

# THE EVOLUTION OF DOUBLE TAXATION TREATIES:

## Current Developments to Prevent the Improper Use of Tax Treaties for Tax Avoidance

By Counsel Julius Nandeeba

May 2026

### 1. Introduction

Double Taxation Agreements (DTAs), commonly referred to as tax treaties, have historically served an important role in international taxation by preventing the same income from being subjected to tax in more than one jurisdiction. Through agreed allocation of taxing rights between contracting states and relief mechanisms such as exemptions and foreign tax credits, tax treaties have promoted international trade, cross-border investment, and economic integration.

Traditionally, tax treaties were negotiated on the assumption that businesses would operate through physical presence and generate income within identifiable territorial boundaries. However, developments in international commerce, multinational enterprise structures, digitalization, and increasingly sophisticated tax planning mechanisms exposed vulnerabilities within treaty frameworks.

Over time, some taxpayers and multinational groups began structuring transactions not merely to eliminate double taxation, but to **obtain double non-taxation, treaty shopping benefits, artificial reductions in withholding taxes, and shifting of profits to low-tax jurisdictions.**

These developments triggered one of the most significant reforms in international tax policy. Countries increasingly recognized that while double taxation discourages investment, non-taxation and treaty abuse equally undermine fairness, erode tax bases, and distort competition.

Accordingly, modern tax treaty policy has evolved to ensure that treaties facilitate legitimate investment while preventing their improper use to intentionally avoid taxation.

This article examines the major contemporary developments incorporated into modern double taxation treaties to address treaty abuse and protect taxing rights.

### 2. Historical Purpose of Double Taxation Treaties

Double taxation treaties traditionally pursued four primary objectives:

- i. elimination of juridical double taxation;
- ii. allocation of taxing rights between residence and source jurisdictions;
- iii. promotion of international trade and investment;
- iv. reduction of fiscal barriers to cross-border economic activity.

Under conventional treaty models, countries negotiated provisions governing:

- business profits;
- dividends;
- interest;
- royalties;
- capital gains;
- employment income; and
- methods for eliminating double taxation.

The assumption underlying these frameworks was that treaty access would be used by genuine residents conducting substantive economic activities.

However, increased globalization revealed that treaty provisions could also create opportunities for aggressive tax planning.

### **3. The Shift from Preventing Double Taxation to Preventing Double Non-Taxation**

One of the most important developments in international taxation has been the policy shift from merely preventing double taxation toward also preventing double non-taxation.

Historically, tax treaties were interpreted generously in favour of treaty access.

Modern treaty policy now emphasizes that Tax treaties should eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance.

This principle fundamentally changed treaty interpretation and administration.

Today, tax authorities increasingly evaluate not only whether a taxpayer technically satisfies treaty provisions, but also whether granting treaty benefits aligns with the treaty's intended purpose.

This evolution reflects the broader international movement toward substance-based taxation.

### **4. Anti-Abuse Preambles in Modern Tax Treaties**

Modern treaties increasingly incorporate explicit anti-abuse language within treaty preambles.

Historically, treaty preambles referred only to avoiding double taxation.

Contemporary treaty wording now expressly states that treaties are intended “...to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance.”

Although appearing introductory, treaty preambles play an important legal role because they influence treaty interpretation.

Tax authorities and courts increasingly rely on these preambles when evaluating whether a transaction falls within the intended scope of treaty protection.

This development strengthens the ability of tax administrations to challenge arrangements lacking commercial purpose.

## **5. Principal Purpose Test (PPT) under BEPS Action 6**

Perhaps the most transformative anti-abuse development incorporated into modern treaties is the **Principal Purpose Test (PPT)**.

### **5.1 The PPT Rule**

Under the PPT, Treaty benefits may be denied where it is reasonable to conclude that obtaining such benefits was one of the principal purposes of an arrangement unless granting the benefit is consistent with the object and purpose of the treaty.

The rule therefore introduces an economic substance inquiry.

### **5.2 Practical Application**

Examples that may trigger PPT analysis include:

- i. routing investments through intermediary jurisdictions;
- ii. inserting holding companies without substantive operations;
- iii. creating artificial financing structures;
- iv. restructuring solely to reduce withholding tax exposure.

### **5.3 Policy Impact**

The PPT significantly expands the ability of tax administrations to deny treaty benefits even where legal form appears compliant.

This marks a movement from **strict legal entitlement** toward **purpose-oriented treaty application**.

## **6. Limitation on Benefits (LOB) Clauses**

Another major anti-abuse mechanism incorporated into modern treaties is the **Limitation on Benefits (LOB)** clause.

Unlike the PPT's broad anti-abuse standard, LOB provisions rely on objective qualification tests.

Typical tests include:

- i. ownership requirements;
- ii. active business requirements;
- iii. publicly traded entity tests;
- iv. base erosion tests; and
- v. derivative benefits rules.

Under these provisions, treaty benefits are available only where specified criteria are satisfied.

LOB clauses therefore restrict treaty access to persons with genuine economic connection to treaty jurisdictions.

## 7. Beneficial Ownership Requirements

Modern treaties increasingly condition reduced treaty rates on the recipient being the **beneficial owner** of income.

The concept commonly applies to:

- dividends;
- interest; and
- royalties.

Beneficial ownership seeks to ensure that treaty relief is granted only where the recipient:

- enjoys economic ownership of income;
- exercises control over its use;
- bears economic risks; and
- is not merely a conduit or nominee.

This prevents artificial intermediary structures designed solely to capture treaty advantages.

## 8. Strengthened Permanent Establishment Rules

Modern treaties have significantly strengthened **Permanent Establishment (PE)** rules.

Historically, businesses could avoid source taxation by minimizing physical presence.

Recent reforms target such practices through:

## 8.1 Anti-Fragmentation Rules

Businesses can no longer divide operations among related entities to claim exemptions.

## 8.2 Commissionaire Structures

Businesses concluding contracts through dependent agents may still create taxable presence.

## 8.3 Construction Project Aggregation

Artificially splitting projects into shorter contracts may no longer avoid PE thresholds.

These developments reinforce taxation based on substantive economic activity.

## 9. The Multilateral Instrument (MLI) and Treaty Modernization

One of the most innovative treaty developments has been the **Multilateral Instrument (MLI)**.

Historically, treaty amendments required bilateral renegotiations.

The MLI allows jurisdictions to modify multiple treaties simultaneously.

Key reforms introduced through the MLI include:

- anti-abuse preambles;
- Principal Purpose Test provisions;
- enhanced dispute resolution;
- strengthened Permanent Establishment provisions; and
- anti-hybrid mismatch measures.

The MLI has accelerated implementation of international tax reforms globally.

## 10. Anti-Hybrid Mismatch Measures

Hybrid mismatches exploit differences in legal characterization across jurisdictions.

Common outcomes include:

- deductions without corresponding income inclusion;
- duplicate deductions; and
- untaxed cross-border payments.

Modern treaty reforms increasingly neutralize such outcomes through:

- denial of deductions;

- denial of treaty exemptions;
- alignment of tax treatment across jurisdictions.

These provisions strengthen consistency and reduce opportunities for arbitrage.

## **11. Exchange of Information and Administrative Cooperation**

Modern treaties have substantially expanded administrative cooperation.

Developments include:

- exchange of information upon request;
- automatic exchange of information;
- spontaneous information exchange;
- joint tax examinations; and
- mutual agreement procedures.

These mechanisms improve transparency and strengthen treaty enforcement.

## **12. Implications for Developing Economies Including Uganda**

For developing countries, treaty abuse can significantly reduce domestic revenue mobilization.

This is particularly relevant where:

- withholding taxes constitute important revenue sources;
- foreign investment structures dominate key sectors; and
- treaty networks continue to expand.

Modern treaty reforms create opportunities to:

- protect domestic tax bases;
- enhance tax certainty;
- discourage aggressive tax planning;
- promote genuine investment.

For tax administrations, treaty administration increasingly requires integration between:

- domestic anti-avoidance provisions;
- transfer pricing rules;
- beneficial ownership analysis;
- information exchange mechanisms; and
- treaty interpretation principles.

### **13. Conclusion**

Double taxation treaties are experiencing a fundamental transformation.

The international tax system has evolved from focusing exclusively on preventing double taxation to ensuring that treaty benefits are not exploited to generate artificial tax advantages.

Developments such as anti-abuse preambles, the Principal Purpose Test, Limitation on Benefits clauses, beneficial ownership requirements, strengthened Permanent Establishment rules, anti-hybrid measures and expanded information exchange mechanisms demonstrate the growing emphasis on economic substance and genuine commercial activity.

The future of treaty policy therefore lies in achieving an appropriate balance—protecting legitimate cross-border investment while preserving the taxing rights necessary to sustain national development.

#### **About the Author**

Julius Nandeeba is an Advocate of the High Court of Uganda and also a passionate writer and Tax Educator with keen interest in international taxation, financial sector taxation and emerging international tax policy developments.