PS LA 2020/2 - Administering general anti-abuse rules, such as a principal or main purposes test, included in any of Australia's tax treaties

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PS LA 2020/2
Administering general anti-abuse rules, such as a principal or main purposes test, included in any of Australia's tax treaties

This Law Administration Practice Statement provides guidance to ATO staff on the administrative process of applying a principal or main purposes test included in any of Australia's tax treaties.

This Practice Statement is an internal ATO document and is an instruction to ATO staff.

1. What this Practice Statement is about

This Practice Statement helps you to apply a principal or main purposes test in any of Australia's tax treaties, including for a private ruling, a public ruling (including a product or class ruling) or any other document setting out the ATO view.

In this Practice Statement, we use 'purpose test' as a term of convenience to cover the tests it applies to. These are:

- the principal purposes test under paragraph 1 of Article 7 of the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*[1] (MLI) as it applies to a Covered Tax Agreement (CTA)[2] (the MLI PPT)
- a principal purposes test in an Australian tax treaty that is not a CTA[3] (a PPT), and
- a main purposes test (MPT)[4] in an Australian tax treaty that is yet to be or will not be modified by the MLI.

Unless otherwise stated, a reference to a purpose test is a reference to any or all of these tests.

This Practice Statement is divided into the following sections:

(a) what to do when considering applying a purpose test

(b) framing questions and documents that may be relevant when you are considering applying a purpose test, and

(c) background and relevant considerations in applying the MLI PPT.

This Practice Statement has been developed in recognition that applying a purpose test to deny a benefit under a tax treaty is a serious matter.

2. What should you do if you consider that a purpose test may apply?

Before deciding that a purpose test applies to deny a treaty benefit, you must first:

- notify the appropriate International specialist team
- refer the matter to the Tax Counsel Network (TCN) business line
- refer the matter to the General Anti-Avoidance Rules (GAAR) Panel, and
- consider possible requests under paragraph 4 of Article 7 of the MLI.

Notify the International specialist team

If you consider that a purpose test may apply, you must present the relevant facts and circumstances to the appropriate International specialist team[5] as soon as possible. You may also engage other relevant technical experts in your business line (for example, the Technical Leadership and Advice stream of the Private Wealth business line).

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[1] [2019] ATS 1.

[2] A CTA is a double-tax agreement that has its operation modified by the MLI.

[3] For example, paragraph 2 of Article 23 of the *Agreement between Australia and the Federal Republic of Germany for the Elimination of Double Taxation with respect to Taxes on Income and on Capital and the Prevention of Fiscal Evasion and Avoidance* [2016] ATS 23.

[4] An MPT has the effect of denying the benefits of a specific Article of a tax treaty (generally in relation to dividends, interest or royalties) that restricts source taxation where obtaining those benefits was the main purpose (or one of the main purposes) of any person concerned with the creation or assignment of the property or rights in respect of which the relevant income is paid. For example, paragraph 7 of Article 10, paragraph 9 of Article11 and paragraph 7 of Article12 of the *Convention between the Government of Australia and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital Gains* [2003] ATS 22, prior to the modifications by the MLI.

[5] The Treaties Consultation Unit – email taxtreaties@ato.gov.au

The International specialist team and technical experts may help you decide whether the matter should be referred to TCN.

Refer the matter to the Tax Counsel Network

You **must** refer a purpose test matter to TCN in the following circumstances:

- before applying a purpose test to deny a benefit under an Australian tax treaty.[6]

  In the usual case, the matter will be referred to TCN before issuing an ATO position paper indicating that a purpose test may apply.

- before giving a private ruling, product ruling or class ruling, or issuing any other ATO product that states that a purpose test applies to an arrangement or transaction.

  (See Section 3 of this Practice Statement for more information on giving a private ruling, including where the taxpayer has not requested a ruling on whether a purpose test applies.)

- where a request for a class ruling includes the application of a purpose test, including where it is considered that it would not apply.

However, a decision that a purpose test would not apply in response to an application for a private ruling or a product ruling does not always require referral to TCN. Similarly, a decision not to apply a purpose test in the context of an audit does not always require referral to TCN. In such cases, the business line will make a judgment about whether the matter needs to be referred to TCN, depending on whether the application of a purpose test is seriously contemplated. Where the application of a purpose test is not seriously contemplated, the matter need not be referred to TCN.

When TCN confirms a decision not to apply a purpose test, the matter is returned to the decision maker in the business line as a preliminary step to the making of the decision. If, however, the TCN officer is of the view that a purpose test may apply to the matter, they will provide interim advice to the decision maker and arrange for that advice and relevant papers to be provided to a Deputy Chief Tax Counsel for further consideration before the decision is made. Further, the decision maker will be required to refer the matter to the GAAR Panel.

A decision on review or objection or in the course of litigation to reverse a decision to apply a purpose test must not be made without first referring the matter to a Deputy Chief Tax Counsel or the Chief Tax Counsel.

Further guidance for ATO staff on escalating matters to TCN can be found in Law Administration Practice Statement PS LA 2012/1 *Engagement of Tax Counsel Network on high risk technical issues*.

Refer the matter to the General Anti-Avoidance Rules Panel

The application of a GAAR is a serious matter. As such, the Commissioner established the GAAR Panel to advise on the application of GAARs to particular arrangements. Due to the seriousness of applying a purpose test to deny a benefit under an Australian tax treaty, we use the GAAR Panel to provide advice on particular arrangements.[7]

The GAAR Panel provides advice to the decision maker to ensure that decisions in relation to the purpose tests are objective and consistent in approach.

The role and procedures of the GAAR Panel, as detailed in paragraphs 18 to 41 of PS LA 2005/24, apply to purpose test matters. Unless otherwise indicated, matters for which a decision maker is proposing to apply a purpose test must be referred to the GAAR Panel by the decision maker before a final decision is made. In the usual case, a matter will be referred to the GAAR Panel after the TCN officer to whom it has been referred has fully considered the matter.

A competent authority sits on the GAAR Panel for all purpose test matters. The role of the competent authority is to provide specialist advice to the GAAR Panel on the provisions of the relevant Australian tax treaty.

Consider possible requests under paragraph 4 of Article 7 of the MLI to grant a benefit denied under the MLI PPT

When considering the application of the MLI PPT to a particular arrangement, the possibility of a request under paragraph 4 of Article 7 of the MLI should also be contemplated. Refer to Section 7 of this Practice Statement for more detail.

3. Purpose tests in rulings, advance pricing arrangements and settlements

Private ruling applications

The process for considering the application of a purpose test for the purposes of a private ruling is

[6] Refer to Law Administration Practice Statement PS LA 2005/24 *Application of General Anti-Avoidance Rules*.

[7] Refer to PS LA 2005/24.

consistent with normal practice for GAAR matters as detailed in paragraphs 9 to 13 of PS LA 2005/24.

Advance pricing arrangements program

In most cases, it is not expected that the potential application of a purpose test to an arrangement or transaction would affect the outcome of an advance pricing arrangement (APA). However, where it does represent such a risk, you should seek to address and resolve a purpose test risk as a collateral issue in parallel with the development of the APA. The normal practice for addressing and resolving collateral issues is detailed in section 22 of Law Administration Practice Statement PS LA 2015/4 *Advance Pricing Arrangements*.

Where it is not possible to resolve a purpose test risk during the APA process, you must:

- in accordance with PS LA 2015/4, consult with the appropriate internal stakeholders on whether it is appropriate for us to proceed with the APA, and
- ensure that the matter is referred in accordance with the guidance in this Practice Statement.

Settlements

If there is a risk that a purpose test may deny a treaty benefit arising from an arrangement or transaction covered by a proposed settlement, you should ensure the matter is referred in accordance with the guidance in this Practice Statement before deciding whether to proceed with the settlement.

4. Denial of a benefit under a purpose test

A purpose test is self-executing in the sense that the Commissioner does not need to first make a determination in order to give effect to a decision that it applies.[8]

After a decision is made that a purpose test applies to an arrangement or transaction, and a benefit or relief under the Australian tax treaty is denied, follow the correct procedure for the type of benefit denied. For example, making or amending an assessment or raising a withholding tax liability on dividend, interest or royalty payments.

When a benefit or relief is denied, the taxpayer's position will revert to the position under Australian domestic tax law. For example, where the limitation on a withholding tax rate is denied, the withholding tax rates under Australian domestic tax law will be applicable.

The mutual agreement procedure under the Australian tax treaty may also be relevant – general guidance on mutual agreement procedure can be found on our website.

5. Requests under paragraph 4 of Article 7 of the MLI

Only a competent authority can make a decision under paragraph 4 of Article 7 of the MLI to grant a benefit that is otherwise denied under the MLI PPT (or to grant different benefits). If you receive a request from a person under paragraph 4 of Article 7 of the MLI, you must refer it to:

- the Competent Authority Network[9]
- the appropriate specialist in the International specialist team, and
- TCN.

Where possible, the officers that were involved in the original matter should be assigned to the request to grant a benefit under paragraph 4 of Article 7 of the MLI. Further, as outlined in Section 2 of this Practice Statement when considering the application of the MLI PPT in the first instance, the possibility of a request under paragraph 4 of Article 7 of the MLI should be contemplated.

The Australian competent authority must consult the competent authority of the other Contracting Jurisdiction before rejecting a request to grant benefits. This does not apply if the Australian competent authority decides to grant the benefit according to the taxpayer's request.

6. Framing questions and documents

This section outlines framing questions and documentation that may be relevant when you are considering the application of a purpose test. In relation to the MLI PPT, this section should be read in conjunction with Section 7 of this Practice Statement.

The questions and documentation set out in this section are intended to serve as a general guide only and should not be treated as an exhaustive list outlining every matter you may take into account. You must consider whatever additional matters are relevant to the particular purpose test and the circumstances of each case.

The questions and documentation that may be relevant will depend on which purpose test is being considered

[8] Unlike, for example, Part IVA of the *Income Tax Assessment Act 1936* (Part IVA). All legislative references in this Practice Statement are to the *Income Tax Assessment Act 1936* unless otherwise indicated.

[9] InternationalsGatekeeper@ato.gov.au

and whether the relevant arrangement or transaction (referred to hereafter as the 'arrangement') involves:

- treaty shopping[10] where you would need to consider why an entity was established or why a taxpayer moved their residence to a particular jurisdiction, or
- the conversion of one type of income into another, or other changes in the circumstances in which income is derived in order to obtain a treaty benefit.

Framing questions

Preliminary questions specific to MLI PPT and PPT

- What is the arrangement?
- Does that arrangement result in the taxpayer obtaining a benefit under the relevant treaty?
- Has the taxpayer satisfied the requirements under the relevant provisions of the treaty in order to obtain that benefit?
- Have the specific requirements of the purpose test in the relevant treaty been satisfied?

Preliminary questions specific to an MPT

- Does the arrangement result in the taxpayer obtaining a benefit under an article in the relevant treaty that includes an MPT (or to which an MPT applies)?
- Does the arrangement involve the creation or assignment of the shares, debt claim or other rights in respect of which the relevant income is derived or paid?
- Has the taxpayer satisfied the specific requirements of the MPT in the relevant treaty?

Framing questions relevant to determining purposes

The following questions may be relevant to allow you to understand and consider the objective purposes of the arrangement:

- What is the broader business context in which the arrangement has been implemented?
- What are the objective effects of the arrangement? That is, what are the results which it produces or is capable of producing?
- How does the arrangement go about achieving its results?
- What are the terms of the arrangement?
- What are the overt acts by which the arrangement was carried into effect?
- What do the terms and circumstances of the arrangement indicate about the characteristics of the arrangement and the results it was intended to produce?
- What does the way in which the arrangement was implemented indicate about the characteristics of the arrangement and the results it was intended to produce?
- What does what the arrangement was intended to effect indicate about the characteristics of the arrangement?
- Is there an alternative way that the non-tax objectives of the arrangement could be achieved?
- Is the arrangement more complex or does it contain more steps than is necessary to achieve the non-tax objectives? For example, is there a more convenient, commercial or cost-effective way of achieving the same non-tax objectives?
- What are the non-tax benefits and drivers for establishing each of the relevant entities in each relevant jurisdiction?
- Is the role of any entity in the arrangement explicable solely or principally by tax reasons or for obtaining the relevant benefit?
- What are the quantifiable non-tax financial benefits of the arrangement?
- Is there a discrepancy between the substance of what is being achieved under the arrangement and the legal form it takes?
- Does the arrangement involve the transfer or effective transfer of valuable intangible assets and/or centralisation of risks?
- Does the arrangement involve the change in character of payments or a mischaracterisation of payments? For example, service fees rather than royalties, interest rather than business profits?
- What are the functions, assets and risks of each entity in the arrangement? Does each entity possess the necessary competencies and

[10] Treaty shopping is a type of treaty abuse. It involves arrangements through which a person who is not a resident of a State might transfer its residence to that State, or establish another entity as a resident of that State, in order to reduce or eliminate taxation in another State through the benefits of a treaty concluded between the two States.

capacity to manage its functions, assets and risks?

- Does the arrangement avoid the existence of a permanent establishment in one of the jurisdictions?
- Does the arrangement involve the change of residence of an entity or taxpayer?
- Does the arrangement involve the use of hybrid entities or instruments?
- Is there evidence of market conduct/industry practice that resembles the arrangement? If so, what are the commercial drivers for that practice?
- Does the arrangement include the use of back-to-back or flow-through arrangements?

Additional framing questions specific to determining purposes for an MPT

- What objective evidence exists regarding the consideration and rejection of possible alternative ways of implementing the arrangement?
- Does the arrangement alter the circumstances in which the relevant income is derived in order to obtain a benefit or a more favourable benefit than was previously available?
- What steps were undertaken by the taxpayer or related person to give effect to the creation or assignment (or other relevant arrangement)?
- What is the nature of any connection between the relevant taxpayer and any other person concerned with the creation or assignment of the shares, debt-claim or other rights in respect of which the relevant income is derived or paid?

Framing questions – paragraph 4 of Article 7 of the MLI

The following framing questions may be relevant to your consideration of a possible request under paragraph 4 of Article 7 of the MLI for the relevant arrangement.

In the absence of the arrangement, would:

- the same benefit that was denied by the application of the MLI PPT have been granted under the CTA?
- a different benefit have been granted under the CTA?
- the granting of that benefit be in accordance with the object and purpose of the CTA?

Documents

There is no specific record-keeping requirement for purpose tests on top of those set out under Australia's tax laws.

The following types of documents may be relevant when you are establishing the relevant facts and circumstances and considering the application of a purpose test. This is intended as a general guide only and is not an exhaustive list of every document you may need to take into account. The relevance of particular documents will depend on the circumstances and the arrangement.

Documents in our possession

You should generally consider information in our possession, which may include:

- lodged Australian tax returns
- international dealings schedules
- reportable tax position schedules
- Australian notices of assessment
- Country-by-Country reporting data exchanged automatically or by exchange of information request
- information obtained from foreign jurisdictions through exchange of information processes
- information provided previously under other compliance activities, and
- other relevant information from third-party sources.

Documents that we may request

You may ask the taxpayer to provide the following information:

- a general submission outlining their views about the application of the purpose test
- international dealings schedules working papers
- annual reports or general-purpose financial statements
- contemporaneous transfer-pricing documents, and
- inter-company agreements and relevant company policies regarding such dealings.

Source documents

You may also consider source documents, including but not limited to:

- source documents relating to the arrangement such as agreements between the relevant entities
- presentations and other papers relating to the arrangement or transaction as disseminated to the taxpayer's senior management team and board of directors
- physical or electronic documents that evidence an intention, election, choice or rule for the taxpayer's management team and board of directors to meet in a specific country and/or countries
- minutes of board and other meetings at which the arrangement or transaction was considered
- internal cost-benefit analyses – this could include quantifiable productivity gains, cost savings, synergistic benefits, location-specific benefits, reduction of non-income tax costs, provision of government incentives and any other relevant costs and benefits associated with the arrangement, and
- commercial, regulatory and tax advice relating to the arrangement or transaction and details of the people involved in putting that arrangement or transaction in place.

7. MLI PPT – background and relevant considerations

This section focuses on the PPT in the MLI. It does not deal with other purpose tests included in our bilateral tax treaties.

Background to the MLI and the MLI PPT

The MLI is a key outcome of the Organisation for Economic Co-operation and Development (OECD)/G20 Base Erosion and Profit Shifting (BEPS) project.[11] It enables countries to swiftly modify the operation of their tax treaties to implement a series of measures that were developed in the course of the BEPS project.

Jurisdictions that sign the MLI are required to nominate which tax treaties they want the MLI to apply to. The MLI only modifies the operation of an agreement if each party to the agreement specifically identifies it in a notification to the OECD Depositary.[12] A CTA is a double-tax agreement that will have its operation modified by the MLI.

The date of effect of the MLI for each CTA depends on when it has come into force in both jurisdictions. The MLI came into force for Australia on 1 January 2019. Therefore, the earliest the MLI may take effect for Australia is:

- for withholding taxes, on income derived on or after 1 January 2019
- for all other taxes, for income years starting on or after 1 July 2019, and
- for dispute resolution, generally on or after 1 January 2019.

Given the flexibility provided by the MLI, the extent to which the operation of each CTA is modified depends on the choices, notifications and reservations of each jurisdiction. However, certain articles of the MLI enable jurisdictions to meet minimum standards under various BEPS project actions. Those articles must be adopted by members of the OECD/G20 BEPS project.

In particular, BEPS Action 6[13] identified treaty abuse, including treaty shopping, as a significant cause of concern. The minimum standard for the prevention of treaty abuse under BEPS Action 6 requires jurisdictions to include an express statement in their tax treaties: [14]

> … 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.

Paragraph 1 of Article 6 of the MLI modifies the operation of Australia's CTAs to include preamble text which meets this standard.

The minimum standard under BEPS Action 6 also requires that jurisdictions include in their tax treaties:

- a PPT only
- a PPT and either a simplified or detailed Limitation on Benefits provision, or

[11] Actions which have been developed in the context of this project are available at oecd.org/tax/beps/beps-actions/. Details of the Group of Twenty (G20) is available at g20.org/

[12] Article 1 and subparagraph 1(a) of Article 2 of the MLI.

[13] Action 6 culminated in the following report: OECD, 2015, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 – 2015 Final Report,* OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris (Action 6 report). Action 6 of the BEPS project aims to prevent the granting of benefits in situations where those benefits were not intended to be granted, which includes treaty abuse and treaty shopping (see the Executive Summary of the Action 6 report, p. 9).

[14] Executive Summary of the Action 6 Report, p. 10.

- a detailed Limitation on Benefits provision supplemented by a mechanism that deals with conduit financing arrangements not already addressed in their tax treaties.[15]

Because a PPT is the only approach that can satisfy the minimum standard on its own, it is presented as the default option in the MLI. Australia has adopted the PPT under the MLI.

The MLI PPT is set out in paragraph 1 of Article 7 of the MLI:

> Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement 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 the Covered Tax Agreement.

Australia has also adopted the associated rule provided for under paragraph 4 of Article 7 of the MLI which enables treaty benefits to be granted in certain circumstances, notwithstanding the application of the MLI PPT:

> Where a benefit under a Covered Tax Agreement is denied to a person under provisions of the Covered Tax Agreement (as it may be modified by this Convention) that deny all or part of the benefits that would otherwise be provided under the Covered Tax Agreement where the principal purpose or one of the principal purposes of any arrangement or transaction, or of any person concerned with an arrangement or transaction, was to obtain those benefits, the competent authority of the Contracting Jurisdiction that would otherwise have granted this benefit shall nevertheless treat that person as being entitled to this benefit, or to different benefits with respect to a specific item of income or capital, if such competent authority, upon request from that person and after consideration of the relevant facts and circumstances, determines that such benefits would have been granted to that person in the absence of the transaction or arrangement. The competent authority of the Contracting Jurisdiction to which a request has been made under this paragraph by a resident of the other Contracting Jurisdiction shall consult with the competent authority of that other Contracting Jurisdiction before rejecting the request.

The application of paragraph 4 of Article 7 of the MLI to a particular CTA will depend on whether the other Contracting Jurisdiction has also chosen to adopt it.

Considerations that may be relevant when considering the application of the MLI PPT

Some of the considerations that may be relevant when you are considering the application of the MLI PPT include:

- the ATO's views on interpreting double-tax agreements
- benefits to which the MLI PPT may apply
- one of the principal purposes – obtaining a benefit contrary to the object and purpose of a CTA, and
- granting a benefit under the discretion in paragraph 4 of Article 7 of the MLI.

The matters discussed are not exhaustive and are intended to serve as a general guide only. You must consider whatever additional matters are relevant to the circumstances of each case.

ATO's views on interpreting double-tax agreements

The ATO's views on interpreting double-tax agreements, including general treaty interpretation rules, are provided in Taxation Ruling TR 2001/13 *Income tax: Interpreting Australia's Double Tax Agreements*. In accordance with the principles outlined in TR 2001/13, the MLI (including the MLI PPT) is interpreted in good faith in accordance with the ordinary meaning of the terms of the treaty in their context and in light of its object and purpose. The object and purpose of the MLI is to implement the tax treaty-related BEPS measures.[16] Therefore, the commentary in the final BEPS package, including the Action 6 Report, is relevant guidance material.[17]

The Commentaries on the OECD Model Tax Convention (MTC) are also relevant for interpreting Australia's CTAs to the extent that they are based on the MTC.[18] The Action 6 Report acknowledges that implementation of the final BEPS package requires changes to existing bilateral tax conventions, as well as changes to the MTC. To the extent the provisions are equivalent, the Commentary on the PPT in the

[15] Executive Summary of the Action 6 Report, p. 10.
[16] As reflected in the preamble to the MLI.
[17] Paragraph 12 of the Explanatory Statement to the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*.
[18] TR 2001/13 provides guidance on when subsequent changes to OECD Commentaries could be used as an aid to interpretation.

MTC[19] can be used as a supplementary means of interpretation for the MLI PPT.[20]

The MTC commentary and the Action 6 Report include examples.[21] These may be useful in assessing whether the MLI PPT applies to an arrangement or transaction. However, the examples are explicitly stated to be purely illustrative and should not be interpreted as providing conditions or requirements for similar transactions to satisfy in order to avoid the application of the MLI PPT. You must consider whether the MLI PPT applies to deny a treaty benefit under an arrangement having regard to all relevant facts and circumstances.

Benefits to which the MLI PPT may apply

The MLI PPT can potentially apply to any 'benefit' under a CTA. Depending on the relevant arrangement being considered, it may include a limitation on the taxing rights of a source jurisdiction (such as a tax reduction, exemption, deferral or refund), or the relief from double taxation provided to residents. It may also include the protection afforded to residents and nationals of a jurisdiction under non-discrimination articles or any other similar limitations.

Some examples of limitations on Australia's source-country taxing rights under a CTA are the limited tax rates that apply in respect of dividends, interest and royalties and the restriction on taxing business profits of an enterprise of another jurisdiction (unless such profits are attributable to a permanent establishment in Australia).

Unlike the basis for establishing whether there is a tax benefit for the purpose of Part IVA, the identification of a benefit for the purpose of applying the MLI PPT does not require consideration of an alternative postulate.[22]

One of the principal purposes – obtaining a benefit contrary to the object and purpose of the CTA

The MLI PPT does not list specific matters to be considered in drawing a conclusion about purpose. The purposes of the arrangement are to be determined having regard to 'all relevant facts and circumstances'.[23] Relevantly, it must be reasonable to conclude after an objective analysis of the relevant facts and circumstances that one of the principal purposes of the arrangement was to obtain a benefit under the CTA.

The test is an examination of the arrangement itself, including the overt acts by which it was implemented, in order to ascertain its objective purposes.[24] An analysis is required to determine whether the arrangement exhibits (by contrivance, lack of substance, or otherwise) the requisite purpose of obtaining the relevant benefit, the granting of which would not be in accordance with the object and purpose of the CTA. A review of the objective evidence is necessary, having regard to:

- the arrangement itself
- its terms
- what it achieves
- what it was intended to effect
- how it was implemented
- the results which it is capable of producing
- other possible ways of implementing the arrangement, and
- other relevant facts and circumstances.

An arrangement may be reasonably explained by a number of purposes and it may have more than one principal purpose. In this context, 'principal' does not mean strictly 'first or highest in rank', but rather 'among the most important, prominent, leading, main'.[25] The reference to 'one of the principal purposes' means that obtaining the benefit under the CTA need not be the sole, or even the dominant, purpose of the particular arrangement. It is sufficient that at least one of the principal purposes was to obtain the treaty benefit, even if that was not the dominant purpose.

This means that an arrangement may attract the operation of the MLI PPT even where it attains commercial objectives and is consistent with

[19] Paragraph 9 of Article 29 (Entitlement to Benefits) of the MTC, which was inserted to give effect to the Action 6 Report. The Commentary on paragraph 9 of Article 29 of the MTC largely reflects the content of the Action 6 Report. Hereafter, instead of referencing both the Action 6 Report and the Commentary of the MTC, for convenience only the Commentary is referenced. Where paragraph references are provided, these are to the 2017 version of the Commentary.

[20] The Commentary on paragraph 9 of Article 29 of the MTC is of particular relevance.

[21] The examples commence at paragraph 182 of the Commentary on paragraph 9 of Article 29 of the MTC.

[22] Also referred to as an 'alternative hypothesis' or 'counterfactual', paragraph 75 of PS LA 2005/24.

[23] This is unlike sections 177D, 177DA and 177J in Part IVA, which require that the purpose of person(s) be objectively ascertained having regard to specified matters.

[24] In relation to the purpose of an arrangement see, for example, *Newton v Federal Commissioner of Taxation* [1958] UKPCHCA 31(at [8]; and *Commissioner of Taxation (Cth) v Gulland; Watson v Commissioner of Taxation (Cth); Pincus v Commissioner of Taxation (Cth)* [1985] HCA 83.

[25] Refer to paragraphs 11 to 16 of Law Companion Ruling LCR 2015/2 *Section 177DA of the Income Tax Assessment Act 1936: schemes that limit a taxable presence in Australia* for guidance on a similar test 'a principal purpose of, or for more than one principal purpose that includes a purpose of'.

commercial gain. It is not necessary to show that the arrangement has no commercial substance or that its only effect is to obtain the benefit that arises under the CTA (obtaining the treaty benefit need not be the only reasonable explanation of the arrangement). Also, where one of the principal purposes of an arrangement is to obtain the relevant treaty benefit and another of its principal purposes is to achieve a particular commercial objective, the test will be met, without the need to determine which purpose is dominant. The text, context and purpose of the MLI PPT make clear that it is not a sole, dominant or primary purpose test.

Where the arrangement may be fairly described as an ordinary commercial dealing[26] and no aspect of its form can only be explained by the obtaining of a treaty benefit, the arrangement will not have the requisite purpose even though its effect may be to obtain a treaty benefit. Where, however, it is reasonable to conclude that the arrangement was implemented in a particular way so as to obtain a treaty benefit, it may then be concluded that one of the principal purposes of the arrangement was to obtain that benefit, regardless of the existence of any other commercial purposes of the arrangement.

As noted under *'Benefits to which the MLI PPT may apply*' in Section 7 of this Practice Statement, there is no requirement to consider an alternative postulate in determining whether there is a benefit for the purposes of applying the MLI PPT. However, it may be useful to consider other possible ways of implementing the relevant arrangement as this may cast light on its objective purposes.

Like other anti-avoidance rules, the MLI PPT seeks to distinguish arrangements entered into or carried out for the purpose of obtaining treaty benefits that are consistent with the object of the treaty, from arrangements used to secure treaty benefits by a means that amounts to an improper use of the treaty, or treaty abuse. Both the text of the MLI and its Commentary express this important distinction. Thus, the MLI PPT will not operate to deny a benefit if granting that benefit in the relevant circumstances 'would be in accordance with the object and purpose' of the CTA. This ensures that the treaty applies in accordance with the purpose for which it was entered into, that is, to provide benefits in respect of bona fide exchanges of goods and services, and movements of capital and persons, as opposed to arrangements whose principal objective is to secure a more favourable tax treatment.[27] It also makes clear that the MLI PPT will not apply where an arrangement has been adopted merely with an eye to its tax advantages, unless it amounts to an abuse of the treaty.

In applying the MLI PPT, the tests relating to the 'principal purposes' of an arrangement and the 'object and purpose' of the CTA should be read together. Although the MLI PPT expresses the distinction between arrangements that amount to treaty abuse and those that do not, it should be understood that in practice:

- obtaining a treaty benefit by a means consistent with the purpose for which it is conferred will not exhibit the requisite purpose to attract the MLI PPT, and
- conversely, granting a treaty benefit resulting from an arrangement which exhibits on its face the requisite purpose would not accord with the object and purpose of the provisions of the CTA.

The preamble to the relevant CTA (as modified by the MLI), in which the Contracting States express their intention not to create '… opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements …)', will be important in determining whether it would be contrary to the object and purpose of the provisions of the CTA to grant a benefit.

Where the MLI PPT applies to deny a treaty benefit in a particular case, Part IVA may still apply either:

- in the alternative to the application of the MLI PPT, or
- in addition to the MLI PPT – that is, to cancel any tax benefit remaining after the application of the MLI PPT.[28]

Discretion in paragraph 4 of Article 7 of the MLI

Where a person is denied a benefit under the MLI PPT, paragraph 4 of Article 7 of the MLI provides that person shall nevertheless be treated as being entitled to the benefit, or to different benefits under the CTA, if, upon request and after consideration of the relevant facts and circumstances, the relevant competent authority determines that such benefits would have been granted to the person in the absence of the relevant transaction or arrangement.

Although the provision provides a broad discretion to the competent authority, it has notable limitations. It does not enable the competent authority to grant benefits to any person other than the taxpayer, or to grant benefits that may have been available under a

[26] That is, one that is not contrived, has economic substance, forms part of a presence in the jurisdiction that is involved in carrying on the core business activities of the entity or group that adds economic value.

[27] Paragraph 174 of the Commentary on paragraph 9 of Article 29 of the MTC.

[28] See subsection 177B(1) and subsection 4(2) of the *International Tax Agreements Act 1953.*

different treaty. Further, it does not provide a general power of reconstruction.

Determining what benefits would have been granted to the person under the CTA in the 'absence of' the relevant arrangement requires a consideration of the actual facts but for the impugned arrangement. The discretion is not available to grant a treaty benefit that might have resulted from a different arrangement. However, it may be possible to identify an 'arrangement' for the purposes of the MLI PPT in such a way that, if disregarded, leaves standing other facts that would give rise to a treaty benefit. In other words, it may be possible to shear an underlying larger arrangement of its objectionable features.

The discretion will also be available where the impugned arrangement replaced an existing arrangement between the same parties in the same jurisdiction where a benefit would have been granted to the person under the CTA. It can then be said that the benefit would have been available if the impugned arrangement had not been entered into, and the original arrangement had remained in place.

In determining what benefits would have been granted in the absence of the impugned arrangement, you must take into account whether the MLI PPT would have also applied to the remaining facts.

8. More information

For more information, see:

- Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting
- Explanatory Statement to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting
- Treasury Laws Amendment (OECD Multilateral Instrument) Bill 2018 (first reading)
- Explanatory Memorandum to Treasury Laws Amendment (OECD Multilateral Instrument) Bill 2018
- Model Tax Convention on Income and on Capital 2017 – condensed version

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Amendment history

Date of amendment	Part	Comment
2 March 2021	Section 4	Delete 'varying the foreign resident withholding amount'

References

Legislative references	ITAA 1936 Part IVA ITAA 1936 177B(1) ITAA 1936 177D ITAA 1936 177DA ITAA 1936 177J International Tax Agreements Act 1953 4(2)
Case references	Commissioner of Taxation (Cth) v Gulland; Watson v Commissioner of Taxation (Cth); Pincus v Commissioner of Taxation (Cth) [1985] HCA 83; (1985) 160 CLR 55; 60 ALJR 150; 62 ALR 545; 17 ATR 1; 85 ATC 4765 Newton v Federal Commissioner of Taxation [1958] UKPCHCA 1; 98 CLR 1; 37 ATC 245
File references	1-K113R7S
Related public rulings	TR 2001/13 LCR 2015/2

Related practice statements	PS LA 2005/24 PS LA 2012/1 PS LA 2015/4

ATO references

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