in the breach of the principle of reciprocity.[12]

The improper use of DTT for the benefit of ineligible taxpayers is now generally referred to as 'treaty abuse' or 'treaty shopping' which is considered as a form of tax avoidance or evasion that can negatively impact on government's revenue generation.[13] In recent years, there has been a dramatic increase in treaty abuse/shopping which made the Organisation for Economic Co-operation and Development (OECD) to expressed its concern in labelling the present bilateral structure of the international tax treaties as one that has lost its integrity.[14]

It is in this regard that OECD introduced certain anti-avoidance/abuse measures to tackle tax treaty abuse/shopping in order to prevent the tax avoidance or evasion that can arise therefrom. This article therefore examined the concept of tax treaty abuse/shopping and the various anti-avoidance measures introduced by the OECD to counter treaty abuse/shopping. The article also consider the current position of the Nigerian government on treaty abuse/shopping.

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6 Brian J. A., 'An Introduction to tax treaties' United Nations Primer on Double Tax Treaties <http://www.un.org/esa/ffd////capacity-development-tax/primer-dtt.html> accessed on 8 August 2020

7 Petkova K., Stasio A., and Zagler M., 'On the Relevance of Double Tax Treaties' (2018) WU International Taxation Research Paper Series No. 2018-05 <http://dx.doi.org/10.2139/ssrn.3126593> accessed on 8 August 2020.

8 OECD's Model Tax Convention on Income and on Capital 2017, art. 1.

9 Keohane R. O, 'Reciprocity in International Relations' <http://www.jstor.org/stable/2706740> accessed on 27 May 2021

10 Ibid

11 OECD, 'Prevention of Treaty Abuse - Peer Review Report on Treaty Shopping: Inclusive Framework on BEPS: Action 6, OECD/G20 Base Erosion and Profit Shifting Project' (2019) <https://doi.org/10.1787/9789264312388-en> accessed on 8 May 2021.

12 Shukla G. and Ghosh J., 'Tax Avoidance and Limitation of Benefit' (2015) 2 (2) *Indian Journal of Tax Law* 2.

13 Ibid

14 Omri M., 'Unilateral Responses to Tax Treaty Abuse: A Functional Approach' (2016) 41 (3) *Brooklyn Journal of International Law, 1158.*

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2. Concept of Tax Treaty Abuse/Shopping

DTT offers taxpayers the benefit of relief of double taxation in respect of their income and capital [illegible] eliminating the barrier (double taxation) that can discourage international trades and investments. By virtue of the provision of Article 1 of the OECD Model Tax Treaty, the benefit of relief of double taxation applies only to a taxpayer that is a resident of the contracting States to the DTT.[15] The term 'resident of a Contracting State' means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof as well as a recognised pension fund of that State.[16] This indicates that taxpayer who does not qualify as 'a resident of a Contracting State' is not eligible to enjoy the benefit of relief from double taxation provided by DTT.

It will therefore amount to a tax treaty abuse/shopping where a taxpayer uses deliberate measures and arrangements to access the benefits of a DTT when such taxpayer is not resident in either of the countries that is a party to DTT. Accordingly, tax treaty abuse/shopping typically involves the attempt by a taxpayer to indirectly access the benefits of a DTT between two countries without being a resident of any of the country.[17] It is now a common practice for taxpayers engaging in cross border activities to adopt corporate and operational structures to abuse tax treaties in order to avoid or evade taxes. This may involve interposing or organising a 'conduit company' in one of the contracting States for the purpose of shifting profits or rerouting profits to take advantage of DTTs.[18]

The most common example of tax treaty abuse/shopping involves a situation where a person sets up an arrangement or structure to indirectly access the benefits of a DTT.[19] A practical illustration on tax treaty abuse/shopping is provided below:

Take an example of 3 countries, Nigeria, Zambia and South Africa. Nigeria has a DTT with South Africa but not with Zambia. Zambia also has a DTT with South Africa. All the countries charge withholding tax on dividends paid to non-resident persons. However, the DTTs in place provide for exemption of dividends from withholding tax if they are paid to a person resident in a contracting state. None of the countries taxes dividends received from companies resident in other states. A person (Investor) is resident in Nigeria and owns a company (known as 'Dallo') which carries on business in Zambia. Whenever 'Dallo' distributes dividends, they are subjected to withholding tax because there is no DTT between Nigeria and Zambia. To avoid paying the withholding tax in this regard, the Investor registers a company (known as Shoppy) in South Africa and transfers his shares to it. 'Shoppy' does not do any business in South Africa; it is established for the sole purpose of exploiting the DTT benefits between Zambia and South Africa. 'Dallo' pays dividends to 'Shoppy' and the dividends are exempted from withholding tax because of the DTT between Zambia and South Africa. Accordingly, the dividends are not subject to any tax in South Africa. 'Shoppy' then pays the dividends to the Investor who is resident in Nigeria and the dividends are not taxed because of the DTT between Nigeria and South Africa.

From the above, it is clear that 'Shoppy' in South Africa is a conduit company set up by the investor resident in Nigeria mainly for the purpose of obtaining the treaty benefits provided by the DTT between South Africa and Zambia. Accordingly, due to the existence of a DTT between Zambia and South Africa, the dividends paid by 'Dallo' to 'Shoppy' will be exempted from withholding tax in South Africa. In addition,

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[15] OECD's Model Tax Convention on Income and on Capital 2017, art. 1, para. 1

[16] OECD's Model Tax Convention on Income and on Capital 2017, art. 4, para. 1.

[17] OECD, 'Prevention of Treaty Abuse - Peer Review Report on Treaty Shopping: Inclusive Framework on BEPS: Action 6, OECD/G20 Base Erosion and Profit Shifting Project' (2019) <https://doi.org/10.1787/9789264312388> accessed on 8 May 2021.

[18] Ibid

[19] Shukla G. and Ghosh J., 'Tax Avoidance and Limitation of Benefit' (2015) 2 (2) *Indian Journal of Tax Law* 4.

the dividend paid by 'Shoppy' to the Investor in Nigeria will also be exempted from withholding tax due to the existence of a DTT between South Africa and Nigeria.[20]

The implication of this is that, there will be no taxation of the dividends in Nigeria, Zambia and South Africa due to the fact that the dividends have been rerouted to take advantage of the benefits of relief of double taxation provided by the DTT between the countries. This means that the dividends have somehow escape taxation in Nigeria, Zambia and South Africa. The non-taxation of the dividends in this regard constitute an abuse of tax treaty which is a form of tax avoidance or evasion as the case maybe.

Tax treaty abuse/shopping has an impact on the reciprocal 'balance of sacrifices' accepted by each contracting state in negotiating a tax treaty. This is because if a treaty can be accessed by residents of another state, the fairness of the treaty bargain may be undermined and the incentive for countries to enter into tax treaties in the first place may be reduced.[21] Therefore, the use of a 'conduit' company to access the benefits of a DTT in the scenario above is perceived as an improper use of tax treaties by both the OECD[22] and the United Nations.[23]

According to the OECD,[24] tax treaty abuse/shopping is undesirable for the following reasons:

i. Treaty benefits negotiated between the parties to an agreement are economically extended to residents of a third jurisdiction in a way the parties did not intend. The principle of reciprocity is therefore breached and the balance of concessions that the parties make is altered;
ii. Income may escape taxation altogether or be subject to inadequate taxation in a way the parties did not intend; and
iii. The jurisdiction of residence of the ultimate income beneficiary has less incentive to enter into a tax agreement with the jurisdiction of source, because residents of the jurisdiction of residence can indirectly receive treaty benefits from the jurisdiction of source without the need for the jurisdiction of residence to provide reciprocal benefits.

Tax treaty abuse/shopping also has an undesirable negative effect of undermining tax sovereignty as it enables taxpayers to claim treaty benefits in situations where these benefits were not intended to be granted thereby depriving countries of potential tax revenues.[25] The International Monetary Fund (IMF) estimated that at more than €770 million in revenue was lost by developing countries to tax treaty abuse/shopping in 2011.[26] In addition, ActionAid estimated that Nigeria lost about $27 million in 2015 to treaty abuse/shopping.[27] This antecedent revenue losses resulting from tax treaty abuse/shopping therefore constitute serious concerns which have weakened the integrity of the international tax system and have

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[20] Ibid

[21] Rosenbloom H. D., '*Tax Treaty Abuse: Policies and Issues,' (1983) 15 (3) Law and Policy in International Business* 774-775.

[22] OECD Committee on Fiscal Affairs, '*International Tax Avoidance and Evasion: Four Related Studies, Issues in International Taxation Series*', (OECD Publishing 1987) (vol. 1) p. 90.

[23] United Nations, 'Treaty Abuse and Treaty Shopping' <https://www.un.org/esa/ffd/wp-content/uploads/2014/10/2STM_Taxation-Treaty-Abuse_EC1820062.pdf> accessed on 8 May 2021..

[24] OECD) 'Prevention of Treaty Abuse - Peer Review Report on Treaty Shopping: Inclusive Framework on BEPS: Action 6, OECD/G20 Base Erosion and Profit Shifting Project' (2019) <https://doi.org/10.1787/9789264312388-en> accessed on 8 May 2021.

[25] OECD, 'Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project' (2015) <http://dx.doi.org/10.1787/9789264241695-en> accessed on 7 May 2021

[26] International Monetary Fund, *Spillovers in International Corporate Taxation* (IMF Publishing, 2014) p. 22.

[27] ActionAid, 'The Impact of Tax Treaties on Revenue Collection: A case study of developing and least developed countries Executive' (2018) <https://actionaid.nl/wp-content/uploads/2018/11/The-Impact-of-Tax-Treaties.pdf> accessed on 10 May 2021

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reduced the incentives for countries to enter tax treaties.[28] This is because, when a person is able to
conduit companies to indirectly access the benefit of a DTT, the DTT which is merely designed to elim
double taxation may end up being used to eliminate and escape taxation.[29]

Over the last couple of decades, there has been an increasing number of DTTs. It is estimated that o
3,000 DTTs are currently in effect.[30] This is a good development to encourage international trade a
investment. However, on the other hand, the increasing number of DTTs also create opportunities
taxpayers to take advantage of the vast tax treaty network to avoid or eliminate taxation.[31] To counter
treaty abuse/shopping, the OECD introduced certain anti-avoidance measures to prevent the improper
of DTT to avoid or evade tax which are examined below.

3. Measures to Counter Tax Treaty Abuse/Shopping

There have been various attempts in the past to counter tax treaty abuse/shopping. For example, in 19
OECD in its Model Tax Treaty, introduced the concept of 'beneficial owner' to articles on dividen
interest, and royalties to clarify the meaning of the words 'paid to' which effectively dealt with simple
treaty abuse/shopping situations where income is paid to an intermediary resident of a treaty country w
is not treated as the owner of that income for tax purposes (such as an agent or nominee).[32] Also in 19
OECD updated the Commentary on Article 1 of the Model Tax Convention to include a section on
improper use of tax agreements.[33]

Furthermore, in 1986, the Committee on Fiscal Affairs (CFA) of the OECD published two reports: Doub
Taxation and the Use of Base Companies and Double Taxation and the Use of Conduit Companies
address the issue of tax treaty abuse/shopping.[34] In 2002, the Committee also published the repo
'Restricting the Entitlement to Treaty Benefits', which was meant to counter tax treaty abuse/shoppi
while the Commentary on Article 1 of the Model Tax Convention was expanded on several occasion
notably in 2003, with the inclusion of sample provisions that countries could use to counter tax trea
abuse/shopping.[35]

In 2015, OECD released the Final Report on Base Erosion and Profit Shifting (BEPS) to address vario
tax avoidance schemes/strategies usually employed by taxpayers to artificially shift profits from high ta
jurisdiction to low or no-tax locations. This report identified tax treaty abuse/shopping as major form of ta
avoidance or evasion.[36] The Final Report of the Base Erosion and Profit Shifting (BEPS) in relation to treat
abuse/shopping are considered below.

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[28] Omri M., 'Unilateral Responses to Tax Treaty Abuse: A Functional Approach' (2016) 41 (3) *Brooklyn Journal o*
International Law, 1158.

[29] Van Weeghel S., *The Improper Use of Tax Treaties* (Kluwer Law International, 1998) p.121

[30] Brian J. A., 'An Introduction to tax treaties' United Nations Primer on Double Tax Treaties
<http://www.un.org/esa/ffd////capacity-development-tax/primer-dtt.html> access 10 May 2021

[31] Duff D. G., 'Tax Treaty Abuse and the Principal Purpose Test - Part I' (2018) *Canadian Tax Journal*, 624-625.

[32] OECD, 'Prevention of Treaty Abuse - Peer Review Report on Treaty Shopping: Inclusive Framework on BEPS:
Action 6, OECD/G20 Base Erosion and Profit Shifting Project' (2019) <https://doi.org/10.1787/9789264312388-
en> accessed on 8 May 2021.

[33] Paragraphs 7-10 of the Commentary on Article 1 of the 1977 Model Tax Convention.

[34] OECD, 'BEPS Action 6 on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances: Peer
Review Documents' (2017) <http://www.oecd.org/tax/beps/beps-action-6- preventing-the-granting-of-treaty-
benefits-in-inappropriate-circumstance-peer-review- documents.pdf> accessed on 4 May 2020

[35] Ibid

[36] OECD, 'OECD presents outputs of OECD/G20 BEPS Project for discussion at G20 Finance Ministers meeting'
(2015) <https://www.oecd.org/tax/oecd-presents-outputs-of-oecd-g20-beps-project-for-discussion-at-g20-
finance-ministers-meeting.htm> accessed on 19 July 2021

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3.1. Base Erosion and Profit Shifting (BEPS)

Base Erosion and Profit Shifting (BEPS) is a term generally use to refer to various tax avoidance schemes/strategies usually employed by taxpayers to artificially shift profits from high tax jurisdiction to low or no-tax jurisdictions.[37] BEPS schemes enable taxpayers to move profits from where they are taxed at higher rates to where they are taxed at lower rates which has the implication of reducing revenue accruable to the government.[38] Addressing the issue of BEPS was therefore a key priority for various governments around the globe.

In 2012, OECD countries and the G20 countries working together embarked on what is now regarded as the most significant and ambitious objective of re-writing international tax rules in a century.[39] This ambition was to revise the existing international tax rules and align them to developments in the world economy to ensure that profits are taxed where economic activities are carried out and where value is created.[40]

On 12 February 2013, OECD issued a lengthy report to address BEPS known as the BEPS Report.[41] This was followed up with the publication of a 15-Action Plan on BEPS on 19 July 2013.[42] The 15-Action Plan otherwise known as the BEPS Package equips the governments with the domestic and international instruments needed to tackle BEPS and was eventually endorsed by the G20 Finance Ministers during their meeting of 8 October 2015 in Lima while the G20 Leaders followed suit by endorsing the BEPS package during their summit held in Antalya, Turkey between 15 and 16 November 2015.[43]

The 15-Action Plan as contained in the BEPS Final Report published in October 2015 are:

i. Address the tax challenges of the digital economy;
ii. Neutralise the effects of hybrid mismatch arrangements;
iii. Strengthen Controlled Foreign Company rules;
iv. Limit base erosion via interest deductions and other financial payments;
v. Counter harmful tax practices more effectively, taking into account transparency and substance;
vi. Prevent treaty abuse;
vii. Prevent the artificial avoidance of PE status;
viii. Assure that transfer pricing outcomes are in line with value creation- Intangibles;
ix. Risk & capital;
x. Other high-risk transactions;
xi. Establish methodologies to collect and analyse data on BEPS and the actions to address it;
xii. Require taxpayers to disclose their aggressive tax planning arrangements;
xiii. Re-examine transfer pricing documentation;
xiv. Make dispute resolution mechanisms more effective;
xv. Develop a multilateral instrument.[44]

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[37] OECD, 'Base Erosion and Profit Shifting' (2015) < http://www.oecd.org/tax/beps/> accessed on 13 August 2020.
[38] Ibid
[39] OECD, 'OECD/G20 Base Erosion and Profit Shifting Project 2015 Final Reports: Information Brief' <http://www.oecd.org/ctp/beps-reports-2015-information-brief.pdf> accessed on 13 May 2021.
[40] Ibid
[41] OECD, 'Addressing Base Erosion and Profit Shifting' (2013) <http://www.oecd.org/ctp/beps.htm> accessed on 13 May 2021.
[42] OECD, 'Action Plan on Base Erosion and Profit Shifting' (2013) <http://www.dx.doi.org/10.1787/9789264202719-en> accessed on 13 May 2021.
[43] Ibid

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Tax treaty abuse/shopping was identified as one of the most important sources of BEPS concerns. It was therefore not surprising that Action Plan 6 of the BEPS Package is a specific action plan to prevent treaty abuse/shopping by taxpayers. Action 6 of the BEPS Package is considered below.

3.2 BEPS Action Plan 6 on Prevention of Tax Treaty Abuse/Shopping

The main aim of Action Plan 6 of the BEPS Package is to provide countries with requisite anti-avoidance measures to counter tax treaty abuse/shopping by preventing the granting of treaty benefits in inappropriate circumstances.[46] According to the BEPS Final Report, the objective of Action Plan 6 of the BEPS Package is to: 'Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. Work will also be done to clarify that tax treaties are not intended to be used to generate double non-taxation and to identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country. The work will be co-ordinated with the work on hybrids.'.[47]

To achieve the above objective, the BEPS Final Report recommended that countries should commit and adopt a minimum standard to provide a minimum level of protection against tax treaty abuse/shopping. The minimum standard, in this regard, requires countries to include two components in their DTTs to wit: an express statement of common intention to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance and the inclusion of a specific anti-avoidance provision and general anti-avoidance provision in DTTs to counter tax treaty abuse/shopping.[48] It was further recommended that the OECD Model Tax Treaty be amended and updated to implement this recommended minimum standard.[49] The minimum standard recommended by the BEPS Package Action 6 is considered below:

i. Express Statement on Prevention of Tax Avoidance or Evasion

A major recommendation proposed by the BEPS Final Report on Action 6 (Preventing the Granting of Treaty Benefits in inappropriate Circumstances) is that, when negotiating a DTT, countries should agree to include in DTT, an express statement that their common intention is to 'eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance including through treaty shopping arrangements aimed at obtaining reliefs provided in this tax treaty for the indirect benefit of residents of a third country that is not party to the tax treaty'.[50] This recommendation is in line with the now established and recognised position that the purpose of a DTT is not only to eliminate double taxation but also to prevent tax avoidance or evasion that could occur through tax treaty abuse/shopping arrangements.[51]

This express statement has been incorporated into the preamble of the 2017 update to the OECD Model Tax Treaty in the following manner:

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45 OECD, 'BEPS Action 6 on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances: Peer Review Documents' (2017) <http://www.oecd.org/tax/beps/beps-action-6- preventing-the-granting-of-treaty-benefits-in-inappropriate-circumstance-peer-review- documents.pdf> accessed on 4 May 2021.

46 (OECD) 'Prevention of Treaty Abuse - Peer Review Report on Treaty Shopping: Inclusive Framework on BEPS: Action 6, OECD/G20 Base Erosion and Profit Shifting Project' (2019) <https://doi.org/10.1787/9789264312388-en> accessed on 8 May 2021.

47 OECD, 'OECD/G20 Base Erosion and Profit Shifting Project: Executive Summaries 2015 Final Reports' <http://www.oecd.org/tax/beps.html> accessed on 13 May 2021.

48 OECD) 'Prevention of Treaty Abuse - Peer Review Report on Treaty Shopping: Inclusive Framework on BEPS: Action 6, OECD/G20 Base Erosion and Profit Shifting Project' (2019) <https://doi.org/10.1787/9789264312388-en> accessed on 8 May 2021

49 Ibid

50 Ibid

51 Tolley Study Manual, *Principles of International Taxation* (Lexis House 2019) 52.

'(State A) and (State B) Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States).'.[52]

In addition, the title of the OECD Model Tax Treaty has been revised to reflect the dual purposes of DTT.[53] The title of the OECD Model Tax Treaty which previously bears 'Convention between (State A) and (State B) with respect to taxes on income and on capital'[54] now bears 'Convention between (State A) and (State B) for the elimination of double taxation with respect to taxes on income and on capital and the prevention of tax evasion and avoidance' under the 2017 update to the OECD Model Tax Treaty.[55] This is equally in line with the recommendation of BEPS Final report that the OECD Model Tax Convention has a purpose to prevent tax avoidance or evasion that can arise from tax treaty abuse/shopping.[56]

ii. Tax Treaty Anti-Avoidance Provisions

The BEPS Final Report on Action 6 recommended for the inclusion of a specific anti-avoidance provision and a general anti-avoidance provision in DTTs to provide safeguards against tax treaty abuse/shopping.[57] The BEPS Final Report gives countries the freedom to include either one of the specific anti-avoidance provision or the general anti-avoidance provision in their DTTs or a combination of the two (2) anti-avoidance provisions in their DTTs.[58] The intention here is to offer countries some flexibility with regard to what they can decide to negotiate in their DTTs.[59]

The recommended specific anti-avoidance provision is the 'Limitation of Benefit (LoB) Rule' while the recommended general anti-avoidance provision is 'principal purpose test (PPT) rule'.[60] The 'principal purpose test (PPT) rule' is meant to address other forms of tax treaty abuse/shopping situations not be covered by the LoB rule.[61] It is to be noted, as stated earlier, that countries are allowed to either include any of the recommended anti-avoidance provision in their DTTs or they can adopt a combination of the two anti-avoidance provisions in their DTTs to counter tax treaty abuse/shopping.[62] The two anti-avoidance provisions are considered below:

a. Limitation of Benefit (LoB) Rule

The Limitation of Benefit (LoB) rule is a specific anti-avoidance provision recommended by the BEPS Final Report to be included in DTTs to counter tax treaty abuse/shopping situations based on the legal nature, ownership and general activities undertaken by a resident of a country to the tax treaty.[63] Pursuant

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[52] The Preamble, OECD Model Tax Convention on Income and on Capital 2017

[53] OECD, 'Commentary on the Model Tax Convention on Income and on Capital: Condensed Version' *OECD Publishing* (2017) <http://dx.doi.org/10.1787/mtc_cond-2017-en> accessed 12 August 2020.

[54] OECD, Articles of the Model Convention with respect taxes on Income and on Capital 2010

[55] OECD, Articles of the Model Convention with respect taxes on Income and on Capital 2017

[56] OECD, 'OECD/G20 Base Erosion and Profit Shifting Project: Executive Summaries 2015 Final Reports' <http://www.oecd.org/tax/beps.html> accessed on 13 August 2020.

[57] Ibid

[58] Ibid

[59] Tolley Study Manual, *Principles of International Taxation* (Lexis House 2019) p. 159.

[60] OECD) 'Prevention of Treaty Abuse - Peer Review Report on Treaty Shopping: Inclusive Framework on BEPS: Action 6, OECD/G20 Base Erosion and Profit Shifting Project' (2019) <https://doi.org/10.1787/9789264312388-en> accessed on 8 May 2021

[61] Ibid

[62] Ibid

[63] OECD, 'Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 - 2015 Final Report' <http://dx.doi.org/10.1787/9789264241695-en> accessed on 25 May 2021

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to the recommendations of the BEPS Final Report, the LoB rule can now be found in the first seven paragraphs of the updated Article 29 of the 2017 OECD Model Tax Treaty.[64]

The LoB Rule, sets out in Article 29 (1) –(7) of the 2017 OECD Model Tax Treaty, consist of a series of objective tests that can be used to determine whether a person is 'qualified' and thus eligible for treaty benefits. The objective tests are based on characteristics such as legal nature, ownership and activities undertaken. This is to ensure a link between the person claiming benefit of the treaty and the residence country.[65]

By virtue of the provision of Article 29 (1) of the 2017 OECD Model Tax Treaty, a person who is a resident of a country that is a party to a tax treaty shall not be entitled to the benefits of the tax treaty unless such person is a 'qualified person.' This means that the LoB rule in Article 29(1) of the 2017 OECD Model Tax Treaty restricts the general scope of Article 1 of the OECD Model Tax Treaty to the extent that a taxpayer will only be entitled to treaty benefits if it is a 'qualified person'. This represents a significant departure from the provision of Article 1 of the OECD Model Tax Treaty because 'residency' is no longer the major determinant factor to make a taxpayer eligible to treaty benefits.

The provision of Article 29 (2) of the 2017 OECD Model Tax Treaty determines who constitutes a 'qualified person' by reference to the nature or attributes of various categories of persons such as an individual who is a resident, government-owned agencies of the other contracting State, charities under certain circumstances, a publicly-traded company and so on. Any person to which this paragraph applies is a 'qualified person' who is entitled to all the benefits of the tax treaty.

It is important to note that a taxpayer, who is not a 'qualified person' under Article 29(2) of the Model Tax Treaty, may nevertheless be entitled to treaty benefits where the income or capital is derived in active conduct of a business in its country of residence and the income emanates from, or is incidental to that business.[66] However, the treaty benefits can be lost if there is a base erosion (that is, if too much of the income received by the taxpayer is paid out to a person resident in a third country). Nonetheless, the treaty benefits can be reinstated if the taxpayer resident in a third country would have enjoyed equivalent benefits if the income had been paid to it directly.[67]

The application of the LoB rule has raised serious concerns for developing countries such as African countries. It is argued that the complexity of the LoB provision may make its application difficult for African tax administrations with weak and limited administrative capacity, bearing in mind that the successful application of the LoB rule requires access to information to verify the pre-requisites of qualifying under the provision.[68] Additionally, LoB provisions often intend to cover a number of sophisticated financing structures that are not very relevant for African countries.[69]

ii. Principal Purpose Test (PPT) Rule

The principal purpose test (PPT) is a purpose-based general anti-avoidance provision meant to operate as an overarching general groundwork for denying treaty benefits in cases when a taxpayer might otherwise

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[64] Article 29(1-7) of OECD Model Tax Convention on Income and on Capital 2017

[65] Tolley Study Manual, *Principles of International Taxation* (London: Lexis House, 2019) 161

[66] Article 29(3) of OECD Model Tax Convention on Income and on Capital 2017.

[67] OECD) 'Prevention of Treaty Abuse - Peer Review Report on Treaty Shopping: Inclusive Framework on BEPS: Action 6, OECD/G20 Base Erosion and Profit Shifting Project' (2019) <https://doi.org/10.1787/9789264312388-en> accessed on 8 May 2021.

[68] International Monetary Fund, *Spillovers in International Corporate Taxation* (IMF Publishing Washington D.C., 2014) p. 27.

[69] Trepelkov A. , Tonino H. and Halka D., 'United Nations Handbook on Selected Issues in Protecting the Tax Base of Developing Countries' <https://doi.org/10.18356/c8c4a273-en> accessed on 8 May 2021.

appear to satisfy the requirements to enjoy treaty benefits.[70] Under this rule, treaty benefits would be denied when it is reasonable to conclude, on the basis of all relevant facts and circumstances, that obtaining treaty benefits was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit.[71]

Pursuant to the recommendations of the BEPS Final Report, the 2017 update to the OECD Model Tax Treaty incorporated a provision on PPT in Article 2 (9) of the Model Tax Treat in the following manner: Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.

The main aim of the principal purpose test, as can be seen in Article 29(9) above, is to deny the benefits of a DTT where it is reasonable to conclude, having considered all the relevant facts and circumstances, that one of the principal purposes of an arrangement or transaction was for a benefit under a tax treaty to be obtained.[72] This means that the benefits of a tax treaty should not be available where one of the principal purposes of certain transactions or arrangements is to secure a benefit under a tax treaty and obtaining that benefit would be contrary to the object and purpose of the relevant provisions of the tax treaty.[73]

Therefore, the PPT rule in Article 29(9) of the OECD Model Tax Treaty 2017 allows countries to address cases of improper use of tax treaty to obtain benefits not otherwise due even if their domestic law does not allow them to do so.[74] This is intended to deny treaty benefits where transactions or arrangements are entered mainly for the purpose of obtaining the benefits of the DTT in inappropriate circumstances.[75]

However, it is important to point out that a 'purpose' will not be a 'principal purpose' if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining the benefit was not a principal consideration and would not have justified entering into any arrangement or transaction that has, alone or together with other transactions, resulted in the benefit. This portends that where an arrangement is inextricably linked to a core commercial activity, and its form has not been driven by considerations of obtaining a benefit, it is unlikely that its principal purpose will be considered to be to obtain that benefit.[76] An important exception to the PPT rule is that, a treaty benefit will be granted where it is established that granting that benefit in such circumstances would be in accordance with the object and purpose of the relevant provisions of the DTT.[77]

4. Implementation of the Recommended Minimum Standard Through the Multilateral Instrument (MLI)

The minimum standard recommended by the BEPS Final Report to counter tax treaty abuse/shopping is a tax treaty related measures of the OECD/G20 BEPS Project. The inclusion of this minimum standard into DTTs will necessitate the need for countries to amend their existing DTTs to comply with this minimum

[70] Meyer-Nandi S., Preventing Tax Treaty Abuse – A toolbox with preventive measures for Ghana, South Africa, and Nigeria (LL.M Dissertation, University of Economics and Business Vienna, Austria) 21.

[71] Tolley Study Manual, *Principles of International Taxation* (London: Lexis House, 2019) 162.

[72] OECD, 'Commentary on the Model Tax Convention on Income and on Capital: Condensed Version 2017', <http://dx.doi.org/10.1787/mtc_cond-2017-en> accessed on 19 May 2021.

[73] Ibid

[74] Ibid

[75] OECD, 'Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 - 2015 Final Report' <http://dx.doi.org/10.1787/9789264241695-en> accessed on 25 May 2021 .

[76] Ibid

[77] Ibid

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standard. The BEPS Final Report recommended that the minimum standard to counter tax treaty abuse/shopping should be implemented through the Multilateral Instrument (MLI).[78]

The Multilateral Instrument (MLI) is an outcome of BEPS Action Plan 15 of the OECD/G20 BEPS Project.[79] MLI allows governments to introduce tax treaty related measures of the OECD/G20 BEPS Project into their existing bilateral tax treaties in a consistent, efficient and synchronised manner without the need to renegotiate the tax treaties.[80] MLI entered into force on 1st July 2018[81] and as at 20 April 2021, 95 countries are signatories and parties to the MLI.[82]

MLI implements the minimum standards recommended by the BEPS Final Report to counter tax treaty abuse/shopping.[83] In this regard, the MLI amended the preamble of tax treaties to clarify that the purpose of tax treaties is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance.[84] In addition, MLI further amended the tax treaties to include specific and general anti-avoidance rules to prevent treaty benefits from being granted in an unintended circumstances.[85] These amendments are in line with the minimum standard recommended by the BEPS Final Report on Action 6 under which countries are expected to include either of Limitation of Benefit (LoB) rule or Principal purpose test or a combination of both in their DTTs.[86]

It is to be noted that the amendments made by MLI automatically affect existing tax treaties identified by treaty partner countries. This means that existing DTTs are automatically amended through the MLI to include the recommended minimum standards without the need for countries to renegotiate their existing DTTs. In addition, these amendments will also affect future tax treaties since the amended preamble as well as Limitation of Benefit (LoB) rule and Principal Purpose Test (PPT) rule have been included in the 2017 update of the OECD Model Tax Treaty.[87]

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78 OECD, 'Multilateral Convention to implement Tax Treaty related measures to prevent BEPS' <https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm> accessed on 26 May 2021

79 Deloitte, 'Multilateral Instrument (MLI) Ratification Impact on Indian tax treaties' (2019) <https://www2.deloitte.com/content/dam/Deloitte/ie/Documents/Tax/IE_Tax_Multilateral%20Instrument%20(MLI)%20Ratification.pdf> accessed on 13 August 2020.

80 OECD, 'Multilateral Convention to implement Tax Treaty related measures to prevent BEPS' <https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm> accessed on 26 May 2021

81 Ibid

82 OECD, 'Signatories and Parties to the Multilateral Convention to implement tax Treaty related measures to prevent Base Erosion and Profit Shifting' <https://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf> accessed on 26 May 2021

83 OECD, 'Multilateral Convention to implement Tax Treaty related measures to prevent BEPS' <https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm> accessed on 26 May 2021

84 Article 6 of the Multilateral Convention to Implement Tax Treaty Related Measures To Prevent Base Erosion and Profit Shifting https://www.oecd.org/tax/treaties/multilateral-convention-to- implement-tax-treaty-related-measures-to-prevent-beps.htm> accessed on 26 May 2021.

85 Article 7 of the Multilateral Convention to Implement Tax Treaty Related Measures To Prevent Base Erosion and Profit Shifting https://www.oecd.org/tax/treaties/multilateral-convention-to- implement-tax-treaty-related-measures-to-prevent-beps.htm> accessed on 26 May 2021.

86 OECD, 'Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 - 2015 Final Report' <http://dx.doi.org/10.1787/9789264241695-en> accessed on 25 May 2021

87 Korving . J. and Van Hulten L., 'MLI: Testing the principal purpose' <https://www.internationaltaxreview.com/article/b1f7n2f6tqcfyx/mli-testing-the-principal-purpose> accessed on 26 May 2021

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5. Position of the Nigerian Government on Tax Treaty Abuse/Shopping

The Nigerian government, in its bid to prevent tax treaty abuse/shopping in the country, became a signatory to the Multilateral Instrument (MLI) on 17 August 2017.[88] The implication of this, as stated earlier, is that the existing DTTs of the country are automatically amended through MLI to implement the minimum standards recommended by the BEPS Final Report to counter treaty abuse/shopping.[89]

Currently, Nigeria has an existing and operational DTTs with 13 countries namely: Belgium, Canada, China, Czech Republic, France, Korea (ROK), Netherlands, Pakistan, Philippines, Romania, Slovakia, South Africa and the United Kingdom.[90] Since Nigeria is already a signatory to MLI, the government do not need to renegotiate these existing DTTs to implement the minimum standards recommended by the BEPS Final Report bearing in mind that the DTTs have been automatically amended through MLI. This is highly significant and it represent a major remarkable development in Nigeria to prevent the tax base of the country from being eroded by tax avoidance or evasion schemes such as treaty abuse/shopping.

For taking this bold step of becoming a signatory to MLI, the Nigeria government deserved commendation for this significant step which will go a long way in providing the government with the requisite tools to prevent and counter treaty abuse/shopping in the country. This remarkable development also signifies the intention of policy makers in the country to prevent treaty abuse/shopping by adopting international best practices as recommended by the OECD/G20 BEPS Project.[91]

In addition to the above, the Federal Inland Revenue Service (FIRS), on 4 December 2019, published an information circular on the claim of tax treaties benefits in Nigeria.[92] This is highly commendable on the part of FIRS and it further indicates how serious the Nigerian government is willing to provide clarification on how taxpayers can claim tax treaty benefits in Nigeria.

The Information Circular was issued by the FIRS pursuant to Sections 45 and 46 of the Companies Income Tax Act (CITA) Cap. C21 LFN 2004 (as amended), Sections 38 and 39 of the Personal Income Tax Act (PITA) Cap. P8 LFN 2004 (as amended), Sections 61 and 62 of the Petroleum Profits Tax Act (PPTA) Cap. P13 LFN 2004 and Section 41 of the Capital Gains Tax Act (CGTA) Cap. C1 LFN 2004.[93] The aim of the Information Circular is to provide guidance and clarity on the requirements, process of accessing and computing various tax treaty benefits available to residents and non-residents deriving income from Nigeria and its treaty partners. A summary of the key aspects of the Information Circular are examined below:

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[88] OECD, 'Signatories and Parties to the Multilateral Convention to implement tax Treaty related measures to prevent Base Erosion and Profit Shifting' <https://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf> accessed on 26 May 2021

[89] OECD, 'Multilateral Convention to implement Tax Treaty related measures to prevent BEPS' <https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm> accessed on 26 May 2021

[90] PWC, 'Worldwide tax Summaries- Nigeria Corporate Withholding Taxes' (2019) <http://www.taxsummaries.pwc.com/ID/Nigeria-Corporate-Withholding-taxes> accessed 14 August 2020.

[91] OECD, 'Multilateral Convention to implement Tax Treaty related measures to prevent BEPS' <https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm> accessed on 26 May 2021

[92] Federal Inland Revenue Service (FIRS) 'Information Circular on the claim of Tax Treaties Benefits in Nigeria' <https://www.firs.gov.ng/wp-content/uploads/2021/01/circular-on-the-claim-of-tax-treaties-benefits-in-nigeria.pdf> accessed on 26 May 2021

[93] Ibid

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i. **Eligibility to Treaty Benefits in Nigeria**
The Information Circular specifies that a taxpayer can only be entitled to benefits under the treaty between Nigeria and its treaty partners if the taxpayer is a resident of either Nigeria the treaty country or both countries.[94]

ii. **Denial of Treaty Benefits**
A taxpayer, resident or non-resident may be denied treaty benefits if, based on facts and circumstances, it is discovered that its residency of one of the treaty countries was principally for the purpose of accessing that treaty benefit (treaty shopping) or if it is discovered after review of the case that one of the principal purposes of the arrangement of a transaction or business is to take advantage of the treaty or abuse its provisions (Principal Purpose Test "PPT").[95]

iii. **Available of Treaty Benefits**
The Information Circular outlines five reliefs under Nigeria's DTTs with its treaty partners provides explanations on what constitutes the benefit under each relief. These include relief for double taxation, treaty tax rates to foreign airlines or shipping companies, treaty withholding rates for passive income or fees for technical service, access to Mutual Agreement Procedure (MAP) for dispute resolution, non-discrimination in tax matters.[96]

iv. **Procedures for Claiming Treaty Benefits in Nigeria**
A taxpayer seeking treaty benefits is required to complete a Certificate of Residence for Nigerian or non-Nigerian residents (as applicable), obtain its tax authority's endorsement on the certificate before submitting a formal application (together with the endorsed certificate, evidence of foreign tax paid, etc.) to the tax authority of the other country for approval.[97]

The Information Circular published by the FIRS, as can be seen from its key aspects above, stipulated procedures for accessing tax treaty benefits in Nigeria. Therefore, with the issuance of this Information Circular, the process of claiming treaty benefits in the country should be seamless for eligible taxpayers. According to a tax expert in Nigeria, Mr Wole Obayomi who is the Partner & Head, Tax, Regulatory and People Services KPMG Nigeria, the issuance of the Information Circular on claim of tax treaty benefits is a welcome development as it provides the much-needed clarity on the procedure to access tax reliefs and concessions as provided in the tax laws and under the various DTTs between Nigeria and its treaty partners.[98]

6. Conclusion and Recommendations

The article provided an in-depth understanding of tax treaty abuse/shopping. The article revealed that tax treaty abuse/shopping is where a taxpayer uses deliberate measures and arrangements to access the benefits of a DTT in an inappropriate manner. The article further revealed that tax treaty abuse/shopping is a form of tax avoidance or evasion which can negatively impact on revenue generation of countries which necessitated the need to introduce certain measures to counter and prevent treaty abuse/shopping.

The article examined the recommendations made by the OECD/G20 BEPS Final Report to prevent tax

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[94] Federal Inland Revenue Service (FIRS) 'Information Circular on the claim of Tax Treaties Benefits in Nigeria', para. 3.1

[95] Federal Inland Revenue Service (FIRS) 'Information Circular on the claim of Tax Treaties Benefits in Nigeria', para. 3.3

[96] Federal Inland Revenue Service (FIRS) 'Information Circular on the claim of Tax Treaties Benefits in Nigeria', para. 4.0.

[97] The forms are available on the FIRS' website <https://www.firs.gov.ng/TaxResources/TreatyRelatedForms>

[98] KPMG, 'FIRS issues Information Circular on the claim of Tax Treaty Benefits in Nigeria' <https://home.kpmg/ng/en/home/insights/2019/12/FIRS%20issues%20Information%20Circular%20on%20the%20claim%20of%20Tax%20Treaty%20Benefits%20in%20Nigeria.html> accessed on 27 May 2021

treaty abuse/shopping. It also examined the position of the Nigerian government on tax treaty abuse/shopping. The article revealed that the Nigerian government is a signatory to the Multilateral Instrument (MLI) which automatically amends the country's existing 13 DTTs to implement the minimum standards recommended by the BEPS Final Report.

The examination revealed that the BEPS Final Report recommended an amendment to the Preamble of the OECD Model Tax Treaty to indicate that, the purpose of a DTT include prevention of tax avoidance or evasion and for the inclusion of a specific anti-avoidance/abuse provision (Limitation of Benefit rule) and general anti-avoidance/abuse provision (Principal Purpose Test rule) in tax treaties to counter treaty abuse/shopping. These recommendations, according to the article, have been implemented through the Multilateral Instrument (MLI) which allows governments to introduce the tax treaty related measures of the OECD/G20 BEPS Project into their existing bilateral tax treaties without the need to renegotiate the tax treaties.

The article further revealed that the Nigerian government through FIRS, published an Information Circular on claim of tax treaty benefits. The publication of this Information Circular has been hailed as one that will provide the much-needed clarity on the procedure to access tax treaty benefits in the country. It is recommended that the Nigerian government should continue to follow up with international developments on prevention of tax treaty abuse/shopping as this will go long a way to assist the country to prevent tax avoidance and evasion that can arise therefrom. It is further recommended that the Nigerian government should ensure that the minimum standards recommended by OECD are included in tax treaties to be negotiated in future with other countries.

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