Combatting tax avoidance, the OECD way? The impact of the BEPS Project on developing and emerging countries' approach to international tax avoidance

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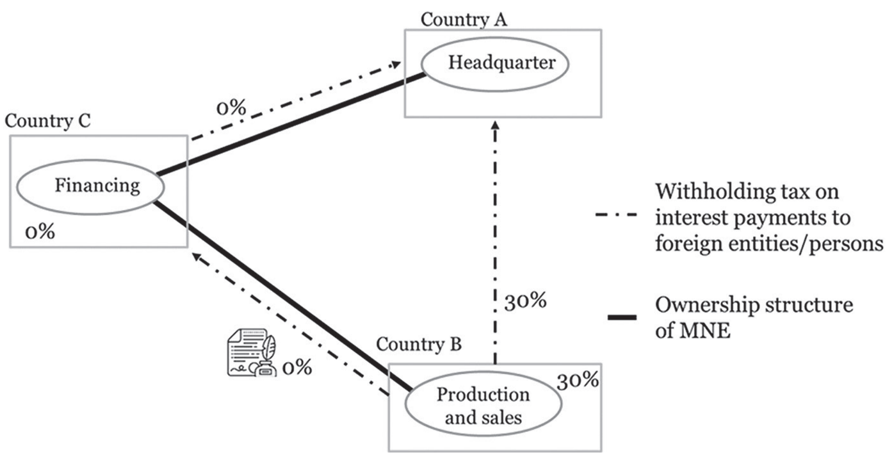
7 Tackling treaty shopping

7.1 Introduction

By concluding bilateral or multilateral tax treaties, countries establish rules for the taxation of cross-border income that a resident of one country earns in the other. One of the principal effects of tax treaties is a restriction on the amount of tax that the country in which the income is generated (the "source" country) may levy on a recipient of the income who is resident in the other country ("residence" country). Since most countries' treaty networks are incomplete, covering only a part of the world's more than 200 independent tax jurisdictions, and because treaties sometimes vary in how much benefit they provide to taxpayers relative to the countries' domestic laws, there can be an incentive for investors to "treaty shop". A multinational enterprise (MNE) engages in treaty shopping if it uses a conduit in a state other than the state from which a payment originates and the state of the "true" recipient of the payment and routes the payment through this conduit subsidiary in order to benefit from a (more advantageous) tax treaty. Figure 11 shows a basic diagram of an MNE which attempts to reduce the applicable withholding tax on interest payments.

Figure 11: Basic treaty shopping structure



Source: the author

In this section, I investigate the different dynamics that cause states to adopt a "finely delineating", a "blunt" or a "tolerance" approach to international tax avoidance in the concrete case of treaty shopping to investigate. While the BEPS Project suggested with the PPT and the LOB two solutions which could both be considered as "finely delineating" approaches, more variation can be observed regarding the approaches taken by different countries: Colombia, India, Senegal and Nigeria adopted markedly different strategies to deal with the phenomenon. Based on these cases, I discuss the relevance of different factors that are theoretically derived or mentioned by interviewees in the four countries and consider the evidence to judge whether they may have played a role affecting the strategies adopted by countries. Afterwards, I explore based on other literature and information from the ICTD Tax Treaties dataset and EY Corporate Tax Guides to what extent these cases could be representative for the wider universe of developing countries.

7.2 History of countering treaty shopping and BEPS Action 6

How to adequately deal with the phenomenon of treaty shopping has been discussed for several decades: In the United States tax discussion, for example, treaty shopping has been a recurrent topic at least since the 1980s.[1] Basic provisions against treaty shopping, the beneficial ownership clauses added to articles dealing with passive income, were already part of the 1977 OECD Model Convention and the 1980 UN Model Convention.[2] However, subsequent reports published by the OECD (in 1986) and by the UN (in 1988) acknowledged that these were not sufficient in addressing the issue, because conduit companies could relatively easily fulfil the beneficial ownership requirement, as the term was used in a narrow way.[3]

The reports describe different treaty shopping structures and different solutions adopted by countries that go beyond the beneficial ownership clauses. Among the approaches, one can differentiate between a general anti-avoidance approach, approaches that seek to directly prevent conduit companies from accessing the benefits of a convention – the look-through, exclusion, subject to tax, channel approaches -, and more general approaches in treaty policy, such as developing a treaty network that reduces incentives

1 Avi-Yonah and Panayi, "Rethinking Treaty-Shopping: Lessons for the European Union," 41; Rosenbloom and Langbein, "United States Tax Treaty Policy: An Overview."

2 For an overview of the history see Avi-Yonah and Panayi, "Rethinking Treaty-Shopping: Lessons for the European Union." See also OECD, Model Tax Convention on Income and on Capital 1977, arts. 10–12; United Nations, Model Tax Convention between Developed and Developing Countries, arts. 10–12.

3 United Nations, "Contributions to International Co-Operation in Tax Matters. Treaty Shopping, Thin Capitalization, Co-Operation between Tax Authorities, Resolving International Tax Disputes," 8; OECD, "Double Taxation Conventions and the Use of Conduit Companies."

for treaty shopping. With respect to the last point, the 1986 OECD report recommends not signing treaties with low tax jurisdictions.[4]

Following an additional report in 2002, the Commentary to Article 1 of the OECD Model Convention was updated to include several paragraphs that argued that taxpayer should not be granted the benefits of the treaty where their main purpose was to obtain these benefits, the so-called "Guiding Principle".[5] Other approaches suggested by academics include a reinforcement of residence tests contained in tax treaties,[6] or an approach that combines tests on residence, tax liability, and ownership of income derived.[7]

BEPS Action 6 is built on the premise that previous approaches have not been sufficient in tackling treaty shopping. Whether this is because of a lack of strength of these clauses is, however, unclear. In the Colombian case for example, the persistence of "gaps" in the network and a failure to audit treaty shopping may have been the main causes. Colombia's treaties with Switzerland and Chile already contained anti-avoidance rules in their original version (a subject to tax clause in the Chilean case, and a channel approach rule in the Swiss case, in which benefits are denied if more than 50% of income received by a resident of a contracting state is transferred to an associate in a third country).[8] A Colombian tax lawyer qualified this rule as strong and through they would make treaty shopping structures through Switzerland relatively unlikely.[9] In the knowledge of another Colombian tax advisor, however, there has never been a case where the tax administration had invoked any of these rules in an audit.[10]

Despite the early reports on the phenomenon, countries have continued concluding treaties with potential conduit jurisdictions, often without including anti-avoidance clauses. The Colombian treaty with Spain (signed in 2005) and the Senegalese treaty with Mauritius (signed in 2002) are cases in point (see also section 7.3.1. Moreover, there is extensive qualitative and quantitative evidence on treaty shopping. An edited volume by Eduardo Baistrocchi documents judicial disputes in countries around the world related to treaty shopping.[11]

4 OECD, "Double Taxation Conventions and the Use of Conduit Companies," para. 17.
5 OECD, Model Tax Convention on Income and on Capital: condensed version 2017., para. Commentary on Article 1, 61; van Weeghel, "A Deconstruction of the Principal Purposes Test"; Danon, "Treaty Abuse in the Post-BEPS World: Analysis of the Policy Shift and Impact of the Principal Purpose Test for MNE Groups."
6 Escribano, "Alternative Approaches to Address the (Yet to Be Defined) Treaty Shopping Phenomenon."
7 Wheeler, "The Missing Keystone of Income Tax Treaties."
8 Convenio Entre la República de Colombia y la Confederación Suiza Para Evitar la Doble Imposición en Materia de Impuestos Sobre la Renta y el Patrimonio, 2007, art. 21
9 CO29
10 CO20
11 Baistrocchi, *A Global Analysis of Tax Treaty Disputes*.

Recent research uses "special purpose entity statistics" to demonstrate the extent of the phenomenon. Lejour, Möhlmann, and van 'Riet find that tax savings through treaty shopping are a significant explanatory variable for the origin and destination of income flows passing through Dutch special purpose entities.[12] Moreover, the fact that countries, which have large treaty networks and other conduit jurisdiction features account for a disproportionate amount of global foreign direct investment flows is consistent with a widespread use of treaty shopping structures.[13]

Substantively, BEPS Action 6 extends and refines the approaches considered in previous reports. It proposes the introduction of one of three types of combinations of rules into the treaties, which would enable a tax administration to disallow transactions that were undertaken for the purpose of treaty shopping. The three options among which countries can choose are: 1) a so-called "Principal Purpose Test" (PPT), 2) a simplified "Limitation on Benefits" (LOB)-rule supplemented with the PPT or 3) a detailed LOB rule, supplemented by a rule that could be applied to conduit financing arrangements (e.g., a domestic general anti-avoidance rule or a substance-over-form doctrine). The application of the PPT rule would allow the country from which the income is sourced to deny the benefit of the treaty if "one of the principal purposes" of the way by which a transaction was carried out was for the avoidance of tax.

The LOB rule on the other hand proceeds the other way around by stating that only "qualified persons" are entitled to treaty benefits and by providing a positive list of such persons. Additionally, it includes the possibility for the tax administration to grant discretionary relief in cases not included in the list, where the taxpayer requests obtaining benefits and can demonstrate that obtaining the benefit of the convention was not one of the "principal purposes" of the establishment of the entity.[14] The main difference therefore is that in case an LOB clause is included, there is a "whitelist" of entities which are deemed to have a low treaty shopping risk. However, even if a taxpayer meets the criteria of the LOB, a tax authority can still apply the PPT or an anti-conduit financing rule to deny benefits.

Further, the Action mandates a reformulation of the preambles of tax treaties to clarify that the treaty is "not intended to create opportunities for tax evasion and tax avoidance". In the past, many treaty preambles only included a reference to the avoidance of double taxation. This has led courts to approve situations of treaty shopping, as these did not conflict with the objective of the tax treaty.[15]

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12 Lejour, Möhlmann, and van 't Riet, "The Immeasurable Tax Gains by Dutch Shell Companies."

13 Damgaard, Elkjaer, and Johannesen, *What Is Real and What Is Not in the Global FDI Network?*; Garcia-Bernardo et al., "Uncovering Offshore Financial Centers."

14 OECD, Model Tax Convention on Income and on Capital: Full Version (as it read on 21 November 2017), sec. Commentary on art. 29, paras. 101–110.

15 Union Of India (Uoi) And Anr. vs Azadi Bachao Andolan And Anr.; van Weeghel, "A Deconstruction of the Principal Purposes Test."

While a "one of the principal purposes test" clause would likely be more effective in catching tax avoidance structures than previously enacted clauses referring to "*the* main purpose", it may, depending on tax administrations' interpretations also catch some structures which could still have a certain degree of commercial substance. However, the PPT rule also requires tax administrations to undertake a "reasonableness" test and to consider "all facts and circumstances" before denying a treaty benefit, thereby requiring administrations to not lightly assume tax avoidance.[16] In addition, the PPT was supplemented in the Commentary to the Model Convention by a number of examples of schemes in which it should be applied and not. Danon argued that, according to international law, these examples should be considered as binding and tax administrations should not interpret the PPT in a way that goes beyond them.[17] This suggests that Action 6 attempts to set boundaries on countries' efforts to counter treaty shopping, which indicates adherence to the finely delineating logic of tackling international tax avoidance.

The Action 6 report also prompted that a longer discussion of the conditions under which a country should enter into a tax treaty at all be included in the OECD Model Convention, among them whether there is a significant amount of cross-border trade and investment with the country and whether there are actual risks of double taxation in relation with that country.[18] This could make it easier for countries to refuse a proposal to enter into a negotiation with a conduit jurisdiction. The paragraph also mentions that the decision of terminating a treaty could be taken for similar reasons, but stresses that it should only be considered as measure of last resort.[19] Therefore, similarly to the transfer pricing area, the BEPS Project expresses some acceptance of blunt measures, while still seeking to narrowly circumscribe their use.

Lastly, it is important to point out that BEPS Action 6 does not explicitly require countries to defend themselves against treaty shopping, i.e., it remains agnostic about countries "giving up" or "not responding". For example, the terms of reference of the peer review on BEPS Action 6 state: "If a jurisdiction is not itself concerned by the effect of treaty-shopping on

16 The clause reads as follows: "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." OECD, Model Tax Convention on Income and on Capital: condensed version 2017., art. 29(9).

17 Danon, "Treaty Abuse in the Post-BEPS World: Analysis of the Policy Shift and Impact of the Principal Purpose Test for MNE Groups."

18 OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 - 2015 Final Report*, 94.

19 OECD, 94; Marian, "Unilateral Responses to Tax Treaty Abuse: A Functional Approach," 1161.

its own taxation rights as a State of source, it will not be obliged to apply provisions such as the LOB or the PPT [the two different anti-avoidance rules proposed] as long as it agrees to include in a treaty provisions that its treaty partner will be able to use for that purpose."[20] The result is that a country can pass the Action 6 peer review, while not taking any action against treaty shopping or giving up on taxing transactions if it does not obstruct the ability of other countries to take action.[21] "Giving-up" in the context of treaty shopping means that a country starts to sign more and at least equally favourable treaties with all countries from which treaty-shopping investors "really" originate or makes treaties redundant by reducing or eliminating withholding taxes or other source-based taxes from domestic law. Arel-Bundock hypothesized that countries would reduce source taxation in domestic law, if due to the prevalence of treaty shopping, the higher withholding taxes can in practice not be imposed on most transactions and finds some evidence for such an effect in an analysis of countries' domestic withholding regimes and tax treaty networks, albeit only in a cross-sectional analysis of the situation in 2012.[22]

Overall, the approach to treaty shopping advocated by BEPS Action 6 is thus mainly the finely delineating approach, but it does not rule out that other approaches are taken by countries. It is therefore interesting to investigate what approaches countries actually adopt. This is the purpose of the following section.

7.3 Policy choices to tackle treaty shopping in India, Colombia, Senegal, and Nigeria

7.3.1 The emergence of treaty shopping and responses in Colombia, India, Nigeria and Senegal

India

Among the four countries, India is the country with the oldest and today largest treaty network. The India history of treaty shopping started when India negotiated a tax treaty with Mauritius in 1982. Unlike other Indian treaties, it allocated the right to tax capital gains exclusively to the residence country.[23] However, at that time, Mauritius did not have any features use-

20 OECD, "BEPS Action 6 on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances – Peer Review Documents," 12.

21 This is different for EU Members States, where the Anti-Tax Avoidance Directives, which is generally considered as the EU implementation of the BEPS project, creates an obligation for member countries to legislate and enforce against international tax avoidance.

22 Arel-Bundock, "The Unintended Consequences of Bilateralism: Treaty Shopping and International Tax Policy," 352.

23 It can be speculated upon that the Indian government imagined at the time that it would usually be the resident country in bilateral investment flows since India's economy is much bigger in size and Mauritius hosts an important Indian diaspora.

ful for setting-up conduits yet. One could reckon that Indian policymakers were expecting that investment would rather flow from India to Mauritius, making the capital gains clause favorable for the Indian revenue. With the support of Indian tax lawyers, Mauritius introduced in 1992 the "Global Business Company" regime which would allow companies to invest into India without tax liability in Mauritius and – thanks to the treaty – with no capital gains tax liability in India upon divestment (which would have amounted to at least 10% otherwise).[24] That structure became common among companies from all over the world,[25] so that Mauritius quickly accounted for one third of FDI into India.[26] After the Mauritius treaty, India also agreed to two more treaties with a similar pattern, namely Cyprus (in 1994) and Singapore (protocol signed in 2005). Subsequently, the share of investment from Singapore rose as well.[27]

Treaty shopping structures gave soon raise to debates among policymakers and judicial fora in India. For example, in the 1995 NatWest case, the Indian Authority for Advance Rulings (AAR) denied providing a British bank, that had invested in India through two wholly owned subsidiaries in Mauritius whose directors were chartered accountants from Mauritius, with certainty that its Indian operations would not be subject to capital gains tax in India, judging that a UK resident bank could have invested directly in India without passing through Mauritius.[28]

However, a circular issued by the Central Board of Direct Taxes (CBDT) in 1994 confirmed that a mere tax residency certificate from Mauritius would be sufficient for obtaining protection under the India-Mauritius tax treaty.[29] Despite this, tax auditors started questioning the validity of these certificates in notices issued to taxpayers in March 2000, which led to significant value losses in the Indian stock market and reported divestments by foreign investment funds.[30] Subsequently, the CBDT published a new circular clarifying that the notices issued were not valid and the Mauritian tax residency certificated, in turn, remained sufficient proof of residency. [31]

This circular became then subject to a dispute, which culminated in the Azadi Bachao Andolan decision from 2003 by the Indian Supreme Court,

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24 Robertson, "India's Offshore Pivot: The Implications of a Tougher Approach towards Mauritius," 241.

25 Gopalan and Rajan, "India's FDI Flows: Trying to Make Sense of the Numbers."

26 Kotha, "The Mauritius Route: The Indian Response," 204.

27 Although most of these structures were probably less artificial, since many MNEs probably had a real economic presence in Singapore and there was a limitation on benefits clause requiring some degree of substance in Singapore.

28 "Re: Advance Ruling No. P-9 Of ... vs Unknown on 22 December, 1995. 1996 220 ITR 377 AAR." "Re: Advance Ruling No. P-9 Of ... vs Unknown on 22 December, 1995. 1996 220 ITR 377 AAR."

29 Jain, "How Vodafone International Has Overruled Azadi Bachao Andolan Decision," 131. Jain, 131.

30 Vikraman, "In Fact: The Good and Not-so-Good in the Mauritius Tax Treaty." Vikraman.

31 Income Tax Department, Clarification regarding taxation of income from dividends and capital gains under the Indo-Mauritius Double Tax Avoidance Convention (DTAC).

which has become one of the landmark tax treaty cases worldwide.[32] In this case, the Indian government defended its explicit permission of treaty shopping against the civil society organization Azadi Bachao Andolan and a retired officer of the Indian tax authority, Shiva Kant Jha.[33] The court upheld the validity of the circular, concluding that the permission of treaty shopping was one of the objectives of the conclusion of the treaty with Mauritius and that treaty shopping should be considered as "a tax incentive to attract scarce foreign capital or technology".[34]

In an article analyzing the subsequent jurisprudence, Jain highlighted that the Azadi Bachao decision has had an important impact, as in most cases that involved Mauritian shell companies, the benefit was granted to the taxpayer.[35] He nevertheless highlighted that this was not always the case since the AAR or High Courts have ruled against such schemes from time to time.

The first ten years of the history of treaty shopping in India could be summarized as struggle between some forces in the government (mainly in the political levels of the tax administration) which saw benefits in tolerating treaty shopping and other forces (mainly the field levels of the tax administration), which considered the practice as harmful to India. Other Indian tax experts were divided as to whether this policy was desirable and whether the Supreme Court decision was legally correct.[36] One interviewee, for example, stated that in his/her view, "the supreme court got it completely wrong […] and sanctified treaty shopping. The court got carried away with the thought of foreign investment going away. When the court interprets tax treaties, it should interpret that, and not whether investment is affected".[37]

There is evidence, though, that the Indian government has since 1995 sought to renegotiate the tax treaty with Mauritius at several occasions.[38] However, it was only in 2017 that these attempts culminated in the signature of an amending protocol, which shifts the rights to tax capital gains to

32 Union Of India (Uoi) And Anr. vs Azadi Bachao Andolan And Anr.; Kotha, "The Mauritius Route: The Indian Response"; van Weeghel, "A Deconstruction of the Principal Purposes Test"; Baistrocchi, "The Use and Interpretation of Tax Treaties in the Emerging World: Theory and Implications," 362.

33 Azadi Bachao Andolan describes itself on its website as "a national movement in India to counter the onslaught of foreign multinationals and the western culture on Indians, their values, and on the Indian economy in general." http://azadibachaoandolan.freedomindia.com/

34 van Weeghel, "A Deconstruction of the Principal Purposes Test," 13; Union Of India (Uoi) And Anr. vs Azadi Bachao Andolan And Anr.

35 Jain, "How Vodafone International Has Overruled Azadi Bachao Andolan Decision," 132–33. Jain, 132–33.

36 IN19, IN12

37 IN03, see also on that point Kumar, "Incoherence in Applying International Tax Law: Hemorrhaging Development." IN03, see also on that point Kumar.

38 Kotha, "The Mauritius Route: The Indian Response," 206.

the source state and includes a specific limitation on benefits clause applicable to the capital gains clause in the treaty.[39] At the same time, the treaties with Singapore and Cyprus were renegotiated, as well. The re-negotiations were not the only measure to address treaty shopping. India also signed the Multilateral Instrument and implemented a general anti-avoidance rule in domestic law. However, both measures occurred at the same time or after the renegotiations. Moreover, Mauritius did not list India among its covered jurisdictions under the MLI.[40] Hence, according to interviewees, these other measures did not matter anymore. Although a beneficial treatment was still potentially left for some types of transactions,[41] one advisor commented: "Anyway, it's irrelevant now because Mauritius is out now. So anyway, long term capital gains are subject to 10% in India. So no one is really caring about it."[42]

India and Mauritius are connected because of the large Indian diaspora that lives in Mauritius.[43] According to interviewees from the Indian tax authority, the political connections may have played a role in preventing India from threatening with a termination in light of Mauritius' refusal to re-negotiate, despite the obvious difference in economic power between the two countries.[44] However, according to a tax treaty negotiator the emergence of an international consensus that double non-taxation is not acceptable anymore contributed to having the Mauritian government agree to the re-negotiation.[45] This interpretation was shared by practitioners, one of whom mentioned that: "Amendments were long overdue. The world at large was frowning upon India and upon liberal jurisdictions. But there was also pressure by the new world order, which is BEPS."[46]

However, Kotha pointed out that the introduction of the GAAR in 2017 (which had been planned for several years beforehand) may have convinced the Mauritian government to agree to the renegotiation since the clause may have created uncertainty anyways as to whether treaty benefits would be granted.[47]

In sum, India transitioned from an approach in which treaty shopping was explicitly tolerated by the government to a relatively blunt response. Since the beginning, the approach was contested, and it seems likely that

39 KPMG, "India and Mauritius Sign a Protocol Amending the India-Mauritius Tax Treaty."
40 Tandon, "The Multilateral Legal Instrument: A Developing Country Perspective."
41 I.e., the fact that the right to tax capital gains tax at source was only attributed to India in case of sales of shares, but not other types of financial instruments. Kotha, "The Mauritius Route: The Indian Response," 214.
42 IN10
43 Betz and Hanif, "The Formation of Preferences in Two-Level Games: An Analysis of India's Domestic and Foreign Energy Policy," 12.
44 IN11288
45 IN11288
46 IN18
47 Kotha, "The Mauritius Route: The Indian Response," 208.

the concurrence of various factors, such as a general step-up in anti-avoidance efforts of the government and a change in the international discourse, contributed to the policy change.

Colombia

Colombia started negotiating tax treaties significantly later than India. However, the ratification of Colombia's first OECD/UN-style double tax treaty with Spain (2007) already opened avenues for treaty shopping.[48] In 1995, Spain had introduced a holding company regime, the ETVE regime (Spanish: Empresa de Tenencia de Valores Extranjeros), emulating policies adopted by other European countries such as the Netherlands and Luxembourg.[49] Interviewees reported that a story frequently told in Colombia is that the treaty with Spain was "negotiated in one day" and that the proposed version by Spain was accepted without negotiations.[50] There is evidence that direct pressure was exercised by then-president Álvaro Uribe to conclude as many treaties as quickly as possible, with an unrealistic target set at 25 treaties per year.[51] A tax advisor said that the absence of an anti-abuse clause made the Spanish treaty the most widely applied.[52] Other treaties were negotiated with Switzerland (2008) and Chile (2009). Chile and Switzerland also had regimes that were favourable for conduit activities. However, both treaties already contained anti-avoidance rules. One tax advisor described the anti-avoidance rule in the treaty with Switzerland as particularly strong.[53] Therefore, the treaty with Spain should be considered as the main potential avenue for treaty shopping.

As to whether many companies made use of the treaty with Spain to indirectly invest in Colombia, tax advisors generally confirm that this was the case, but do not cite it among the first issues when asked about the most important tax avoidance strategies that Colombia was exposed to.[54] SPE statistics seem to confirm this picture, although there is some uncertainty the numbers.[55] No interviewee was aware that treaty shopping structures had given rise to disputes with the tax authority and there are no court cases in Colombia which deal with the question. However, this may not be evidence that there is no treaty shopping since a former government official

48 A multilateral tax treaty had been concluded earlier: the Andean community treaty, to which Colombia's neighbouring countries were a party. However, this treaty had a very different structure, providing generally for exclusive taxing rights for the source country. Hence, it is unlikely to have presented any treaty shopping risks.

49 Fundación de Estudios Bursátiles y Financieros, "Presente y Futuro En El Régimen de Las ETVE."

50 CO07, CO05

51 CO01

52 CO30

53 CO29

54 Most rather speak of schemes used by Colombian headquartered companies to defer taxation through the use of controlled foreign companies, or of transfer pricing issues. CO16, CO14

55 For a more detailed discussion, see section 0.

described that only more recently, tax officials started to receive training on how to identify whether entities located in other countries such as Spain had substance.[56]

Nevertheless, officials in the tax administration were so concerned the treaty with Spain that they already tried to re-negotiate the treaty several years before the MLI process started. But due to the close diplomatic relations between the countries, making bold moves such as threatening termination was difficult. Colombian negotiators were not able to secure backing from their Ministry of Foreign Affairs: "We were not able to apply […] pressure, because our Ministry of Foreign Affairs said 'the Spanish are helping us to lift the VISA requirement to enter the Schengen area. The Spanish are supporting the peace process. So we're not going to do it.' Today we are with that old agreement and now the Spanish argument is essentially 'Well, we don't have to renegotiate anything anymore because we are both members of the MLI, so we are going to have a PPT'. In reality, the agreement had many more things to renegotiate than the PPT."[57] Therefore, Colombia did not take steps beyond the suggested approach of the BEPS Project.

As of early 2023, the MLI is still not ratified, which a former government official attributed to the amount of time needed to make an informed decision with respect to clauses that could optionally be amended through the MLI.[58] This suggests a potential drawback of the MLI procedure. While the main aim of the MLI is to allow countries to efficiently introduce the minimum standards of Actions 6 and 14, countries can also opt to introduce other recommendations of the BEPS Project that relate to tax treaties, such as recommendations on the permanent establishment clause (contained in Action 7) and recommendations on rules that deal with hybrid mismatches (Action 2).

In sum, Colombia is therefore essentially sticking to the OECD approach of tackling tax avoidance. Since the implementation has not yet taken place, it is not yet possible to analyze how this is applied in practice.

Senegal

Until 2012, Senegal had a liberal treaty policy, where – according to a policymaker – the imperative was to sign treaties without a lot of consideration given to the concrete conditions. Negotiations were usually engaged upon request of the other country or by the Senegalese ministry of foreign

56 CO39

57 CO01. Translated by the author. Original quote: "Nosotros no fuimos capaces a aplicar […] presión, porque nuestro ministerio de relaciones exteriores dijo 'los españoles nos están ayudando a que nos levanten el requisito de VISA Schengen para entrar al espacio Schengen. Los españoles están apoyando el proceso de paz en esto. Entonces no lo vamos a hacer'. Hoy en día estamos con ese convenio antiguo y ahora toda la argumentación española es 'Bueno ya no hay que renegociar nada porque somos los dos miembros del MLI, entonces vamos a tener una PPT'. En realidad, el convenio tenía muchas cosas más que renegociar que el PPT."

58 CO39

affairs.[59] Indeed, Senegal's first tax treaties were concluded in the 1970 and in 2002 Senegal signed a treaty with Mauritius, which allocated very little source taxing rights to Senegal. According to tax administration officials, the investment promotion agency APIX had taken the lead in this negotiation, and there was very little involvement of the tax administration.[60] Interviewees confirm that subsequently many companies established subsidiaries with little substance in Mauritius to invest in Senegal to avail themselves of lower withholding rates or to indirectly transfer Senegalese property when selling the investment with the goal of avoiding capital gains taxation.[61]

Faced with this issue, several steps were undertaken: Senegalese tax administration officials explained that in the past the administration tried to audit cases of treaty shopping based on the beneficial ownership provision in the treaty or based on domestic general anti-avoidance principles.[62] In addition, Senegal signed the MLI in 2017, and ratified it in 2022. However, considering that these measures were insufficient the government adopted a more stringent approach and terminated the Mauritius treaty in 2019. A tax administration official explained that given the quantity of cases which proved to be complicated and substance requirements introduced by Mauritius would have made arguing cases solely based on the anti-abuse provisions too challenging: "With Mauritius, if we had the multilateral instrument, it would be useful, it's true. But there will always be a real problem ...because they have gone so far as to develop elements of substance in the legislation. So they were going to fix the abuse problem."[63]

Domestically, it does not seem as if this type of action was as controversial as in India. On the one hand, there was support from local civil society. One NGO representative mentioned that his organization had carried out activities since 2012 to obtain the termination of the treaty, speaking about it on the radio, on the television, and each time that the organization met with government representatives.[64] On the other hand, while there was resistance by business groups, these do not seem to have had a widespread support by the tax advisory sector, in contrast to the Indian case.[65]

However, diplomatic pressures posed challenges: according to a Senegalese official involved in the process, Mauritian policymakers had approached Senegalese President Macky Sall pleading not to terminate the treaty. However, the tax administration was able to convince the President

59 SN16
60 SN01, SN16
61 SN01
62 SN09, SN16
63 SN16. Translated by the author. Original quote: "Avec Maurice, même si on avait l'instrument multilatéral, ça servait à quelque chose, c'est vrai. Mais il y aura toujours un problème réel de… parce qu'ils sont allés jusqu'à développer dans la législation les éléments de substance. Donc ils allaient régler le problème de l'abus."
64 SN03
65 SN16

about the necessity to terminate given the tax revenue losses.[66] A tax administration official highlighted how the BEPS Project has helped the tax administration to show the Senegalese political authority what the problem with the Mauritius treaty was: "We think that in general, BEPS, nevertheless, helped us a lot. And besides, if there had not been BEPS, we would perhaps not have denounced the agreement with Mauritius. […] The realization that this type of phenomenon is a BEPS phenomenon. It also allows […], if it is said internationally, in a consensual way, it gives more weight to the political authority, because what will it see? I need jobs, I need investment, there is a cost to that. And that's how [the authority] saw it. Now, we tell them "Watch out! It's true that there is that aspect, but people will take more than they should have taken because there are [BEPS] phenomena involved."[67]

It should however be noted that other factors played a role in the timing, as well. One factor was the start of investment in Senegal's nascent oil industry. Historically, the first big wave of foreign investments into Senegal came when the mining sector started growing in Senegal in the 2000s. In recent years, a similar wave took off with the start of the development of the oil and gas industry. This gave the termination of the treaty an urgency since according to a tax official it could be already seen that some oil exploration companies had started structuring their investment through Senegal and that the "bad" experience with the mining industry in terms of treaty shopping risked being repeated.[68]

In sum, Senegal switched from a very loose treaty policy to a blunter approach, not only relying on the MLI but terminating the treaty that was problematic in terms of treaty shopping.

Nigeria

The first Nigerian treaty concluded with a potential conduit jurisdiction was with the Netherlands in 1993. Other potential conduit treaties are the ones concluded with the United Kingdom, South Africa, Spain (since 2015), Singapore (since 2019).

Nigeria signed the MLI in 2017, but as of 2023 it remains unratified. Interviewees attributed the delay in ratification to generally slow pro-

66 SN16

67 SN16. Translated by the author. Original quote: « On pense que de manière générale, BEPS, quand même, ça nous a beaucoup aidés. Et d'ailleurs, s'il n'y avait peut-être pas eu BEPS, on n›aurait peut-être pas dénoncé la convention avec Maurice, par exemple. […] La prise de conscience que ce type de phénomène est un phénomène BEPS. Ça permet également […], si c›est dit de manière internationale, de manière consensuelle, ça donne plus de poids à l›autorité politique, parce que et elle va voir quoi? À moi, j›ai besoin d›emplois, j›ai besoin d›investissement, il y a un cout à ça. Et c›est comme ça qu'elle voyait les choses. Là, on leur dit « Attention! C›est vrai qu'il y a ça, mais les gens vont prendre plus qu›il fallait prendre parce qu›il y a des phénomènes qui interviennent. »

68 SN16

cedures in the Nigerian parliament.[69] Since bilateral double tax treaties encounter the same fate in Nigeria (all treaties signed after 2000 have remained pending ratification between 6 and 14 years), it is clear that there is no particular political motivation to this delay. However, the tax administration issued an "Information Circular on the Claim of Tax Treaties Benefits in Nigeria" in December 2019, including a general-anti avoidance clause similar to the PPT that would be introduced in tax treaties once the MLI is implemented.[70] Interviewees were skeptical with regards to the legal effect of this circular. Asked on what the legal value of the circular would be, one interviewee stated that it would be "zero".[71] However, a tax administration official explained that Nigeria's domestic general anti-avoidance rule would provide the necessary legal background to enforce treaty shopping cases even where the principal purpose test clause is not yet introduced.[72]

However, in sum, interviewees did not report about many disputes between tax administration and companies related to treaty shopping. An interviewee from a Big 4 explained that though he had been involved in a cases where a client firm was questioned whether it was eligible for treaty benefits, "once a company, any investor, they meet the condition, they would benefit from the treaty, even though we are aware that there's treaty shopping, even if it is obvious, that if they can defend it, they go away with it."[73]

As shown further below, one of the reasons for the lack of enforcement might be that, at least in the past, many treaties have not been significantly more favorable than domestic law. In fact, Nigeria levies relatively moderate withholding taxes of 10% on dividends, interest, royalties, and technical services under domestic law. Most treaties (except the more recently negotiated ones) also provide for a 10% rate, with the exception of technical services payments which are not subject to withholding at source.[74] Meyer-Nandi argued already in 2018 that this consistent practice made treaty shopping less likely for Nigeria.[75] The benefit for tax treaties mainly stemmed from a unilateral policy, which Nigeria instituted in 1999, according to which the withholding rates would be reduced to 7.5% for recipients in treaties coun-

69 NG10, NG02

70 The clause reads: "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 careful 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)'. FIRS, "Information Circular on the Claim of Tax Treaties Benefits in Nigeria," sec. 3.3.

71 NG02

72 NG13

73 NG05

74 NG13

75 Meyer-Nandi, "Preventing Tax Treaty Abuse–a Toolbox with Preventive Measures for Ghana, South Africa, and Nigeria," 11.

tries, even if the treaty provided for a higher maximum rate. Accordingly, treaty withholding rates were slightly beneficial compared to domestic law, but this benefit could be repealed by Nigeria at any time (which indeed happened in 2022).[76]

The salience of treaty shopping may have increased recently for other reasons, though, since Nigeria sought to expand its tax base in two significant ways. The first is a digital service tax levied on digital businesses with a significant economic presence (a notion broader than the physical permanent establishment), which was first introduced in 2019 and amended in 2022.[77] Tax treaties would protect companies from the application of the tax. A tax administration official confirmed that with respect to US headquartered digital companies trading with Nigeria, the treaty with the Netherlands was used for treaty shopping purposes, given that there is no treaty in force between Nigeria and the US: "Our tax treaty with Netherlands is a big problem because most of US MNEs who do business in our country just routed through the Netherlands."[78] Second, Nigeria repealed an exemption of sales of shares from capital gains tax in 2022, which had been in place for more than 20 years.[79] Since the treaty with the Netherlands grants the right to tax capital gains from sales of shares to the residence country, the Netherlands does not tax capital gains earned abroad under its participation exemption, and the treaty does not contain an anti-avoidance clause as long as the MLI is not ratified by Nigeria, it would be attractive for MNEs to invest in Nigeria via the Netherlands.

Nevertheless, the recent *Saipem* case sheds other doubts on whether treaty shopping is actually an issue: In Nigeria, another potential benefit of tax treaties vis-à-vis domestic law relates to the attribution of profits to permanent establishment. Through the so-called "single contract doctrine" according to which the whole of profit related to an engineering-procurement-construction (EPC) contract awarded in Nigeria would be taxed in Nigeria, even if the awardee structures the operation in a way that parts of the contract are carried out by related enterprises abroad, the Nigerian tax administration applies a particularly wide approach.[80] EPC contracts are widespread in Nigeria due to the size of the Nigerian Petroleum sector. Tax

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76 FIRS, "Information Circular on the Claim of Tax Treaties Benefits and Commonwealth Tax Relief in Nigeria."

77 Ministry of Finance, Budget, and National Planning, Companies Income Tax Act (Significant Economic Presence Order), 2020; Obayemi, "Country Note: Taxing The Income Of Digital Non-Resident Companies Under The 'Significant Economic Presence'(Sep) Rules In Nigeria."

78 NG10

79 According to interviewees, originally the purpose of the exemption was to encourage growth of Nigeria's stock market. However, the tax administration increasingly noted transactions where immovable property was sold through holding companies in order to avoid capital gains tax on immovable property sales. NG10

80 Okanga, "The Single Contract Basis of International Corporate Taxation: A Review of Saipem v Firs."

treaties that are based on the OECD or UN Model would generally prevent the application of such a "single contract doctrine",[81] and some treaties contain protocols that make this explicit.[82] Nevertheless, as *Saipem* case illustrates, the tax administration applies the doctrine to attribute profits to Nigeria, even in transactions with treaty countries (and has successfully defended the approach at the level of the High Court).[83] The case is not about treaty shopping as such, since the company in question was not a conduit company, but the case shows that the tax authority seems to have some leeway to engage in treaty overrides, which makes it more difficult for companies to rely on treaties at all.

The evidence discussed until here suggests that the BEPS Project has had a very limited impact on Nigeria's approach to treaty shopping: Nigeria has not yet adopted the MLI, and at the same time, it is not clear to what extent treaty shopping is an issue at all. Nevertheless, there seems to have been an impact of a more indirect nature with regards to another issue: Nigeria had signed a tax treaty with Mauritius in 2012 but was not yet ratified when the BEPS Project started. As of 2023, the treaty remains unratified. A Nigerian treaty negotiator commented with respect to the ratification process: "So Nigeria was going through all those processes when BEPS issue came in, and from the outcome of BEPS, we know that some substantial amendment has to be made to the Treaty and that's the view of the policymakers."[84] Hence, similarly to the cases of India and Senegal, the BEPS Project may have contributed to a shift to a more cautious overall tax treaty policy in Nigeria.

7.3.2 Comparison of specific variables across countries

Amount of benefit conferred by treaty

In the countries researched, the first factor likely to have played a role in explaining the response adopted is the extent to which the treaty led to revenue losses, which in turn depends on the amount of benefits for taxpayers compared to other treaties and the country's domestic law and the extent to which the treaty was actually used by investors from third countries.

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81 See the discussion in paragraphs 8 – 11 of the Commentary on paragraph 1 of article 7 of the 2021 UN Model Convention.

82 "Agreement between the Government of the French Republic and the Government of the Federal Republic of Nigeria for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains," para. Protocol(3)(b).

83 Ogakwu, Saipem Contracting Nigeria Limited & Others v. Federal Inland Revenue Service & Others (2018); Okanga, "The Single Contract Basis of International Corporate Taxation: A Review of Saipem v Firs."

84 NG13

Table 8: Advantage conferred by treaties compared to weighted average of direct routes

dyad	*year*	*treaty in force*	*dividends (direct invest-ment)*	*interest*	*royalties*	*technical services*	*capital gains (land rich companies)*	*capital gains (all shares)*
COL-ESP	2012	yes	0.0	21.9	21.9	0.0	0.0	32.1
COL-ESP	2021	yes	9.2	8.8	8.8	8.5	0.0	9.7
IND-MUS	2012	yes	0.0	0.0	0.0	9.4	19.2	18.2
IND-MUS	2021	yes	8.6	6.5	0.0	0.0	0.0	0.0
NGA-MUS	2012	no	2.3	2.3	2.3	8.3	0.0	0.0
NGA-MUS	2021	no	2.3	2.3	2.3	8.0	0.0	0.0
NGA-NLD	2012	yes	0.0	0.0	0.0	8.3	0.0	0.0
NGA-NLD	2021	yes	0.0	0.0	0.0	8.0	0.0	0.0
SEN-MUS	2012	yes	9.9	19.2	19.1	17.5	23.9	22.1
SEN-MUS	2021	no	0.0	0.0	0.0	0.0	0.0	0.0

Source: Own calculation, based on data by ICTD and EY.[85] Weights are based on GDP, GDP per capita and physical distance of country, see section 10.3. The values for Nigeria-Mauritius are hypothetical (as if the treaty had been ratified in 2012).

Table 8 compares the degree of benefits conferred by the respective treaty through the difference of the tax rate levied at source under the treaty and the average rate that would be levied if the investor chose not to use the conduit country (weighted by the potential importance of the countries as inward investors).[86]

Whereas in the case of India and Mauritius, only a few clauses were making the treaty particularly beneficial compared to other treaties and domestic law,[87] the Senegal-Mauritius treaty provided for a beneficial treatment regarding almost all relevant types of transactions. A Senegalese policymaker explained with respect to the termination: "The first factor is that the convention was not balanced. […] So you look at the agreement we had with Mauritius, 0% interest, 0% royalties and 0% royalties. And the right to tax is practically over there, zero gains. That was a problem."[88] Senegal also

85 Hearson, "Tax Treaties Explorer [Online Database]"; EY, "Worldwide Corporate Tax Guides."

86 For a more detailed explanation of the calculation, see section 10.3 (annex)

87 in the Colombian case, 0% withholding for dividends paid to shareholders that owned more than 20% of the capital of the payor; in the Indian case, an exemption from capital gains levied at source

88 SN16. Translated by the author. Original: "Le premier facteur, c'est que la convention n'était pas équilibrée. […] Donc vous regardez la convention qu'on avait avec Maurice, 0% intérêt, 0% redevances et 0% royalties. Et le droit d'imposition, c'est pratiquement là-bas, les gains zéro. Ça, c'était un problème.

concluded a treaty with Qatar that provides for similarly beneficial rates, but it is questionable whether this treaty could be used for treaty shopping purposes, as Qatar does not have an exemption for foreign earned income and applies a corporate tax rate of 10%.[89] This also shows that from the perspective of the conduit jurisdiction, trying to maximize the benefits in the treaty may not be the best strategy since it could lead to stronger reactions by the other country if the latter's policy direction changes at a later point in time. For example, if the Senegal-Mauritius had been less unequal in terms of allocation of taxing rights, the push for a termination might have been less strong in Senegal. That said, the Senegalese tax administration entered into a renegotiation process before terminating the treaty, so Mauritius had the opportunity to "save" the treaty by conceding Senegal more source taxing rights.[90]

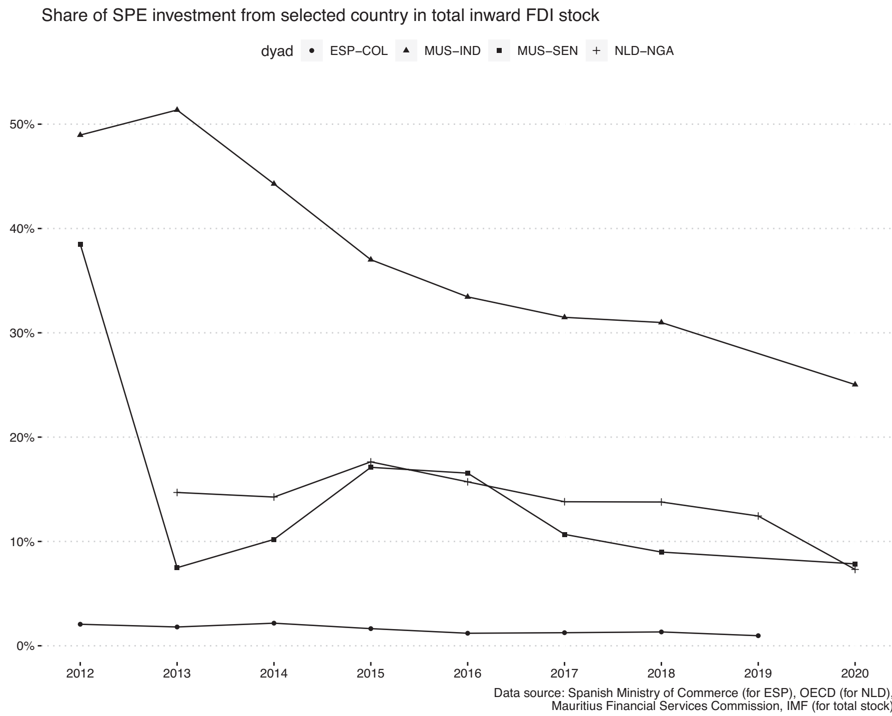
In the Nigerian case, the treaty with the Netherlands used to be not more beneficial than other Nigerian treaties, and only slightly more beneficial than domestic law.[91] However, the data does not capture issues related to permanent establishment clauses and digital services taxes. It also does not capture recent changes such as Nigeria's repeal of the capital gains tax exemption for sales of shares in 2022. In the case of Colombia, the treaty with Spain used to be significantly more beneficial compared to direct transactions with other countries in 2010, but to a lesser degree in 2021. The principal reasons are that since then, Colombia has signed more treaties with potentially important countries from which investment into Colombia originates and has lowered domestic rates for dividends and interests, thus reducing the salience of treaty shopping.

Actual use in treaty shopping structures

Revenue losses only materialize if taxpayers actually make use of the treaty and claim the preferential treatment. Figure 12 therefore considers data on foreign direct investment (FDI) by special purpose entities into the four countries compared to the total FDI stock into the country. It shows that the treaty signed with a conduit jurisdiction has been most used in the case of India (where in 2013 almost half of the inward FDI stock came from Mauritius), followed by Senegal and Nigeria.

89 https://taxsummaries.pwc.com/qatar/corporate/income-determination
90 SN16
91 Withholding rates are reduced to 7.5% instead of 10% under domestic law, and fees for technical services are exempt from withholding.

Figure 12: Share of SPE investment from selected country in total inward FDI stock



Source: compiled by the author, based on data from Spanish Ministry of Commerce, OECD, Mauritius Financial Services Commission, IMF.[92]

This approach is inspired from UNCTAD's "Offshore Exposure Matrix", which assesses to what extent investment in and out of a country is structured through intermediate jurisdictions with favorable tax regimes.[93] This may indicate the extent of treaty shopping into a country, although it should be noted that for several reasons it is only an imperfect indicator: SPE investment is not necessarily motivated by tax reasons, and even if saving tax is part of the motivation it does not need to amount tax avoidance, if the MNE has a significant degree of substance in the country through which investment is channeled, for example a regional headquarter. On the other hand, there could be treaty shopping even though there is no investment from SPEs, since although most dividend and interest payments as well as capital gains are usually connected to FDI flows this is not necessarily the case of royalty and service payments or interest payments made to affiliates

92 Ministerio de Industria, Comercio y Turismo (Spain), "DataInvex Estadísticas de Inversión Española En El Exterior"; OECD, "FDI Positions by Partner Country BMD4"; Financial Services Commission (Mauritius), "Global Business Statistics: Value of Investment 2012-2022"; IMF, "Coordinated Direct Investment Statistics."

93 Bolwijn, Casella, and Rigo, "An FDI-Driven Approach to Measuring the Scale and Economic Impact of BEPS."

that are related but that do not own the capital of the company in question. Hence, SPE investment statistics may both understate and overstate the "true" amount of treaty shopping.

In the case of Nigeria, the fact that for the last ten years more than 10% of total inward investment came from Dutch SPEs is somewhat puzzling since until recently the advantages related to treaty shopping have been relatively small. One explanation could be that investors set-up their initial investment through SPEs out of caution should the treatment under domestic law changes to the worse (such as the change to the capital gains tax in 2022 or the introduction of the digital services tax provisions).

For the dyad Colombia – Spain the share of SPE investment is lowest. However, based on the accounts of Colombian tax practitioners, it seems that the treaty nevertheless played a role in MNEs' tax strategies.[94] Moreover, there is evidence that in the Colombian case, a significant part of inward investment can be attributed to round-tripping (using mainly low-tax jurisdictions such as Panama and the Cayman Islands), potentially to a higher degree than in the other cases, since this type of structure was much more frequently mentioned by interviewees in Colombia than in the other countries studied.[95] Consequently, the share of investment from Spanish SPEs in "real" inward investment could be higher than what is shown in the figures.

An important side note can be made with regards to the usefulness of SPE statistics in assessing policy impact in the future. Some of the evidence collected in the case studies suggests that the evolution of inward investment flows may not necessarily reveal whether policy changes had an effect or not. Tax administration practices may for example discourage companies from abandoning companies established in offshore jurisdictions, if doing so would provide tax advantages. An Indian tax advisor, for example, explained that taxpayers would be hesitant to rearrange their structure from Mauritius to the Netherlands (the treaty with which still provided for some benefits, because this could be considered as being incompatible with the Indian GAAR and the principal purpose test: "So even a transition, why are you transitioning from Mauritius to Netherlands? It's a question begging to be answered from a revenue perspective. And what is the most plausible answer you can give it to? Why would you shift from Mauritius to... It's obviously to claim the tax treaty benefit."[96] This could explain why a recent study only found a "mild decline" in FDI routed through conduit jurisdictions after the implementation of the principal purpose test in a treaty with a partner country.[97]

94 CO28, CO15, CO20

95 CO16. On the notion of round-tripping, see Aykut, Apurva Sanghi, and Gina Kosmidou, "What to Do When Foreign Direct Investment Is Not Direct or Foreign: FDI Round Tripping."

96 IN10

97 Hohmann, Merlo, and Riedel, "Multilateral Tax Treaty Revision to Combat Tax Avoidance: On the Merits and Limits of BEPS's Multilateral Instrument," 3.

Genuine investment flows

The third factor that plays a role in the policy decision is the amount of genuine investment flows between the countries. [98] Data from the Spanish Ministry of Commerce available for the period 2012 to 2019 shows that in the Colombian case, more investment from non-SPEs than SPE investment is coming from Spain. In the case of Nigeria and the Netherlands, OECD data indicates that over the period 2013 to 2020, between 42% and 70% of total FDI from the Netherlands into Nigeria was attributable to SPEs with a decreasing tendency. For Mauritius-India and Mauritius-Senegal, no reliable analysis can be conducted. Values from the Mauritius Financial Service Commission which reports data on SPE investment from Mauritius into India and Senegal consistently exceed 100% of the value of total FDI from Mauritius into these countries reported by the IMF's Coordinated Direct Investment Survey. This is likely due to some differences in definition applied underlying these datasets. Nevertheless, the high figures seem to indicate that the share of SPE FDI in the total amount of FDI from Mauritius is likely very high. This is also consistent with the accounts provided by interviewees.

In the Senegalese case, interviewees emphasized a complete lack of genuinely Mauritian investment.[99] Allegedly, Mauritian negotiators had at the time of the initial negotiation of the treaty motivated the conclusion with potential investment by Mauritian textile companies in Senegal.[100] According to the interviewees, however, such investment never materialized subsequently. One could therefore argue that Senegal did in fact not adopt a blunt approach. If it is true that no transactions between genuine Mauritian and Senegalese residents took place, then terminating the treaty could be considered as in accordance with the finely delineating approach, as there is no increase in tax burden for non-avoiders.

Even where investment from the partner country is mainly undertaken for treaty shopping purposes, one can discuss whether acceptance of treaty shopping could be considered as tax incentive for foreign investors in the specific country, as it was debated in the case of the India-Mauritius treaty.[101] For tax incentives that attract foreign investment, the revenue impact is ambiguous, since the tax losses incurred may be offset by investments that would not have been undertaken but for the incentive – in this case, the provisions of the treaty. Especially if the investment contributes to the creation of additional employment and technology transfer, tolerating

98 Data for the discussion of the following paragraph was compiled by the author, based on data from Spanish Ministry of Commerce, OECD, Mauritius Financial Services Commission, IMF: Ministerio de Industria, Comercio y Turismo (Spain), "DataInvex Estadísticas de Inversión Española En El Exterior"; OECD, "FDI Positions by Partner Country BMD4"; Financial Services Commission (Mauritius), "Global Business Statistics: Value of Investment 2012-2022"; IMF, "Coordinated Direct Investment Statistics."

99 SN13, SN16

100 SN13, SN16

101 Cooper, "Chapter VI: Preventing Tax Treaty Abuse."

treaty shopping could be beneficial, even for the country's tax revenues. In the Senegalese case, according to a tax administration official, most investors that used the Mauritius treaty invested in the mining sector,[102] so that from the start these considerations were less persuasive. Since extractive industries often earn location specific rents, they are usually considered not to be in need of tax incentives.[103] In addition, policymakers highlighted that the mining sector already benefited from other tax incentives.[104]

In the Indian case, the treaty seems to have been used by a broader range of investors, including funds that invested in the Indian stock market.[105] Whether the tolerance of treaty shopping was indeed a net revenue gain or loss is difficult to say, since no useful counterfactual data is available. As one interviewee put it, this debate was more of a "philosophical" question.[106] However, with time the Indian economy became more dynamic, so this argument became less persuasive. As Indian tax advisors explained in interviews: "when India opened up the economy to foreign investors in 1991, the government was under great pressure since there was only so much of foreign exchange to pay for 15 days of import bill."[107] Tolerating treaty shopping as tax incentives might therefore have contributed to attracting additional FDI flows. Later, however, after the economy had grown substantially, these arguments lost salience tilting the balance more towards those in favor of a re-negotiation.[108]

7.3.3 Summary

In India, Mauritius accounted for a large amount of inward investment, and several disputes had arisen in connection with the use of the treaty. In Senegal, the treaty with Mauritius posed problems, as well, whereas in Colombia, the treaty with Spain was used for indirect investment. In Nigeria, the treaty with the Netherlands was susceptible to be used for indirect investment, as well, although the benefits compared to other "direct routes" were less important than in the case of the other countries.

All four countries researched signed the MLI, but not all have ratified it yet. Among the four countries researched the delay was shortest in India (ratified in 2019), followed by Senegal (ratified in 2022). As of February 2023, the MLI has not yet been ratified in Colombia and Nigeria. However, signing the MLI was not the only response adopted. On one end of the

102 SN16
103 Mansour and Świstak, "Tax Competition and Coordination in Extractive Industries."
104 SN16
105 Many cases on the applicability of the India-Mauritius treaty have been decided by different judicial authorities in India involving companies from several different sectors.
106 IN18
107 IN22
108 Robertson, "India's Offshore Pivot: The Implications of a Tougher Approach towards Mauritius."

spectrum of responses taken is Senegal, which took the most sweeping step by terminating its treaty with Mauritius in 2019. On the other end of the spectrum are Colombia and Nigeria, which merely included their treaties with Spain and the Netherlands respectively as covered treaties under the MLI, so that an anti-abuse clause would be introduced after ratification of the MLI. Somewhat in the middle is India, which re-negotiated the treaty with Mauritius in 2017, changing the clause that was most favorable compared to other treaties, but providing for a "grandfathering" period during which investors could still make use of the provision.[109]

Applying the typology of responses to international tax avoidance, Colombia and Nigeria plan to adopt the finely delineating approach suggested by the OECD whereas Senegal and India adopted blunter responses, although, as pointed out above, one could debate in the case of Senegal whether terminating the treaty really was a "blunt" solution given that almost all investment from Mauritius was likely to be treaty shopping.

Why are countries choosing different approaches? These four cases can illustrate how different combinations of several causal factors lead to different outcomes. They highlight the importance of economic considerations such as the amount of revenue losses, which is a function of the degree of benefit the treaty provides vis-à-vis domestic law and other treaties and the extent to which it was used by indirect investors. Among these four countries, the cumulative amount of tax lost compared to potential tax gains can sufficiently explain the choice of the response.

What the loss of tax revenue can only partially explain is timing, which is where political factors come in. Hearson writes that "domestic and international politics make it tough to alter their historically negotiated treaties, even as the economic context changes around them."[110] Termination of a treaty implies a diplomatic procedure in which considerations relating to the protection of the tax base and investment may not be the only ones. For the other decision-making entities such as a Ministry of Foreign Affairs or the Head of State, the diplomatic ties that otherwise exist between the country and the treaty partner may affect to what extent a treaty termination or renegotiation project would be considered as viable. The case studies illustrate that both in Senegal and India, some government actors wanted to address the treaty shopping issue for a long time. In both cases (though to a larger extent in the Indian case), disagreements among different governmental actors may have prevented an earlier solution to the issue.

The evidence allows for some cautious support of the hypothesis that the BEPS Project may have facilitated convincing other domestic actors of

109 "Protocol Amending the Convention Between the Government of Mauritius and the Government of the Republic of India for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, and for the Encouragement of Mutual Trade and Investment, Signed at Port Louis on 24th August 1982," sec. 4.

110 Hearson, *Imposing Standards*, 168.

the necessity of these policy changes, even though renegotiation or termination are not the preferred policy response of the BEPS Project. The case studies hence show how the BEPS Project can be reinterpreted by actors in a strategic way. In the Colombian case, however, the BEPS Project may have rather contributed to strengthening the argument of the treaty partner that no broader renegotiation is necessary. The overall effect is therefore ambiguous.

Table 9: Factors influencing strategies to deal with treaty shopping

Factor	*Senegal*	*India*	*Colombia*	*Nigeria*
Relevant treaty partner	Mauritius	Mauritius	Spain	Netherlands
Outcome	Termination	Renegotiation + notification under MLI	Notification under MLI	Notification under MLI
Year of ratification	2004	1982	2008	1992
Year of termination / modification / re-negotiation	2019	2017	?	?
Degree of advantage conferred by the treaty	High	Medium	Medium	Low
Extent to which treaty was used by indirect investors	High	High	Low	Medium
Extent to which treaty was used by genuine investors	Low	Low	High	Medium
Role as tax incentive for productive investment	Low	Medium	Unclear	Low
Diplomatic ties	Low	Medium	High	Low
Pressure to terminate by domestic groups	High	High	Low	Low

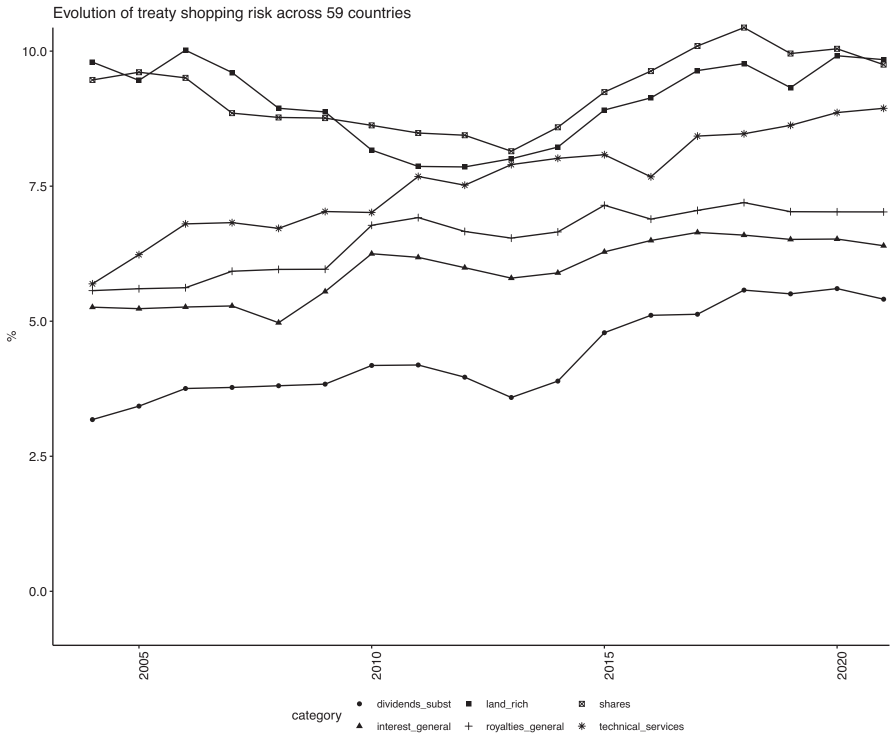
Source: the author

7.4 Beyond the four countries

7.4.1 Evolution of treaty shopping risk

How representative are the trajectories of the four countries for the wider universe of developing countries? At first, I will look at the evolution of the treaty shopping issue across countries, using the summary measure introduced above. Figure 13 displays the evolution of the treaty shopping risk indicator introduced above across the 59 developing countries. For royalties and interest payments, risk has remained about stable over time: Across all countries, companies are able to reduce their withholding tax on interest by on average 5 percentage points if they choose to route the payments through a conduit country (for royalties, the value is about 6 percentage points).

Figure 13: Evolution of treaty shopping risk in developing countries



Source: compiled by the author, based on ICTD Tax Treaty Dataset and EY Corporate Tax Guides.[111]

For payments for technical services and dividends, the risk has steadily increased over time. Finally, for capital gains levied on sales of shares by non-residents (for all types of shares or shares of land-rich companies only), risk has decreased until about 2012 but increased since then again. It is striking to note that over the whole period, risk has been consistently higher for capital gains and technical service payments than for the other types of passive income flows. Previous studies which focus solely on the latter may therefore underestimate the incidence of the treaty shopping phenomenon. For capital gains, this can be explained by the fact that they are often taxed at the domestic rate instead of a lower withholding rate, while treaties often grant a full exemption. For technical services, as well, most treaties grant a full exemption. The UN Model Convention only features an article granting the right to tax technical services to the source country since the 2017 update.[112]

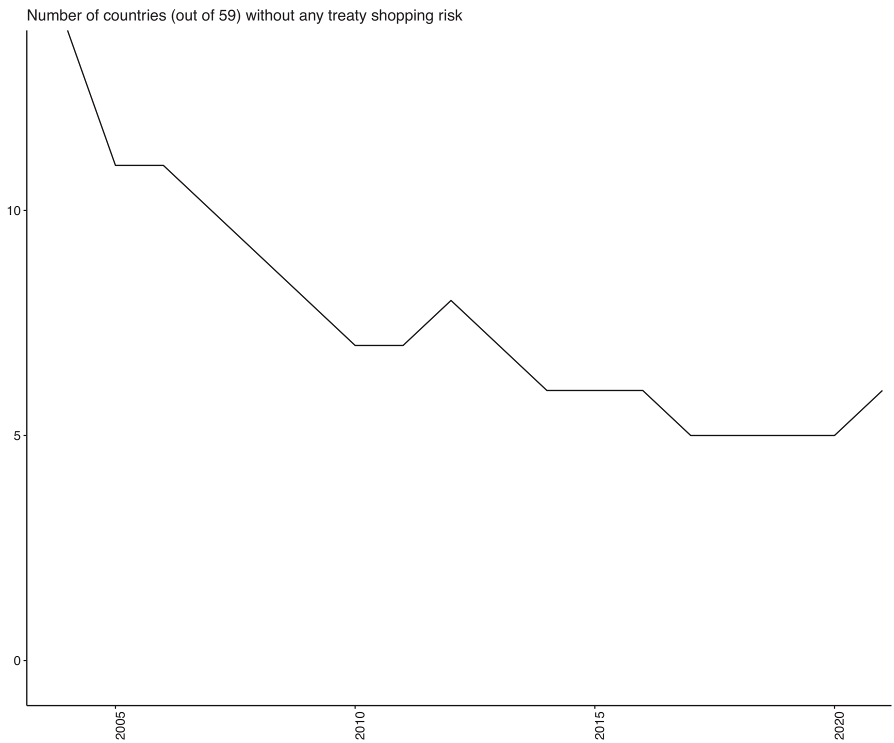
111 Hearson, "Tax Treaties Explorer [Online Database]"; EY, "Worldwide Corporate Tax Guides."

112 Báez Moreno, "The Taxation of Technical Services under the United Nations Model Double Taxation Convention: A Rushed–Yet Appropriate–Proposal for (Developing) Countries?"; United Nations, Model Double Taxation Convention between Developed and Developing Countries 2017, sec. 12A.

However, the average displayed above hides significant heterogeneity across countries. For some countries, such as Angola, treaty shopping risk has remained zero over the whole period, because they have not concluded any treaties with conduit jurisdictions. For other countries, risk has increased after the imposition of higher taxes under domestic law. For example, Uganda introduced new provisions to tax capital gains derived by non-residents in 2016, while still having treaties, which restrict capital gains taxation at source, with several potential conduit jurisdictions for these types of payments in place (Netherlands, Mauritius, South Africa, United Kingdom, Denmark).

Over time, the number of countries without any treaty shopping risk (for no type of payment) has dropped from 13 to 5 and only started to increase again in 2021.

Figure 14: Number of developing countries without any treaty shopping risk



Source: compiled by the author, based on ICTD Tax Treaty Dataset and EY Corporate Tax Guides.[113]

113 Hearson, "Tax Treaties Explorer [Online Database]"; EY, "Worldwide Corporate Tax Guides."

7.4.2 Implementation of BEPS Action 6

To what extent have developing countries implemented the anti-abuse rules from BEPS Action 6? Data is available in four peer review reports have been published on Action 6 since 2018. The review proceeds via a questionnaire, in which countries are asked to list all their double tax treaties in force, whether they are already compliant with the minimum standards, if compliant, which alternative of the different combinations of anti-abuse clauses has been chosen, and if not yet compliant whether a complying instrument (such as the MLI or a protocol) has been signed. The "Multilateral Instrument" (MLI) is a procedural innovation of the BEPS Project's. It is essentially a mechanism through which countries can amend their bilateral tax treaties without going through individual re-negotiation procedures. By the numbers, the MLI was a success: A press release by the OECD issued in October 2022 claims that 1850 bilateral tax treaties are covered by the MLI, 910 of them being already modified due to the ratification by both treaty partners.[114]

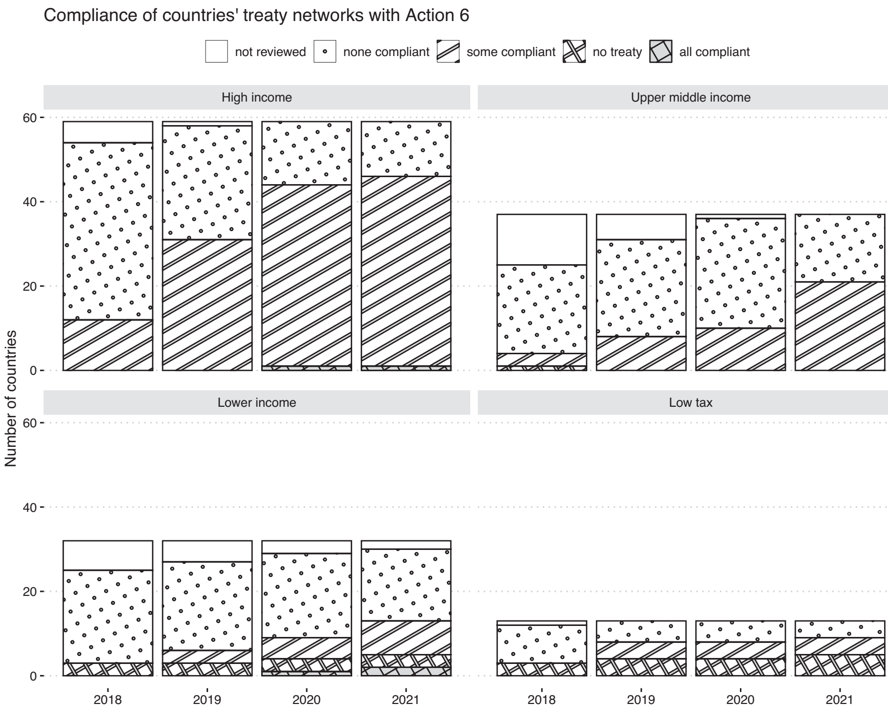
The lists of treaties in the peer review reports also include treaties concluded with countries which are not members of the inclusive framework. However, if these treaties are not compliant, this does not affect the overall compliance rating of the country since the Action 6 minimum standard only applies to treaties among inclusive framework members.[115] Even among inclusive framework members, not introducing the minimum standard into the treaty would not be considered as non-compliance if both jurisdictions consider that the treaty does not represent any particular risk for treaty shopping. But the peer review mechanism allows for countries to complain if another country is refusing to amend the treaty.

As can be seen in Figure 15, in 2018 and 2019, no country had a fully compliant treaty network, except those countries that do not have a treaty network at all. The MLI as principal mechanism to comply with Action 6 was signed by the first jurisdictions in 2017, which explains that there were not yet many countries with compliant treaties.

114 https://www.oecd.org/tax/treaties/mongolia-signs-landmark-agreement-to-strengthen-its-tax-treaties-and-south-africa-deposits-an-instrument-for-the-ratification-of-the-multilateral-beps-convention.htm. See also: Vergouwen, Broekhuijsen, and Reijnen, "The Effectiveness of the MLI in Amending the Bilateral Tax Treaty Network."

115 As of 2021, very few of these treaties are compliant. Most of the compliant ones are treaties with Cyprus, which signed the MLI but could not join the Inclusive Framework due to opposition by Turkey. Some other compliant treaties are new treaties signed since the Action 6 minimum standards have been included in the OECD and UN Model Conventions.

Figure 15: Compliance of countries' treaty networks with Action 6



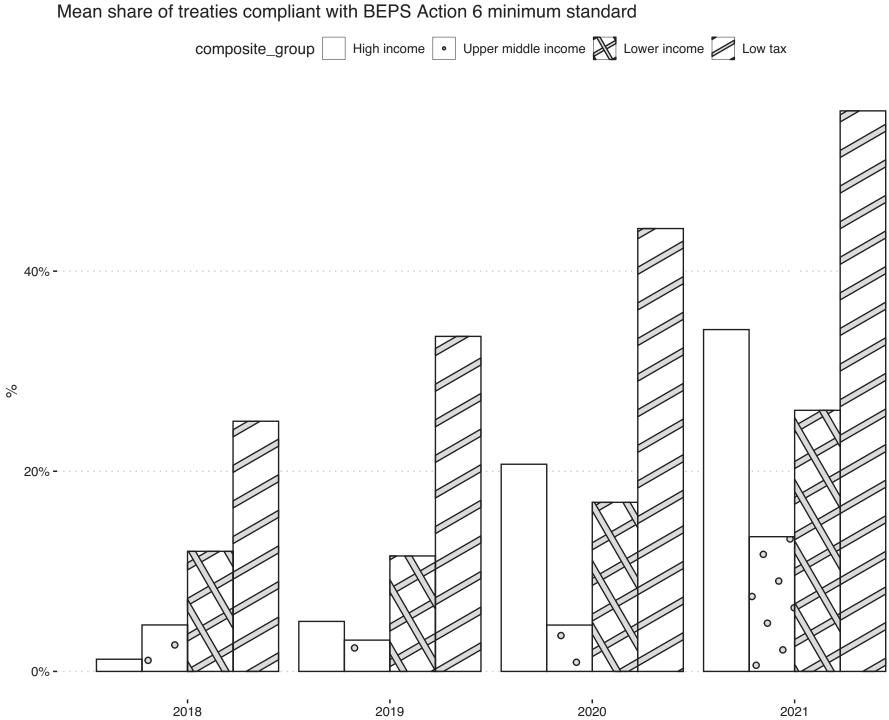
Source: compiled by the author, based on OECD/IF Action 6 Peer review reports.[116]

In 2020, the average number of compliant treaties increased significantly among high income countries (see Figure 16). Throughout the period, low tax jurisdictions have on average displayed the highest level of compliance, which can be explained by the small treaty networks these countries have. But some lower income jurisdictions started to have fully compliant treaty networks as well. This is for specific reasons, however. One of these countries is Angola, which ratified its first two tax treaties in 2019 and 2021. In that sense compliance was easier to achieve because no existing treaties had to be amended.

Overall, the evidence thus shows that the process of including anti-abuse rules in treaties is relatively slow and cumbersome, especially for developing countries (although this is somewhat mitigated for countries that have not signed many treaties in the first place.

116 https://www.oecd.org/tax/beps/prevention-of-tax-treaty-abuse-fourth-peer-review-report-on-treaty-shopping-3dc05e6a-en.htm

Figure 16: Mean share of treaties compliant with the BEPS Action 6 minimum standard



Source: compiled by the author, based on OECD/IF Action 6 Peer review reports and IBFD Tax Research Platform (for number of treaties).[117]

7.4.3 Adoption of other responses

What about other approaches to treaty shopping then? Senegal and India are not the only countries that have taken re-negotiated or terminated treaties. Efforts to renegotiate treaties with conduit countries have also been undertaken by South Africa and Argentina (even though in the Argentinian case, the re-negotiations have mainly focused on introducing anti-avoidance rules).[118] Mongolia and Russia are two examples of countries that have terminated tax treaties considered as conducive to treaty shopping.[119] The Mongolian case sheds some doubt on the hypothesis that the BEPS Project was primarily responsible for encouraging terminations. Mongolia terminated treaties with the Netherlands, United Arab Emirates, Kuwait, and Luxembourg in 2013 and 2014, after consultants from the

117 https://www.oecd.org/tax/beps/prevention-of-tax-treaty-abuse-fourth-peer-review-report-on-treaty-shopping-3dc05e6a-en.htm
118 Hearson, *Imposing Standards*, 7.
119 Wheeler, "Tax Treaties: What Are We Going to Do with Them?"

International Monetary Fund had carried out an analysis of the Mongolian treaty network on behalf of the tax authority, highlighting the weaknesses of the treaties. However, termination should not necessarily be attributed to the suggestions by the IMF, as the report rather recommended Mongolia to re-negotiate the treaties containing weaknesses instead of terminating.[120] In other cases, treaties already signed have been stopped in domestic ratification procedures. In Peru, the ratification of a tax treaty with Spain was stopped in parliament.[121] Finally, in Kenya, a treaty with Mauritius was prevented from being ratified by the Supreme Court in a public interest litigation launched by civil society groups.[122]

7.5 Preliminary conclusions

The BEPS Project's recommendations to deal with treaty shopping are largely in the spirit of the finely delineating approach although they do not explicitly rule out that states adopt other responses. Indeed, the approaches taken by countries vary. While the process to insert anti-abuse clauses seems to encounter an obstacle in the ratification procedures of the MLI (although not necessarily due to an opposition in substance), countries have at times resorted to other measures such as renegotiating or terminating treaties. The variation seems first of all due to a variation in the urgency of the issue: Like in the case of transfer pricing, the extent to which treaty shopping has actually been a policy problem varies among countries, depending on factors such as whether treaties have been signed with potential conduit jurisdictions and the degree of benefits these treaties confer compared to domestic law and other treaties concluded. Where the issue is more sizeable in terms of revenue loss, additional responses to the insertion of an anti-avoidance clause such as renegotiating or terminating are taken.

The fact that the BEPS Action 6 minimum standard only seems to be slowly making its way into countries' treaty networks concurs with the anecdotical evidence on other countries' renegotiations and terminations, even though the case studies also show that alternative responses are not adopted as alternative to BEPS Action 6 but rather as complement. Another important observation though is that data beyond the four countries studied also shows that the phenomenon of treaty shopping is unequally distributed among countries, with some countries not being affected at all.

The case studies also suggest that which approach should be taken is usually a controversial question among different stakeholders within the country that is affected by treaty shopping, and even where the revenue loss is sizeable, it can take a long time until an action is taken. Considerations

120 Michielse, "Mongolia: Technical Assistance Report—Safeguarding Domestic Revenue—A Mongolian DTA Model," 5.

121 CO15

122 Tax Justice Network Africa, "Court Declares the Kenya-Mauritius DTA Unconstitutional."

about investment attraction (i.e., the idea that even investors that are treaty shopping are bringing in welcome additional funds) and diplomacy are powerful counterweights. Other agencies (such as foreign affairs ministries, investment promotion agencies, or even the political level of the finance ministry) thereby act as international veto players towards a blunter approach, whereas the tax administration pushes for a more stringent response. Market power may play a role as the change in Indian policy over time illustrates. Fundamentally, even though the BEPS Project puts an emphasis on a finely delineating approach, it may also have facilitated the adoption of blunter responses due to the propagation of the higher-level message that international tax avoidance is internationally unwanted.

What can we learn from contrasting these results with the results from the preceding chapter on transfer pricing?

The case studies of transfer pricing and treaty shopping showed that countries can vary when it comes to the approach chosen to the respective policy problem at different moments in time and the extent to which they take up the standards and recommendations from the BEPS Projects: In India, for example, tolerating treaty shopping was vigorously defended at the same time when transfer pricing rules started to be enforced in an equally vigorous way in the early 2000s.[123] A potential explanation for this divergence could be that the enforcement of the transfer pricing regime is less easy to control from the ministerial level, whereas on the issue of treaty application, the ministry could settle the issue with one circular. In Senegal, in contrast, tax treaty policy has recently shifted to become very stringent, whereas with respect to transfer pricing a convergence towards the OECD approach is favoured by tax policymakers. The difference here could be that the enforcement transfer pricing regime can be adjusted more easily to the capacity of the tax administration, as auditors can make use of their powers to force companies to negotiate, when the detailed application of the rules becomes too challenging. In contrast, treaty shopping is more difficult to handle with pre-existing existing tools, such as presumptive taxation, which is why a more stringent response at the legislative level may have been necessary. In Colombia, the policy direction seems more aligned across areas where a willingness to adhere closely to a finely delineating approach is present both with respect to transfer pricing and treaty shopping, which could be due to the overriding force of the OECD accession process.

123 A potential explanation could be that tolerance of treaty shopping was mainly limited to capital gains taxation and in that sense did apply more to portfolio investment, generally considered more mobile and more reactive to competitive incentives. With regards to direct investment by MNEs the revenue losses stemming from the tolerance of the Mauritius route most likely did not yet materialize at that moment, whereas transfer pricing was a more pressing issue, since it affected the annual tax bill.