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HARM 53: MASTER THESIS (15 ECTS)

Per Aspera ad Astra: Towards the International Fiscal Meaning of the Concept 'Beneficial Owner'

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1. Introduction

1.1. Background

Beneficial owner, Bénéficiaire effectif, Nutzungsberechtigter, Beneficiario efectivo, Uiteindelijk gerechtigde ... These are only a few examples of how the term that has become a topic of the present thesis sounds in different European languages – English, French, German, Spanish and Dutch.

Having appeared in the common law countries as one of the trust law developments, the term 'beneficial owner' has subsequently become a generally accepted tax legal concept, translated into different languages worldwide, and currently incorporated into more than 2 400 Double Tax Treaties (DTT) concluded by more than 170 countries all over the world[1].

Internationally, the term was first introduced by the OECD in the Model Convention in 1977 and since that time it serves as one of the anti-abuse rules directly provided for in DTTs. 'Beneficial owner' is usually found in the dividends, interest and royalties articles of tax treaties, which normally provide some preferential tax conditions for the persons acquiring income from another contracting state (usually a reduced level of withholding tax or tax exemption). Such tax advantages, however, are only available if the beneficial owner of the dividends, interest or royalty income is a resident of another contracting state. The concept is, therefore, critical for determining the eligibility of a person for the tax treaty benefits and for the allocation of the taxing rights between the two contracting states with regard to the relevant category of income.

Despite its more-than-thirty-year existence in international tax law the term is still a subject of hot discussions in academic and professional circles. The main reason thereof is probably the fact that there is still no clearly defined uniform meaning of 'the beneficial owner' agreed on a supra-national level. Neither OECD Model Convention nor its Commentaries provide a comprehensive positive definition of the term. When it comes to the actual double tax treaties only few of them do contain an explanation of the 'beneficial owner' meaning. The latter is also elusive under the domestic law of most states. One might think that such legislative vacuum should have been "filled" by virtue of the juridical interpretation. Although, during last years more and more international cases on beneficial ownership has appeared, they do not seem to apply a uniform approach and could hardly be used for interpretation of the term in other countries.

1.1.1. *Why is it so important to define a term on international level?*

Due to the process of globalization and liberalization of capital markets, the flow of dividends, interest and royalties between different states has been constantly increasing. Under such conditions the issue of the harmonization of legal concepts, which facilitate the fair allocation of the taxing rights between contracting states, becomes more and more important.

Moreover, in order for the tasks of avoidance of double taxation and treaty abuse to be perfectly accomplished it is to be wished that the instruments used in a DTT are applied consistently. The uniform or so called symmetrical application of the 'beneficial owner' concept

[1] The information was obtained on the IBFD research platform as of 04th of April.

by contracting states would clearly assist the fulfillment of its function of counteracting the treaty shopping and avoidance of multi-layers of taxation.

1.1.2. *What does prevent the international community to accept a uniform treaty definition of the term?*

The main reason of the difficulties in consistent application of the concept in international tax law is said to be the differences in legal systems and traditions of the contracting states, including different approaches in defining the ownership concept. The most noticeable differences exist between the common and civil law jurisdictions. In addition, the difficulties arise because of the need to translate the term - initially known only in English - into other languages. Sometimes such translation changes the core of the phrase and creates additional problems in its interpretation. It is very difficult to arrive at a universal tax language meaning if the term to be interpreted is different, depending on the language of the treaty partner.[2] Moreover, the process of negotiations in such a multi-cultural and multi-interest international organization as OECD is usually time-consuming, which also creates additional difficulties.

1.2. Purpose

The present paper is not the first one, which makes an attempt of shedding light on the international fiscal meaning of the 'beneficial-owner' concept.

In the very beginning the views on this issue were quite skeptical: in late 80's the group of scholars even concluded that 'there seems little chance of there being an accepted universal meaning'[3] of the 'beneficial owner'. The latest researches, however, seem much more optimistic; some authors have already made their conclusions and suggestions as for the possible common definition of the concept. The majority of authors, who wrote about the concept, admit that it is indeed timely and necessary to provide a uniform definition of the 'beneficial owner' for the international tax law purposes, though the task seems to be not easy at all.

The purpose of this paper, therefore, is to examine the history and background of the concept in international tax law by reference to the relevant legal sources and to identify the most significant (core) elements of the notion, which might facilitate defining the concept on international level. Hopefully, this research will assuage the existing uncertainty and will provide the suggestions as for the improvement of the international fiscal meaning of the concept, being currently under discussion in the OECD.

It should be noted that the present research is not aimed at providing a comprehensive legal analysis of all existing legal sources containing the term 'beneficial owner'. Neither the purpose of this study is to solve any procedural or practical intricacies involving beneficial ownership.

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[2] J. David B. Oliver, Jerome B. Libin, Stef van Weeghel and Charl du Toit, *Beneficial Ownership*, IBFD Bulletin, July 2000, p. 311.

[3] John F. Avery Jones, Henri-Robert Depret, Micheline van de Wiele, Maarten J. Ellis, Piere Fontaneau, Pierre-Marie Fontaneu, Jurgen Kilitius, Raoul Lenz, Thomas W. Magney, Donald C. Orrock, Sidney I. Roberts, Sanford H. Goldberg, Victor Uckmar, Guglielmo Maisto and David A. Ward, "The Treatment of Trusts Under the OECD Model Convention', in *European Taxation*, No. 12, 1989, p. 379.

1.3. Disposition

The first part of this paper shall provide an analysis of the evolution of the term in international practice from the moment of introducing the concept into the 1977 OECD-MC till the latest major amendments to the Commentaries happened in 2003. In the second and third parts the domestic law of different countries and EU law, which also could be relevant for the determination of the concept, shall be analyzed. In the fourth part the author shall compare the approaches in judicial interpretation of the concept adopted by the courts in different states. The analysis of the mentioned legal sources shall be made in order to identify the core characteristics of the concept and to make final conclusions as for the current issues connected to the interpretation thereof, including those arisen in the context of the recently issued OECD Discussion Draft.

1.4. Sources and Methodology

One of the most important questions that appears when interpreting the legal instruments provided for in DTTs is determination of the relevant legal sources and methods of interpretation, which should be scrutinized and applied in order to provide a well-defined, substantiated meaning of the tax treaty concept.

The first part of the present paper shall include an analysis of the OECD documentation: Model Convention, Commentaries, Conduit Companies Report. The second and third parts shall analyze respectively the domestic law of different countries and the EU Savings and Interest and Royalties Directives. Further four chosen landmark cases on international fiscal meaning of the concept shall be scrutinized by the author. The final findings of this paper shall also be based on the latest clarifications on the meaning of the concept provided for in the Discussion Draft released on 29 April, 2011. The articles and papers of the scholars found in periodicals, journals and renowned websites shall also be extensively referred to in this paper.

With regard to methodology, the present research follows the traditional legal approach with some elements of comparative studies. A particular attention shall be given to the rules of interpretation provided for in Vienna Convention, including literal, contextual, teleological methods.

2. 'Beneficial Owner' in the OECD Documentation – History and Background

2.1. Preliminary Remarks

The evolution of the term 'beneficial owner' in international tax law has had a long history of 45 years. During this time the term has developed from a hardly understandable to the non-common-law world legal concept to a generally recognized and extensively used legal institute serving as an effective (or rather effective) anti-treaty-abuse instrument envisaged in international double tax treaties worldwide. Now 'beneficial owner' could be found in articles regulating the taxation of dividends, interest and royalties in the OECD Model Convention, the United Nations Model Double Taxation Convention, and United States Model Income Tax Convention. However, the first appearance of the term took place back in 1966 in a bilateral treaty concluded between two common-law countries.

2.2. 1966 Protocol to US-UK Income Tax Treaty – the First Use of the Concept in Tax Treaty

The first time in the international arena[4], that 'beneficial owner' was used, was in the Protocol of 1966[5] attached to the Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income of 16 April 1945, concluded between the United States of America and the United Kingdom of Great Britain and Northern Ireland (US-UK Income Tax Treaty). The Protocol set forth a reduced 15% tax rate on cross-border dividends and exempted interest and royalties income flowing between the countries from taxation. However, these treaty benefits were subject to a condition that respective income be derived and beneficially owned by a resident of another contracting state.

These changes were elaborated in the explanatory note attached to one copy of the protocol, where it was stated that:

> Relief from tax on dividends, interest and royalties... in the country of origin will no longer depend on whether the recipient is subject to tax in the other country, but will depend on the income being beneficially owned by a resident of the other country.[6]

The meaning of 'beneficial ownership' was provided neither in the Protocol, nor explanatory note.

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[4] Initially on a bilateral level, though.

[5] The fourth protocol signed on 17 March 1966 entered into force on 9 September 1966 and is effective as of 1 April 1964/6 April 1965/6 April 1966 (United Kingdom); 1 April 1966 (United States). The US-UK Income Tax Treaty 1945 had been terminated on 1 January 1975 (United States) and 6 April 1973/1 April 1975 (United Kingdom).

[6] Charl du Toit, *The Evolution of the Term "Beneficial Ownership" in Relation to International Taxation over the Past 45 Years*, Bulletin for International Taxation, 2010 (Volume 64), No. 10.

Other examples of the use of 'beneficial ownership' in pre-1977 treaties include the 1968 United Kingdom–Netherlands treaty, the 1969 Australia–Japan treaty, the 1975 United Kingdom–Spain treaty, the 1968 Ireland–France treaty, and the 1968 protocol amending the 1947 United Kingdom–Antigua treaty.[7]

It was in no way fortuitous that the term 'beneficial owner' firstly appeared in the treaties concluded with participation of at least one common-law country since the legal concept of the 'beneficial ownership' had actually originated in the United Kingdom and been known in countries having this type of legal system (Canada, the United Kingdom, Australia) for a long time.

In the meantime, it should be noted that the concept came into existence not within the area of tax law but as a development of trust law in England during the Middle Ages. Initially, the main statutory use of the expression was in relation to implied covenants for title given on the sale of land in English law.[8]

A trust is "a legal arrangement in which an individual (the trustor) gives fiduciary control of property to a person or institution (the trustee) for the benefit of beneficiaries"[9]. The obligation of the trustee as for the income from property may vary: the income can be distributed currently to the beneficiaries, either at or not at the discretion of the trustee, or may be accumulated by the trustee for later distribution.[10] The standing characteristic of such relationship is that trustee is the holder of the title to property, is obliged to keep or use the property for the benefit of others, and to separate trust assets from his own or other assets.

Therefore, in trust law the full ownership in the trust property was split into two constituent elements, which became vested in different persons: the 'legal ownership' in the trustee, and what came to be called the 'beneficial ownership' in the cestui que trust (the beneficiary).[11] While the legal ownership implies the possession of legal title to the asset, the beneficial ownership vests the right to enjoy the ultimate income on the asset as well as the right to control such income receipts and the asset itself.

Coming back to the 1966 Protocol to US-UK Income Tax Treaty, there is an opinion that the reason for adopting the expression was to provide a relief from withholding tax for charities and pension funds, which could not qualify under the former "subject to tax" test. However, if the trust law meaning of beneficial owner applied neither charities nor pension funds, which in both countries are normally constituted as trusts, would be qualified as beneficial owners. If this reason is correct, the trust law meaning of beneficial ownership is irrelevant and merely causes confusion.[12] This conveys a suggestion that the notion of 'beneficial owner' cannot be defined by

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[7] Supra, note 2.

[8] John F. Avery Jones (United Kingdom), Luc De Broe (Belgium), Maarten J. Ellis and Kees van Raad (Netherlands), Jean-Pierre Le Gall (France), Sanford H. Goldberg (United States), Jürgen Killius (Germany), Guglielmo Maisto (Italy), Toshio Miyatake (Japan), Henri Torrione (Switzerland), Richard J. Vann (Australia), David A. Ward (Canada) and Bertil Wiman (Sweden) *The Origins of Concepts and Expressions Used in the OECD Model and their Adoption by States*, Bulletin – Tax Treaty Monitor, June 2006, p. 246.

[9] http://www.investorwords.com/5084/trust.html, as of 8th of April.

[10] S. van Weeghel, *The Improper Use of Tax Treaties: with Particular Reference to the Netherlands and the United States*; Series on International Taxation, Kluwer Law International, 1998, p. 65.

[11] *Ayerst (Inspector of Taxes) v. C&K (Construction) Ltd.*, H.L. [1975] S.T.C. 345.

[12] Supra, note 8, p. 249.

virtue of the trust law language and, therefore, has indeed an autonomous fiscal meaning under the tax treaty.

2.3. 1977 OECD Model Convention – the Introduction of the Term into the OECD-Model Convention

The next phase in the evolution of the concept in international tax law was the year of 1977 when the term 'beneficial ownership' was officially incorporated into the OECD Model Convention. Until fairly recently there was very little information on the history and reasons why it was decided to include beneficial ownership into the OECD Model and – the most importantly – what exactly the term was meant to imply from the very beginning. Therefore, in this regard there was basically no other source but official OECD documentation, such as the OECD Model Convention, the Commentaries, and OECD Conduit Companies Report.

Recently, however, after some materials from the OECD archives connected to the negotiations on the 1977 OECD-MC became available Charl du Toit brought out the United Kingdom's Observations to the OECD-MC draft[13]. The following statement from the document of 9 May 1967 appeared under the heading "Article 10: Dividends" seems quite interesting:

> In our view the relief provided for under these Articles ought to apply only if the beneficial owner of the income in question is resident in the other contracting State, for otherwise the Articles are open to abuse by taxpayers who are resident in third countries and who could, for instance, put their income into the hands of bare nominees who are resident in the other contracting State. You will no doubt have noticed that our recent protocols with the United States and with Switzerland we have introduced this test of beneficial ownership which clearly reflects what was intended by the Committee when the Model Convention was prepared.[14]

This statement shed light on the real intention of the member states to incorporate the beneficial-owner concept into the tax treaties. Even though there is still no clear information on who exactly was meant to fall under the heading of 'beneficial owner' so as the treaty relief was applicable it is evident that the main idea behind its introduction was to put a stop to abuse of tax treaties and exclude from treaty protection "bare nominees" interposed with the mere purpose of enjoying treaty benefits. Therefore, as we can see, the main role intended for 'beneficial owner' in double tax treaties and which in fact remains so up to the present day, is that a concept was used as an anti-treaty-abuse tool.

Unfortunately, there is no information why the OECD Committee on Fiscal Affairs had chosen the term 'beneficial owner', which was unknown to the members belonging to civil law jurisdictions. In this regard Vogel suggested that the former had originally considered making treaty benefits dependent on the payments being liable to tax in the State of residence. However, that solution would have involved various allocation problems and the present wording was, therefore, ultimately agreed upon.[15]

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[13] OECD Fiscal Committee, "Observations of Member Countries on difficulties raised by the OECD Draft Convention on Income and Capital", TFD/FC/216, p. 14.

[14] Charl du Toit, supra, note 6.

[15] Vogel, K. (ed.), Klaus Vogel on Double Taxation Conventions: a commentary to the OECD-, UN- and US model conventions for the avoidance of double taxation on income and capital with particular reference to German treaty practice, 3rd edn. (London, Boston: Kluwer Law International, 1997), p. 561.

As for the amended provisions of the 1977 OECD-MC, Articles 10 and 11 thereof set forth the reduced tax rates for the payer of dividends and interest payments, Article 12 exempted the royalty payments from taxation in a source state. All mentioned benefits and reliefs provided for in three passive income articles are subject to a common condition – in order for reduced rate of withholding tax or exemption at source state to apply the payee should be a beneficial owner of the respective income.

The 1977 Commentaries on Article 1 explained that the introduction of the term stemmed from the need to counteract the improper use of the Convention and to set a limit to the actions intended "to benefit both from the tax advantages available under certain domestic laws and the reliefs from tax provided for in double taxation conventions" performed "through the creation of usually artificial legal constructions".

The intended meaning of 'beneficial owner' in tax treaty context was elaborated in the Commentaries to Articles 10, 11 and 12 as follows:

> [T]he limitation of tax in the State of source is not available when an intermediary, such as an agent or nominee, is interposed between the beneficiary and the payer, unless the beneficial owner is a resident of the other Contracting State. States which wish to make this more explicit are free to do so during bilateral negotiations.

Apart from what was explained in the commentaries quoted above, there was no further definition or elaboration of the term "beneficial owner" in 1977 Model Convention. The only information which could be used for the interpretation of passive income articles is, therefore, that "an intermediary, such as an agent or nominee" is excluded from treaty benefits and, therefore, is not a beneficial owner.

Except for the definition itself, the second sentence of the first commentaries on the notion should also be given a particular attention. It is worthy of note that, not specifying the exact positive meaning of the concept, the OECD left at the discretion of the member states to elaborate and provide their own definition of the 'beneficial owner' if they wish to do so. Some states accepted this suggestion having included the definition of the term into their bilateral treaties.

2.4. 1986 OECD Conduit Companies Report – Further Clarifications

10 years after the term was firstly introduced into the OECD Model Convention, i.e. in 1987, the OECD Council published four related studies in *International Tax Avoidance and Evasion*. One of the studies titled "Double Taxation Conventions and the Use of Conduit Companies" (the "Conduit Companies Report")[16] made some further clarifications as for the interpretation of 'beneficial-owner' concept.

Paragraph 14(b) of the Conduit Companies Report firstly mentioned the economic aspect of the beneficial owner's characterization, having provided that "the limitation [of tax] is not

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[16] Double Taxation Conventions and The Use Of Conduit Companies, report adopted by the OECD Council On 27 November 1986.

available when, economically, it would benefit a person not entitled to it who interposed the conduit company as an intermediary between himself and the payer of the income".

Moreover, the Report elaborates the definition of the concept mentioned in the Commentaries to 1977 OECD-MC, stating that except for "a nominee or agent" that do not fall under the heading of the beneficial owner the same fate should also be shared in "other cases where a person enters into contracts or takes over obligations under which he has a similar function to those of a nominee or an agent". The formal owner of certain assets that has "very narrow powers which render it a mere fiduciary or an administrator acting on account of the interested parties (most likely the shareholders of the conduit company)" is thus to be excluded from the 'beneficial owner' definition. Therefore, together with nominees and agents the ranks of persons who do not fit into the category of the 'beneficial owner' were joined by a formal owner of assets with "very narrow powers" acting as a mere fiduciary or an administrator.

At the same time the Report points at the practical difficulties which might arise in the country of source in connection with qualification of conduit company as a beneficial owner. From the OECD's view, the fact that the main function of the company is to hold assets or rights, does not in itself mean that it is used as a mere intermediary. Indeed, the creation of the company in an intermediary country may have other non-tax reasons, such as access to capital markets, currency regulation, political factors, etc. Such a situation, therefore, requires the overall examination of different factors, including, for example, the information regarding the shareholders of the conduit company, the company's relationships to the shareholders or other interested parties or the decision-making process of the conduit company. Since such information is quite difficult to obtain and process, such examination will "in any case be highly burdensome" not only for the country of source but even for the country of residence so that "even an exchange of information between the country of source and the country of the conduit company may not solve the problem"[17]. As a solution the OECD once again suggested to refer to the Commentaries to 1977 OECD-MC which proposed member states to adopt their own definition of the 'beneficial ownership' during bilateral negotiations of their treaties.

In summary, the Conduit Companies Report expanded the concept originally included into the 1977 OECD Model Convention by elaborating the set of persons not qualifying as 'beneficial owners'. The first time the Report also attempted to state that a substance-over-form approach or an economic approach to the relevant facts could be used in determining the beneficial owner.[18]

The Conduit Companies Report left the question of the positive meaning of the concept of 'beneficial owner' once again open. It had become obvious, however, that more than ever the problem called for further studies involving questions as to whether the OECD should set out policies regarding conduit companies in more detail to prevent improper use of tax treaties and whether the existing commentaries should further be revised.[19]

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[17] Paragraph 14(b) of the Conduit Companies Report.

[18] David A. Ward, *Access to Tax Treaty Benefits*, Research Report Prepared for the Advisory Panel on Canada's System of International Taxation, September 2008, p. 9.

[19] Ibid, p. 8.

2.5. 2003 OECD Commentaries – Major Changes

The next revision of the Commentaries happened in 1995, when the wording of dividend, interest and royalty articles was slightly amended in order to clarify that the treaty rate applied if the beneficial owner was a resident of the other contracting state even if the intermediary recipient was not such a resident. The commentaries also indicated that these amendments were not intended to change the way of the previous wording interpretation.

The Commentaries to the OECD Model were also amended in 1992, 2003, and 2005. However, probably the most dramatic changes to the OECD Commentaries on international meaning of 'beneficial ownership' were introduced in the 2003 update. Generally these amendments reflected what had originally been said in the Conduit Companies Report, though with some modifications.

The 2003 Commentary extended the negative definition of the term 'beneficial owner' in the double tax treaty.[20] Except for nominees and agents, it excluded persons other than agents and nominees acting as a conduit for someone else who in fact receives the benefit of the income concerned. In opinion of Roy Rohatgi this "would, therefore, exclude an agent or nominee when the income or asset beneficiary belongs to the principal. It would also exclude situations like short periods of ownership, remittance just after receipt on back-to-back transactions, small intervention spread with little or no operational substance, etc."[21]

The 2003 Commentary stated that the concept of 'beneficial owner' was introduced with the view that treaty benefits should not be available "merely because that [royalties, dividend or interest] income was immediately received by a resident of a State with which the State of source had concluded a convention". As for the interpretation of the notion it was emphasized that the term 'beneficial owner' should not be used in a narrow technical sense, but, rather, should be understood in its context and in the light of the object and purposes of the tax treaty, including avoiding double taxation and the prevention of fiscal evasion and avoidance.

Specifically in this regard the Commentary made clear that granting a relief or exemption by the source state to the agent or nominee based on its status of a resident of the other Contracting State would be inconsistent with the object and purpose of the Convention. The immediate recipient of the income in this situation qualifies as a resident, but no potential double taxation arises as a consequence of that status since the recipient is not treated as the owner of the income for tax purposes in the State of residence.

Further the Commentaries cited the provisions of Conduit Companies Report on the concept of 'beneficial owner' which excluded conduit company though being a formal owner but having very narrow powers, which render it a mere fiduciary or administrator acting on account of the interested parties. This time, however, the sentence about formal owners with narrow powers was added with a small detail having a particular relevance to the matter of the beneficial owner's interpretation. The phrase "as a practical matter" was added. Being technically a new wording the reference to formal owners who, "*as a practical matter"*, have very narrow powers is in fact a continuation of the discussion regarding economic approach, which had been implicitly opened up in the Conduit Companies Report. As Charl du Toit pointed out this

[20] See OECD Commentary: Article 10, paras. 12.1.-12.2; Article 11, paras. 10-11 and Article 12, paras. 4.1. and 4.2.
[21] Roy Rohatgi, *Basic International Taxation*, BNA International Inc., London, 2007, p. 172.

wording is important and goes to the heart of the matter, i.e. whether beneficial ownership is a legal as opposed to a practical or economic substance test.[22]

The 2003 Commentary's wording formed the basis for subsequent editions of the Commentaries to OECD Model Conventions of 2008 and 2010, thereby leaving many questions regarding international fiscal meaning of the term open both for tax authorities and taxpayers.

2.6. Summary

The history of the beneficial owner's concept in international tax law makes it clear that the term has been introduced to prevent treaty shopping. The beneficial-owner requirement is, therefore, essential in determination whether a person is eligible to enjoy the treaty benefits. The Conduit Companies Report, OECD-MC and OECD Commentaries left the question of the precise positive meaning of the concept open. Instead, they provide a list of persons which do not fall under the heading of 'beneficial owner' and would never enjoy the benefits of the passive income treaty provisions.

In accordance with OECD Commentary this list includes the following categories of persons:

- an intermediary, such as an agent or nominee;
- a conduit company or a formal owner, whose very narrow powers render it a mere fiduciary or administrator of the income.

At the same time the Commentaries emphasized that the term 'beneficial owner' should not be used in a narrow technical sense, but, rather, be understood in its context and in the light of the object and purposes of the tax treaty, which include the avoidance of double taxation and the prevention of fiscal evasion and avoidance. In this regard the Commentaries follow the Vienna Convention[23], which also suggests looking into the object and purpose of the international treaty as a general rule of interpretation.

Based on the examined OECD documentation it can be concluded that the 'beneficial ownership' doctrine so far could be used in attacking only very obvious cases of treaty shopping. This basically appears to be as far as the OECD could achieve consensus on the meaning of 'beneficial ownership'.[24]

On 29 April 2011 the OECD published the Discussion Draft, which provides some further clarifications on the international fiscal meaning of 'beneficial owner' (hereinafter – "the Discussion Draft"). The proposed amendments to the OECD Commentaries on Articles 10, 11, 12 specified therein shall be analyzed in detail in the final chapter hereof. Whether these amendments are adopted as they are, remains to be seen, hopefully, in a not too distant future, currently the Draft is open for a public discussion.

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[22] Charl du Toit, supra, note 6.

[23] Para 1 Art 31 of the UN Vienna Convention of the Law of Treaties of 23 May 1969, ibfd.org.

[24] Philip Baker, *Beneficial Ownership: After Indofood*, GITC Review Vol.VI No.1, February 2007, p. 17.

3. Domestic Law Meanings of the Concept

3.1. Preliminary Remarks

As it appears from the OECD documentation discussed above, it does not provide a precise definition of the term 'beneficial owner'. One might suggest that this issue could be easily solved by reference to Article 3(2) OECD-MC, according to which the term not defined in the DTT is to be given the closest domestic law meaning of the state applying the concept, "unless the context otherwise requires". Some commentators – the proponents of the autonomous tax meaning of the concept -, however, came into conclusion that 'beneficial owner' cannot be construed by reference to the domestic law of the source state, and this is exactly the case when the context of the treaty requires not using the domestic law meaning of the notion.[25] However, in view of the purposes of the present paper the definitions of the concept provided in domestic laws of different states seem at least unreasonable to ignore. Due to the historical and conceptual differences in the interpretation approaches, the legislation of the countries, which shall be discussed in the present chapter, have been divided into two groups in accordance with their belonging to common law and civil law jurisdictions.

3.2. Common Law Jurisdictions

As a tax concept, 'beneficial owner' is used about 70 times and 'beneficial ownership' 50 times in UK tax legislation; hundreds of times in Australian tax legislation. In Canada, the expression appears in the Income Tax Act and the Income Tax Regulation[26]. The concept is also commonly used in the United States legislation.

As the notion of 'beneficial owner' had originated in English law it seems logical to start the present discussion from the United Kingdom. The term 'beneficial owner' is used in tax statutes of the United Kingdom in provisions dealing with income tax implications of losses and exemptions from stamp duties for transactions between associated enterprises[27]. There are also a number of tax cases on the meaning of 'beneficial owner', a few of which involve the above mentioned statutory provisions. The remarkable fact is that the courts in England do not generally distinguish between beneficial ownership for tax purposes and non-tax purposes.[28]

In *Wood Preservation Ltd. v. Prior (Inspector of Taxes)*[29] involving a dispute regarding beneficial ownership of shares, Harman J. held the latter to mean "an ownership which is not merely the legal ownership by the mere fact of being on the register but the right at least to some extent to deal with the property as your own". Lord Donovan in the same judgment explained the situation when the beneficial owner's status was absent with reference to "… a tree which the owner could not sell and could not cut down and of which he could enjoy none of the fruit".

In *Sainsbury plc v. O'Connor*, the Court equated the term 'beneficial owner' with 'equitable owner', stating that:

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[25] See, for instance, Luc de Broe, *International Tax Planning and Prevention of Abuse: A Study under Domestic Tax Law, Tax Treaties and EC Law in Relation to Conduit and Base Companies,* IBFD 2008, p.p. 660 - 671.
[26] John F. Avery Jones, supra, note 8.
[27] Vogel, supra, note 15, p. 561.
[28] Charl P. du Toit, *Beneficial Ownership of Royalties in Bilateral Tax Treaties*, IBFD Publications, 1999, p. 100.
[29] (1968) 45 EC 1126 CA, at 132-133.

> It means ownership for your own benefit as opposed to ownership as trustee for another. It exists either where there is no division of legal and beneficial ownership or where legal ownership is vested in one person and the beneficial owner … in another.[30]

Unlike the English courts, who mainly base their decisions regarding the determination of beneficial owner on a legal approach, the investigation of the United States case-law reveals a strong presence of the substance-over-form principle in the decisions on beneficial ownership[31].

The case-law of the United States elaborated the following criteria relevant for the determination of 'beneficial ownership'[32]:

- The unconditional and absolute control over the property (*Montana Catholic Missions v. Missoula County*[33]);
- The command over property or enjoyment of its economic benefits (*Anderson v. Commissioner*[34]*)*;
- The risk of loss criterion (*Yelenscic*[35]);
- The right to demand the specific performance of a contract[36];
- The criterion of "the transfer of the benefits and burdens or the incidents of ownership of the property" (*Ted F. Merril and Elizabeth H. Merrill v. Commissioner*[37]);
- The vesting of any appreciation or depreciation of the property's value (*Ted F. Merril and Elizabeth H. Merrill v. Commissioner);*
- "[T]he greatest number of the attributes of ownership" criterion (*Pacific Coast Music Jobbers, Inc. v. Commissioner*[38]).

The above *Montana Catholic Missions* case also mentioned another important characteristic of the right of beneficial ownership. Thus, according to Mr. Justice Peckham the right to beneficial use or interest in property must be recognized by law, and be enforced by the courts[39]. Applying the command or benefits test in *Yelenscics*, the court also concluded that "on ascertaining the beneficial owner of stock, the substance of a sale transaction, and not merely its from, will control."[40]

There appears to be no reported case-law dealing with international fiscal meaning of the concept in the DTT context in the United States. The Technical Explanation of the 1996 United States Model Convention, however, defines a 'beneficial owner' for the purposes of Art 12 as "any person resident in a Contracting State to whom that State attributes the payment for purposes of its tax".

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[30] [1991] STC 318, CA, at 330.
[31] Supra, note 29, p. 118.
[32] All following criteria are in a certain way interrelated and some of them are arguably interchangeable.
[33] 200 U.S. 118 (1906).
[34] 164 F.2d 870 (7th Cir. 1947).
[35] 74 T.C. 1513 (1980), at 1528.
[36] Supra, note 30.
[37] 40 T.C. 66 (1963), at 74.
[38] 55 T.C. 866 (1971) at 874.
[39] Supra, note 33, at 127-128.
[40] Supra, note 36, at 1528.

3.3. Civil Law Jurisdictions

Unlike common law countries, where the term 'beneficial owner' has been known for a long time, civil law jurisdictions still have problems with the interpretation of this "transplanted" tax treaty concept and until recently there has been little clarity as to its meaning despite its wide presence in DTTs. The following countries would rather be the exceptions as they are only few, which do have some clarifications as for the meaning of the concept in question.

Thus, the 1965 Dutch Dividend Tax Act sets forth that a shareholder who is the recipient of dividends will not be considered the beneficial owner of the dividends if a person other than the recipient wholly or partly benefits from the dividends, whereby such person retains an interest in the shares on which the dividends were paid and such person is entitled to a credit, reduction or refund of the dividend withholding tax that is less than that to which the recipient is entitled.[41]

German law does not define the 'beneficial owner', though its definition may be found in a few tax treaties concluded by Germany with different states. The first one appeared back in 1989 in the DTT with the USA, according to which 'beneficial owner' is "the person to which the income is attributable for tax purposes' under the laws of the State of source". In Switzerland, the 1962 Abuse Decree excludes from treaty benefits fiduciary or collecting agents of non-resident principals. Belgium and France take the term to exclude only agents and nominees.[42]

The 2011 Ukrainian Tax Code basically reiterates the OECD Commentary and defines the beneficial (actual) recipient (owner) of the income as an entity entitled to receive such an income. It excludes a legal entity or an individual that is an agent or a nominee, or acts only as an intermediary with regard to this income.

In China, whose legal system is close to a civil law tradition, the State Administration of Taxation in 2009 published a Circular[43], having the same legal force as law, with the guidelines on the interpretation of 'beneficial ownership' under China's double tax treaty law. The circular specifies that a "beneficial owner" must have the right of ownership and disposal over either the income received from China or the associated properties and rights. In general, a beneficial owner is supposed to conduct substantive business operations. The latter would mean a performance of manufacture, distribution or management functions, but not a possession of a substance which is barely enough to meet the minimum legal requirements. In addition to a

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[41] S. van Weeghel and Reinout de Boer, *Anti-Abuse Measures and the Application of Tax Treaties in the Netherlands*, IBFD Bulletin, August/September 2006, p. 363.

[42] Roy Rohatgi, supra, note 21, p. 367.

[43] Guoshuihan (2009) No. 601, 27 October 2009. The SAT has previously released two circulars dealing with access to treaty benefits: Guoshuihan (2009) no. 81 on 20 February 2009, setting forth guidance relating to the implementation of dividend clauses in tax treaties, and Guoshuifa (2009) No.124, providing guidance and clarifying procedures and documentation requirements for non-residents seeking to enjoy treaty benefits on their Chinese-source income.

technical legal analysis, the circular emphasizes a substance-over-form test; both dependent on the actual facts of the situation involved.[44]

3.4. Summary

On the first sight it appears that the countries are trying to elaborate their own definitions of 'beneficial owner', though the majority seems to apply the core principles established in the OECD documentation. Interestingly, but according to Charl du Troit from the very beginning the OECD intended to incorporate the common law meaning of 'beneficial owner' into the Model Convention. He argues that since the concept derives from the legal traditions of common law and the drafters of the OECD-MC had several options as for the term, but decided in favor of 'beneficial owner', which was not opposed by the civil law OECD members, the term should be given a common law meaning within the DTTs.[45] While one might indeed find that the OECD Commentaries are not contrary to a common law meaning of the term it seems hardly plausible that the civil law countries will share this opinion and rely on the generic common law definition unless it is incorporated into the OECD Commentaries as a generally accepted.

4. The Notion of the 'Beneficial Owner' in the EU Law

There is an opinion that in the absence of a definition of the concept in the DTT and domestic law, the EU countries may refer to the definition of 'beneficial owner' provided for in the EU law as the latter is a part of the legal system of the EU Member States.[46] The definition of the term 'beneficial owner' was implemented into two EU Directives related to the income taxation: Interest and Royalties Directive[47] and the Savings Directive.[48]

The aim of the Interest and Royalties Directive lies in ensuring that interest or royalty payments are exempted from any taxes imposed on those payments in the source State, provided that the beneficial owner of these payments is an associated company or a permanent establishment of another Member State. The definition of 'beneficial owner' is given in Art 1(4) of the Directive, which specifies that a company shall be treated as the beneficial owner of interest or royalties only if it receives those payments for its own benefit and not as an intermediary, such as an agent, trustee or authorized signatory, for some other person.

The ultimate aim of the Savings Directive is to enable savings income in the form of interest payments made in one Member State to beneficial owners who are individuals resident in another Member State to be made subject to effective taxation in accordance with the laws of the latter (residence) Member State.[49] The Directive deems any individual who receives an

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[44] See Jinyan Li, "*Beneficial Ownership" in Tax Treaties: Judicial Interpretation and the Case for Clarity*, Conference in Honor of John Avery Jones 22nd and 23rd April 2010, available at: aaef.org.ar as of 5 May, 2011.
[45] Charl du Toit, supra, note 28, p.p. 235-237.
[46] Luc de Broe, supra, note 25, p. 673.
[47] Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States , *Official Journal L 157 , 26/06/2003 P. 0049 – 0054.*
[48] Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments *Official Journal L 157/38, 26.6.2003.*
[49] Ibid. preamble recital (8).

interest payment or any individual for whom an interest payment is secured to be a beneficial owner, unless the latter provides evidence that it was not received or secured for his own benefit, that is to say he acts merely as a paying agent.

Both Directives in principle exclude from the 'beneficial owner's' heading the agents collecting income in the name and for the account of another person and intermediaries collecting the income in their own name but for the benefit of another person.[50] This approach is consistent with the meaning given in the OECD Commentaries with the exception that the latter is arguably wider than a mere exclusion of agents, nominees, trustees and fiduciary owners and could include conduit and holding companies receiving income in their own name and for their own account.

There is no decision of the Court of Justice of the European Union (CJEU), which might correlate the EU law meaning of the notion with its meaning in the tax treaties. Some authors argue that "[w]henever the ECJ [now – CJEU] interprets the notion of beneficial owner, it may serve as inspiration for the interpretation of tax treaties. This interpretation of the notion of beneficial owner in tax treaties will not have any binding effect, but it has significance in the relation between the EU states and in the relation to states outside the EU".[51]

In this regard Hinnekens also argued that the EU concept of beneficial owner is an autonomous one, meaning that it can be used only for the purposes of the said Directives[52] and its interpretation should not be affected by the meaning of 'beneficial owner' under the OECD-MC as it evolves over time.[53] This suggests that 'beneficial owner' under DTTs should have the meaning, independent from internal or any supra-national law of the states, the meaning which would facilitate the concept to effectively achieve its anti-treaty-shopping goal.

Except for the OECD documents and domestic law of the countries considered above it ought to mention relevant international case-law which also played a significant role in evolution of the term and in this context was extensively discussed by international tax community.

[50] Luc de Broe, supra, note 25, p. 674.
[51] J. Bundgaard and N. Winther-Sorensen *Beneficial Ownership in International Financing Structures,* Tax Notes International, May 19, 2008, p. 597.
[52] As specified in Articles 2 thereof.
[53] Hinnekens L., *European Commission Introduces Beneficial Ownership in Latest Tax Directives Proposals Adding to the Confusion with Regard to its Meaning,* EC Tax Review, 2000, 43-44.

5. The Concept of 'Beneficial owner' – Examples of Judicial Interpretation

5.1. Preliminary Remarks

The author has chosen four recent landmark cases where the international fiscal meaning of 'beneficial owner' was discussed, namely, the UK *Indofood*, French *Royal Bank of Scotland*, Spanish *Real Madrid*, and Canadian *Prévost* cases. These cases were chosen due to the fact that they deal with different types of passive income: interest, dividends later reclassified into interest, royalties and dividends income respectively. Moreover, the countries, from which the judgments originated, represent both civil and common law systems, the approaches to 'beneficial ownership' requirement of which would be also interesting to compare.

5.2. The *Indofood* case

In 2006 the issue of economic versus legal approaches in the interpretation of the concept was elaborated by the UK Court of Appeal when resolving the dispute between Indofood International Finance Ltd (hereinafter – "Indofood") and JP Morgan Chase NA London Branch (hereinafter – "JP Morgan").[54] This case deserves a particular attention primarily because there is widespread acceptance that it supplies an 'international fiscal meaning' of the term 'beneficial owner'.[55]

It is, however, remarkable that despite the fact that one of the central issues of the judgment was a key concept of international tax law the case itself involved a civil dispute arisen from a loan agreement. On the back of this, none of the judges and none of the counsel participated in the case was an expert in taxation.[56] The governing law of the case was Indonesian law; however, the case was heard in the UK courts because the loan agreements had a choice of jurisdiction clause which gave jurisdiction to the English High Court[57].

The background of the case can be explained as follows. Indofood, an Indonesian company, wished to raise finance for business purposes through the issue of loan notes. Instead of raising the loan directly from foreign investors which under the Indonesian tax law would lead to the 20% withholding tax on the interest, Indofood established for these purposes an intermediary Mauritian subsidiary. In accordance with the Indonesia-Mauritius Double Tax Treaty interest paid from Indonesia to Mauritius benefited from a reduced withholding tax of 10%. There was no withholding tax on the interest paid from Mauritius for the benefit of the loan notes holders, therefore, the total tax burden on interest payments was 10%.

The loan notes were, therefore, issued by the Mauritius special purpose vehicle (hereinafter – "SPV"), which, in turn, passed the money up to the Indonesian company on a back-to-back basis; the defendant – JP Morgan secured the loan. As a result Indofood would pay

[54] High Court of Justice Chancery Division [2006] EWCA Civ. 158 and Court of Appeal [2006] STC 1195.

[55] Miller, A. and Oats, L., *Principles of International Taxation.* 2nd ed., Haywards Heath, West Sussex, England: Tottel Publishing, 2009, p. 361.

[56] Baker, supra, note 24, p. 22.

[57] Ibid., p. 21.

the interest to the SPV, which would then repay it to the loan notes holders. The amounts of money borrowed by Mauritian company and later lent on to the Indonesian parent as well as the rate of interest on the loan to and from Mauritius were identical. As the Court of Appeal established, the Mauritian subsidiary was effectively obliged to pay on every dollar received from its Indonesian parent to the bondholders: none of the interest received could be retained by the Mauritian subsidiary.[58]

The established tax planning scheme went quite well for Indofood until Indonesia decided to terminate its tax treaty with Mauritius[59]. This meant that withholding tax rate on interest payments for the borrower increased up to 20% as provided for in the Indonesian tax legislation and the whole burden of these changes was to be borne by Indofood.[60] Since the interest rates in general at that time were falling and it was basically possible for Indofood to replace the loan with cheaper funds elsewhere, the latter decided to redeem the loan notes ahead of schedule based on the changes in Indonesian tax regime and the absence of the "reasonable measures" that could have been taken in order to avoid paying the increased tax.[61]

The loan note holders, however, obviously interested to keep the loan notes under previous interest rates due to the new market situation, decided to fight the Indofood's decision through their trustee, JP Morgan. In support they referred to the possible "reasonable measure" which could and should have been taken by the Indonesian borrower in order to keep paying the previous interest net amounts.

The proposed measure consisted in the assignment of the loan owed by Indofood to another SPV to be established by the Indonesian company, this time in the Netherlands. The interposition of the Dutch finance subsidiary between the Indonesian parent company and the Mauritian entity would open to the former an opportunity to benefit from the Indonesia-Netherlands Double Tax Treaty, which provided a reduced 10% withholding tax, subject, however, to a condition that the beneficial owner of the interest payments is a resident of another State. The Netherlands has no treaty with Mauritius but does not in general impose withholding tax on outbound interest payments[62]. Basically, the new scheme created an opportunity to keep the original withholding tax at the rate of 10%, which meant that Indofood would have no legal ground to redeem the loan notes early. The proposed tax planning scheme is shown in the following diagram:

[58] Ibid, p. 19.
[59] The reason of the termination was said to be the willingness of Mauritius to condone the setting up of SPVs in its territory, which were mainly used for treaty shopping purposes; this policy was obviously unacceptable for Indonesia.
[60] The loan agreement provided that whatever happened to the rate of withholding tax on the interest imposed by Indonesia; the investors were to continue receiving the same amount of interest in net terms.
[61] In accordance with the loan agreement Indofood was permitted to redeem the loan notes only in case there were no reasonable measures it could take to revert to the reduced withholding tax.
[62] Miller and Oats, supra, note 55, p. 363.

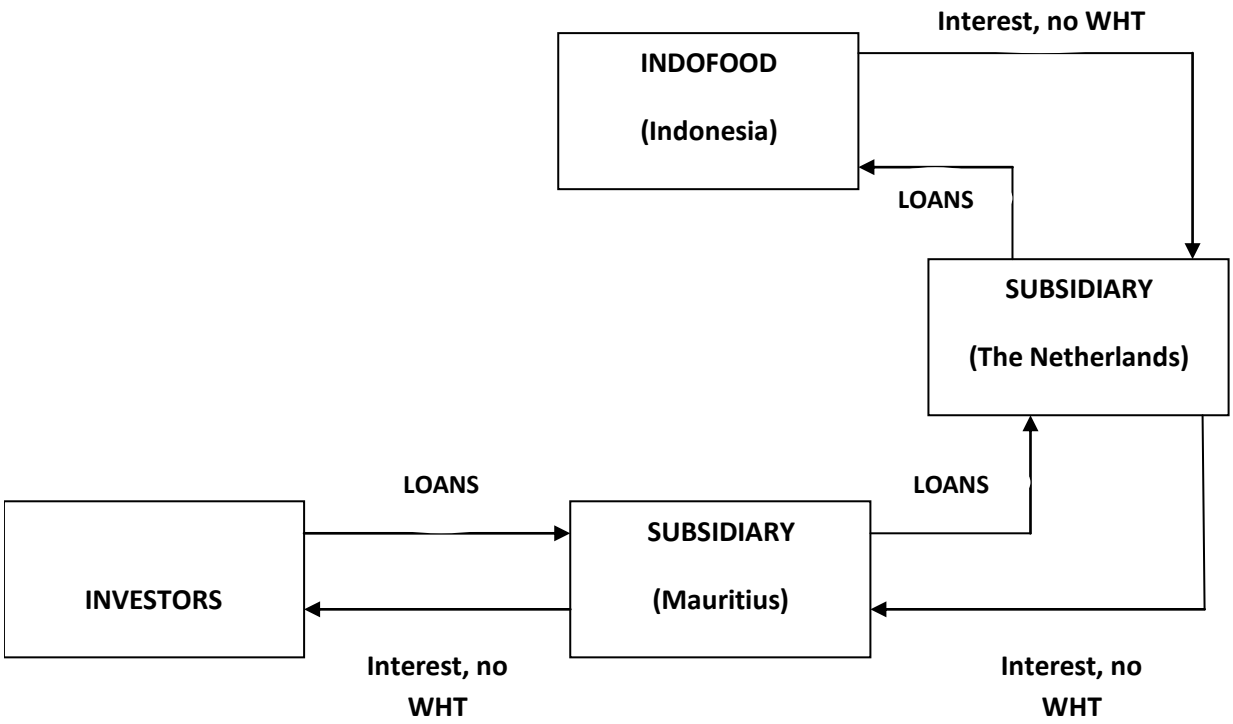

Diagram 1: the disputed tax planning scheme in the Indofood case

Indofood, however, contended that such a scheme would not constitute a "reasonable measure", since the Dutch SPV would not pass the beneficial-owner test for the purposes of granting the reduced withholding tax. The main question to be solved by the UK courts, therefore, consisted in establishing whether the proposed scheme was "reasonable" within the meaning of the loan agreement. This in turn required answering the question whether the Indonesian tax authorities would have granted the 10% withholding tax to the Dutch subsidiary as a beneficial owner of the interest income.

Since the issue touched upon the Indonesian law and practice, the UK Court of Appeal requested the Indonesian tax authorities to inform whether they would permit the Dutch SPV to benefit from the Indonesia-Netherlands Double Tax Treaty with regard to the interest. In reply the Indonesian tax authorities provided their own interpretation of 'beneficial owner' as "the actual owner of the interest income who truly has the full right to enjoy directly the benefits of that interest income"[63]. Subsequently this definition was taken into consideration by the Court of Appeal; however, the latter went even further having provided its thoughts as for the international fiscal meaning of the concept.

First of all, the Court held that the term should not be construed entirely with reference to domestic law, but should have an "international fiscal meaning" implying that it is to be interpreted uniformly in all countries having double tax treaties[64]. In this respect the OECD Commentaries and Conduit Companies Report on the interpretation of the notion in question

[63] The definition given in the letter of 24 June 2005 was later elaborated in the Circular issued on 7 July 2005.
[64] In this regard Baker (note 24, p. 22) pointed out that if one were to applaud any point in the present judgment it is that it interpreted the term within an international, as opposed to a domestic law, meaning.

were cited and analyzed. Secondly, the Court concluded that the proposed scheme would not create for the Dutch company 'the full privilege to directly benefit from the income' as specified in the Indonesian Circular. The reason thereof was that the legal, commercial and practical structure behind the loan notes was created in a way that the subsidiary was supposed to receive the interest payments from Indofood two days before the due date when the loan note holders were to receive their interest, and would be legally obliged to pay it on to the loan note holders the next business day.[65] Thirdly, the Court chose not to focus merely on the technical and legal approaches and looked into the substance of the matter. It pointed out that in practical terms it was impossible to conceive of any circumstances in which either of subsidiaries in the new scheme could derive any "direct benefit" from the interest payable by Indofood. In the Court's view such an exception could hardly be described as the "full privilege" needed to qualify as the beneficial owner; rather, the position of the SPVs equated to that of an "administrator of the income".[66]

On those grounds the Court came into conclusion that it would be "extremely doubtful" if the Dutch subsidiary could be regarded as the beneficial owner of the interest for the purposes of DTT since it appeared that Indonesian tax authorities "would be likely to challenge any such claim" and would most likely win a dispute regarding the interposition of the SPV entities.[67] The scheme employing the Dutch entity was held to be not a "reasonable measure" available to the parties in order to avoid the obligation to pay withholding tax at a rate in excess of 10%[68]. Thereby, the applicant was provided with a legal ground to redeem its loan early.

The Indofood case has been criticized mainly due to its reliance on quite vague definition of beneficial owner provided by the Indonesian tax authorities; it is indeed difficult to comprehend what exactly is understood under "the full right to enjoy directly the benefits of that interest income". Some authors, inter alia Charl du Toit, and tax practitioners put in doubt the wide implications of the case due to the fact that it "was influenced by some domestic elements of Indonesian law" and "dealt with a hypothetical situation".[69] In addition, in Baker's opinion the adoption of the substance-over-form approach in interpreting the cross-border arrangements where "great care is taken on the technical and legal aspects" would lead to uncertainty[70], so desirable in international tax planning.

In any event the case seems to be of great interest since it contains "the first real discussion of the meaning of beneficial ownership around the world"[71]. What deserves a particular attention in the Court's findings is that except for looking into legal side of the Dutch subsidiary's hypothetical contractual obligations, the Court of Appeal went further applying the "practical-matter" approach. The central question in this regard was whether the interposed SPV would have an economic function with regard to the income or have been established simply for performing administrative task. In a situation concerned there was little doubt that the proposed structure had "a blatant tax avoidance motive"[72]: the intermediary entities would have quite

[65] Ibid., para. 43.
[66] Ibid, para. 44.
[67] Ibid., para. 48.
[68] Ibid, para. 47.
[69] Charl du Toit, supra, note 6.
[70] Baker, supra, note 24, p. 24.
[71] Ibid., p. 27.
[72] Charl du Toit, supra, note 6.

narrow function of channeling the income – they were supposed to do nothing, but to receive money and to pay on the identical amounts of interest income downstream.

The case, therefore, brought up important practical question relevant for the determination of the international fiscal meaning of 'beneficial owner': can the beneficial ownership test be limited to a business-purpose or anti-avoidance test, whereby the tax authorities may refuse to grant the tax treaty benefits merely on the ground that there is no economic substance in the interposed entity and the main purpose behind such interposition is to benefit from the tax treaty? This question was partially answered later on by the Her Majesty's Revenue & Customs (HMRC), which has published "Draft Guidance on the Interpretation of the Indofood Decision"; where HMRC appears to strongly endorse such a "substance-over-form" approach with regard to the concept of beneficial ownership.[73] In its opinion the SPV cannot be recognized as the beneficial owner of the interest provided the terms and conditions of the loan agreements show that the flow of income is predestined to be passed from the SPV on to a lender and the main purposes of the interposed company is to avoid the withholding tax which would be due.

To see how the issue of "substance-over-form" application was elaborated in another situation, this time covered entirely by civil law let us address another landmark case - *Royal Bank of Scotland.*

5.3. *Royal Bank of Scotland*

The *Royal Bank of Scotland* case[74] involved the analysis of the beneficial-owner requirement in light of the France - UK Income Tax Treaty of 1968. In November 1992, the US company (Merrel Dow Pharmaceutical Inc.) entered into a usufruct agreement with a UK bank (Royal Bank of Scotland or RBS), whereby the bank acquired dividend coupons attached to the preferred non-voting shares of the French fully owned subsidiary of the US parent company (Marion Merrel Dow S.A.).

The conditions of the sale were as follows. The price paid by RBS was to be recovered by the French company in the form of dividends during three years. In addition to a predetermined amount of dividends RBS would also get a certain amount calculated after the French withholding tax was applied and the French *avoir fiscal* was refunded to RBS. Under the agreement the US parent company also undertook to pay the dividend amounts if the French subsidiary failed to do so as well as additional compensation if the bank did not receive the refund of the *avoir fiscal*; to buy back the shares if the income of the subsidiary did not reach a required thresholds; to provide the French subsidiary with all financial support so that the latter could distribute the agreed dividends.

According to the agreement in 1993 the French subsidiary distributed dividends to the bank subject to a 25% withholding tax under the French legislation. According to the France-UK DTT the rate of withholding tax on cross-border dividends constituted 15%. Thus, RBS applied

[73] Philip Laroma Jezzi, *The Concept of Beneficial Ownership in the Indofood and Prévost Car Decisions,* Bulletin for International Taxation, 2010 (Volume 64), No. 5, 26 March 2010.

[74] Summary of the case *Bank of Scotland vs Ministre de l'Economie, des Finances et de l'Industrie,* Conseil d' Etat of 29 December 2006, No. 283314, ibfd.org database.

for a refund of the French withholding tax paid in excess to the mentioned treaty rate and the *avoir fiscal* tax credit according to Art 9(7) of the mentioned DTT.

The French tax administration rejected the application on the ground that the beneficial owner of the dividend payments was not the UK bank but the US parent company. In its view, therefore, the transaction in question was arranged with the sole purpose of benefiting from the France-UK DTT and did not have a sound business purpose. Thus, the price paid for the dividend coupons corresponded to the amount of the net dividends guaranteed to RBS, before withholding tax. The total amount of dividends to be paid plus the refund of the *avoir fiscal* was greater than the amount initially paid by the bank to acquire the usufruct of the shares.[75] Based on these considerations, the transaction was reclassified by the tax authorities into a loan arrangement, granted for the term of three years and remunerated by the payment of the *avoir fiscal* tax credit available to the UK bank under the DTT in question.

The Court of Appeals of Paris firstly held in favor of the taxpayer. It stated that tax authorities failed to demonstrate that RBS in a given transaction was a nominee, an agent of the US parent company in collecting the dividends, or a conduit company interposed between the US parent company and the French subsidiary. Neither the French tax administration proved that the usufruct agreement was fictitious and should be reclassified as a loan, as well as allocation of risks between the US company and the bank was abnormal as compared to a similar international transaction.

The Supreme Administrative Court (Conseil d'Etat), however, reversed this decision. It denied the access of RBS to the reduced withholding tax rate and the dividend imputation credit based on the fact that the latter was not an effective beneficial owner of the dividend income. It concluded that the transaction in question indeed constituted a disguised loan between the bank and the US parent company, which was to be repaid by the French subsidiary. In reaching this conclusion, the Court found that at the given agreement RBS had "too many guarantees, which reduced, in an unusual way, the risk a shareholder is supposed to bear"[76]. While receiving the predetermined and guaranteed amounts of dividends and *avoir fiscal* the bank did not bear any shareholder risk. Therefore, in this situation the US parent company had merely delegated to its French subsidiary the reimbursement of the loan initially granted to RBS.[77]

The Conseil d'Etat also observed that the arrangement in question was motivated solely by tax considerations: the parties merely sought to benefit from the France-UK DTT, which provided the reduced tax rate and possibility of the *avoir fiscal* not available under the US-France DTT of 31 August 1994. This, for the Conseil d'Etat, was contrary to the object and purpose of the DTT since the beneficial owner of the dividends was not RBS but the US parent.

As we can see the French Supreme Administrative Court in *Royal Bank of Scotland* much the same as the UK courts in *Indofood* adopted an economic approach in determination of the eligibility for treaty protection. In contrast to *Indofood*, however, where an attention was also given to the legal structure of the transaction, the analysis in the *Royal Bank of Scotland* judgment was focused on the economic substance of the usufruct agreement. In applying a

[75] Bruno Gibert and Yacine Ouamrane, *Beneficial Ownership – A French Perspective*, European Taxation, January 2008, p. 6.
[76] Ibid., p. 7.
[77] Ibid.

substance-over-form doctrine the Conseil d'Etat went even further not only disregarding the agreement in question, but also reclassifying it into the loan arrangement.

Interestingly, but except for the beneficial-ownership provision the Conseil d'Etat based its decision on the French general domestic anti-abuse clause.[78] The question, which logically arises in this regard, is whether 'beneficial-owner' could indeed be used as an autonomous mechanism against treaty shopping or only coupled with domestic or other treaty anti-avoidance measures. In this respect *Gibert* and *Ouamrane* concluded that a possible answer would be that the Supreme Administrative Court could have reached the same conclusions without using the concept of fraud to the law, but, rather, directly the beneficial owner provision.[79] They explained that the concept of 'beneficial owner' has not been yet used alone to challenge treaty-shopping transactions in France. The former still lacks a proper distinct definition in French law and the French courts do not seem to be ready to apply the international fiscal meaning of the notion, if any. Therefore, by applying the "fraud-to-the-law" concept the French courts were simply trying to play safe; the 'beneficial-owner' concept could be regarded as an "auto-sufficient" provision against treaty shopping.

5.4. *Real Madrid* Case

The above mentioned statement on the broad anti-abuse and autonomous character of the concept was confirmed in another landmark case on international fiscal meaning of 'beneficial ownership' - *Real Madrid* case[80]. The case has evoked a wide response since it had involved the tax planning schemes used by a famous Spanish football club, Real Madrid, and its not less renowned high profile football players.

The circumstances of the case are as follows. Real Madrid made substantial payments for the exploitation of the image rights of one of its players to a company established in Hungary. The latter, in turn, transferred about 99 per cent of the payment gained to the Netherlands company[81]. In accordance with Art 12(1) of the 1984 Hungary-Spain DTT no withholding tax on royalties was applicable at source.[82] In such a way, therefore, Real Madrid benefited from the zero withholding tax on image rights under the mentioned treaty.

The Spanish tax authorities questioned the above construction, taking the position that the Hungarian company could not be regarded as beneficial owner since it was interposed as a mere conduit with a sole purpose of benefiting from tax exemption. They substantiated these conclusions on the facts that the latter only retained a small part of the payments (1% in the first case) and that there was a close link between payments received and the payments made (the

[78] Adolfo Martín Jiménez, *Beneficial Ownership: Current Trends*, World Tax Journal, 2010 (Volume 2), No. 1.

[79] Ibid., p. 9.

[80] Summary of the judgment No. 1110/2003 *Real Madrid F.C. vs Oficina Nacional de Inspección,* Audiencia Nacional 18 July 2006, ibfd.org database. There are actually a number of cases, which refer to very similar tax planning structures used by the taxpayer: 10 November 2006 (JUR\2006\284679), 20 July 2006 (JUR\2007\16526), 13 November 2006 (JUR\2006\284618) and 26 March 2007 (JUR\2007\101877). The present paper shall use as a base the judgement, which was adopted the first.

[81] In other cases Cypriot companies were also used.

[82] According to A.M. Jiménez "DTT between Hungary and Spain together with the DTT with Bulgaria is a well-known exit route for royalties" (supra, note 77).

payments by the Hungarian company took place on the day of receipt or on the day after)[83]. Moreover, the royalty payments between respective companies were made without invoices, in some cases amounts of such payments did not correspond to the provisions of the contract in force.

The National Court supported the tax authorities' argumentation. It held that the Hungarian company cannot be a beneficial owner of the royalty payments involved.

In contrast to *Royal Bank of Scotland*, however, the Spanish case explicitly recognized 'beneficial ownership' requirement as a notion with a "(very) wide anti-treaty shopping effect" having an impact analogous to the general domestic anti-abuse clause[84]. The Court confirmed the autonomous character of the concept holding that the term should be given an international fiscal meaning independent from the internal law definitions. Much the same as in *Indofood* the Spanish court extensively relied on the OECD Model and its Commentaries, as well as to the Conduit Companies Report.

In the Court's opinion, due to its primary anti-treaty shopping objective the concept of 'beneficial owner' could be given an "economic interpretation", implying that the "formal owner" of the income could be disregarded. Similar to the French Conseil d'Etat in *Royal Bank of Scotland*, no legal powers of the intermediary over the royalties received were considered by the Spanish Court. Rather, the Court assumed that since the Hungarian company received and immediately paid the royalties to the Netherlands company, it did not have any control over the income.[85]

The most interesting characteristic of the *Real Madrid* judgment is that the National Court of Spain explicitly equated 'beneficial owner' test to a business-purpose test[86], whereby in order to enjoy treaty benefits the interposition of the intermediary entity between the payer and the final recipient of the income should have a sound business reason. Such business reason does not exist if the only objective in such construction is to get access to the treaty benefits. In this regard the judgment follows the tendency adopted by the courts in previous cases, where an economic/substance-over-form approach constitutes a basis of analysis related to qualification of the 'beneficial ownership' requirement. The line of the court's argumentations, however, differs in the next landmark case on international fiscal meaning of the concept.

[83] Ibid.
[84] Ibid.
[85] Ibid.
[86] Provided for in the domestic legislation.

5.5. The *Prévost Car* Judgment

The facts of the Prévost Car case[87] were quite straightforward. Prévost Car Inc. (hereinafter – "Prévost") is a Canadian bus manufacturer incorporated under the laws of Quebec, which is a civil law province in Canada. In 1995, its shareholders decided to sell their shares to Volvo Bus Corporation (hereinafter – "Volvo"), a resident of Sweden, and Henlys Group PLC (hereinafter – "Henlys"), a resident of the United Kingdom, which were both bus manufacturers. Volvo undertook to establish a Netherlands resident company called PHB.V. and to sell 49% of its shareholding to Henlys. As a result of this deal 51% of PHB.V.'s shares were owned by Volvo and 49% - by Henlys. The respective corporate structure is shown in the following diagram:

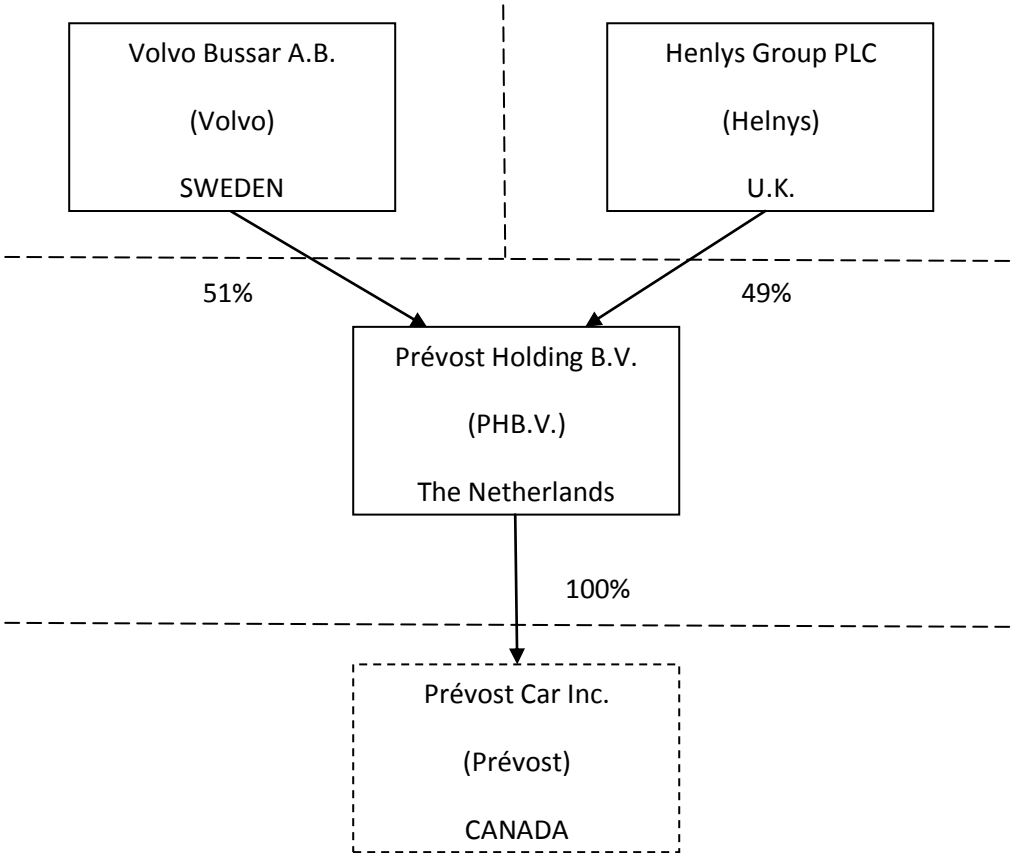

Diagram 2: the corporate structure in the Prévost Car case

The reason behind the incorporation of the Dutch entity had both practical and tax implications. Both companies did not want to establish a joint venture in the other partner's country: "Henlys did not want a Swedish company and Volvo did not want an English

[87] *Prévost Car Inc. vs. Her Majesty the Queen*; Tax Court of Canada, 22 April 2008, 2004-2006(IT)G and 2004-4226(IT)G; ibfd.org database. The case was subsequently confirmed in appeal by the Canadian Federal Court of Appeal (CFCA) on 26 February 2009.

company"[88]. Both wished to set up a company in a neutral territory, preferably European country, where business could be conducted in English. They fixed upon the Netherlands which according to the recommendation of the tax adviser Arthur Anderson & Co. in Rotterdam was a convenient place for the effective management and control of PHB.V. from the international tax planning perspective. Through the Dutch entity both companies also wanted to expand into North America.

Except for the mentioned business considerations, the establishment of the Dutch entity created the opportunity to benefit from a reduced withholding tax on dividends provided for in the Netherlands-Canada Double Tax Treaty.

According to a Shareholders' and Subscription Agreement between Volvo and Henlys not less than 80% of the earnings of Prévost were to be distributed to the shareholders "by way of dividend, return of capital or loan"[89]. The amounts of dividends in question were paid by the applicant to PHB.V. and then distributed by PHB.V. to Volvo and Henlys.[90] The Netherlands-Canada Double Tax Treaty provided the reduced withholding tax on dividends (Article 10) at the rate of 5% (against 25% under domestic law). In contrast, the rates applicable under the Canada-United Kingdom and Canada-Sweden tax treaties amounted to, respectively, 10% and 15%.

When it came to distributing dividends to the Netherlands shareholder, the Canadian tax authorities contested that the mentioned treaty provision did not apply since PHB.V. was not the beneficial owner of the dividends and, as such, was not entitled to the reduced 5% withholding tax. Instead Volvo and Henlys beneficially owned the dividend payments.

The double tax treaty between Canada and the Netherlands does not contain the definition of "beneficial owner". Neither the term is defined in the Canadian Income Tax Act. Therefore, the Canadian Court had to go into the analysis of the notion in the tax treaty context and in this respect pointed out that particular attention in such a process should be given to "a liberal interpretation with a view of complementing the true intentions of the contracting states", and finding "the meaning of the words in question".[91]

Having drawn a parallel between civil law and common law definitions of the beneficial owner as well as the general understanding of the ownership under the Civil Code of Quebec the Court (Justice Rip) gave its own definition of 'beneficial owner':

> In my view the "beneficial owner" of dividends is the person who receives the dividends for his or her own use and enjoyment and assumes the risk and control of the dividend he or she received. In short, the dividend is for the owner's own benefit and this person is not accountable to anyone for how he or she deals with the dividend income. ...[92]

It was also pointed out that this definition does not contemplate the piercing of a corporate veil so that the shareholders of a corporation are the beneficial owners of its assets, including income earned by the corporation. The only exception thereof is where the corporation is a conduit and has absolutely no discretion as to the use or application of funds, or has agreed

[88] Ibid, para. 9.
[89] Ibid, para. 12.
[90] Ibid., para. 14.
[91] Ibid., para. 37.
[92] Ibid., para. 100.

to act on someone else's behalf pursuant to that person's instructions. This was not the case in a situation with PHB.V.

During the proceedings both parties agreed that PHB.V. was not an agent, trustee or nominee for Volvo and Henlys. Neither was it a conduit for two companies in the Court's opinion. The dividend policy described in the Shareholder's Agreement was not binding on the Dutch company; the latter was not legally obliged to pay any dividend to its shareholders. The Court found that the money represented by the dividend is owned solely by PHB.V. until the management board declares and pays it to its shareholders. PHB.V. can use the dividends as it wishes and is not accountable to its shareholders except by virtue of the laws of the Netherlands.[93] Therefore, it was held that "there was no predetermined or automatic flow of funds to Volvo and Henlys even though Henlys' representatives were trying to expedite the process"[94], which meant that there were no grounds for qualifying the Dutch entity as a conduit company.

Much the same as in *Indofood* and *Real Madrid* the Canadian Tax Court extensively referred to the OECD materials. However, in contrast to all three previous decisions, which employed a so-called "practical matter" or economic test, the *Prévost Car* decision has been characterized as adopting a "narrow legalistic" approach"[95]. This difference can be explained by reference to the facts of the case as compared to *Indofood*, for instance. While in *Prévost Car* the Dutch entity along with creating tax opportunities had the obvious commercial purpose of acting as "a corporate nexus for two distinct investors"[96], the SPV in *Indofood* was found to be a mere conduit having no other aims but taking advantage of the Indonesia-Netherlands Double Tax Treaty.

Interestingly, but much the same as in *Indofood*, Dutch subsidiary in *Prévost Car* had no employees and physical office in the Netherlands nor did it have any investments other than the shares in Prévost, and the directors of Prévost were directors of PHB.V that frequently discussed its affairs, including future declarations and payments of dividends. However, despite these facts pointing to rather nominal character of the Dutch SPV, the Canadian Court observed that since tax consideration had not an overriding role in establishing the company, there was indeed the evidence of economic reality in the construction in question. In contrast, there was no sound business purpose behind the construction of the Indofood's scheme. All this suggests that subjective intention of the parties for entering into tax planning arrangement is crucial for giving tax treaty benefits, including those concerning the beneficial owner concept.

In addition, in contrast to Indofood's subsidiary bound by the back-to-back loan arrangements as well as the French subsidiary in *Royal Bank of Scotland* and the Hungarian intermediary in *Real Madrid* all bound by the contracts, PHB.V in *Prévost* had no contractual obligation to pass on the dividends received from Prévost to its shareholders. In this respect, though, it would be interesting to know how the Canadian case would have been solved should

[93] Ibid., para. 105.
[94] Ibid., para. 102.
[95] Charl du Toit, supra, note 6.
[96] Miller and Oats, supra, note 55.

the Prévost's situation had involved the interest or royalties payments, which are usually predetermined by the contractual arrangement.

5.6. Summary

It appears that Article 31 of the Vienna Convention has formed a basis for interpretation in above mentioned court decisions. While in *Indofood, Royal Bank of Scotland* and *Real Madrid* the courts brought into focus the object of the prevention of fiscal evasion and avoidance (teleological method) and, therefore, employed so-called 'practical-matter', economic or 'substance-over-form' approach; in *Prévost Car* the Canadian court adopted a legalistic approach giving to the concept in question the "ordinary meaning" (literal or contextual interpretation) .

It is remarkable that the courts, when interpreting the treaty concepts, also extensively relied on the OECD Commentary. Following its language they found the intermediary companies interposed with the sole purpose to benefit from treaty provisions to be an "administrator of the income" in *Indofood* and "a mere conduit" in *Real Madrid*. In the latter cases the courts have also conceived 'beneficial owner' as a term with an autonomous international meaning. The Spanish Court in *Real Madrid* went even further entirely excluding the application of domestic law from the process of interpretation. The UK Courts in *Indofood* did not rely on the definition provided for in Indonesian circular, however, took it into consideration when interpreting the treaty at stake.

All four cases suggest that subjective intention of the parties for entering into tax planning arrangement is crucial for the 'beneficial owner' qualification. Except for *Prévost Car* the courts did not find the prevailing business consideration behind the transactions under review. The predetermined character of the payments as well as the presence of contractual obligation to pass on the income by the intermediary were also found to be crucial in qualification of the entity for treaty benefits (the respective discussions could be found in *Indofood* and *Royal Bank of Scotland*, for instance).

6. The Issues Connected to the Current International Fiscal Meaning of the Concept

6.1. Domestic Law Meaning vs. Autonomous Treaty Meaning?

The first question, which arises after the analysis of the legal sources on 'beneficial owner', which have been considered in the previous chapters, is whether the term has indeed an autonomous treaty meaning as mentioned, for instance, in *Real Madrid* and *Indofood* cases, or the reference to the individual domestic laws of the contracting state is inevitably needed. The author believes that the history of the introduction of the term and the OECD Commentaries suggest establishing an autonomous treaty meaning of the concept and this is specifically the case when the context of the treaty so requires. This conclusion can be explained by a number of reasons.

First of all, the Commentaries to Art 3(2) OECD-MC suggest that the context in such a case is determined by mutual intentions of the contracting states when entering into the DTT as well as the meaning of the term given in the legislation of the other state.[97] The recourse to the domestic law of any state is, however, absolutely meaningless if the former itself does not contain a definition of 'beneficial owner' for DTT purposes[98].

Secondly, even if the contracting state applying the DTT (in the context of passive income articles - the source state) does have a definition of 'beneficial owner' in its legislation, it may significantly differ from the approach adopted by the other (residence) contracting state. In this regard Walser pointed out that:

> The point of providing a lower rate of source state tax for dividends beneficially owned by a parent corporation is to avoid multiple layers of corporate level tax. The underlying problem of multiple corporate level tax only exists if the residence country views the parent entity as the beneficial owner of the dividends that are received from the other country; thus, in this context it makes sense to ask not only whom the source state views as the beneficial owner but whom the residence country views as the beneficial owner.[99]

Thus, it seems highly desirable for the residence and source states to harmonize the treaty instruments, including 'beneficial ownership'. The absence of the uniform interpretation of the concept by the contracting states would undermine the primary goal of the DTT, namely the avoidance of double taxation as it may cause the situations of double taxation or double non-taxation.

Thirdly, as Vogel suggested in a situation where "none of the national tax systems in question offer a precise definition of the term" the latter must "be interpreted with reference to the context of the treaty, and particularly with a view to the purpose pursued by the

[97] Para. 12 of the Commentaries to Art 3 OECD-MC.
[98] This is actually the case in a majority of countries, especially civil law jurisdictions.
[99] 52nd Congress of the International Fiscal Association; Economic and Social Council, Committee of Experts on International Cooperation in Tax Matters Fourth session, Geneva, 20-24 October 2008.

restriction."[100] As has been shown in the first part of the paper the term was introduced with a purpose to counteract the improper use of the tax treaties. The inconsistent or asymmetrical application of the tax treaty terms by contracting states would neither facilitate the achievement of this goal.

Since the concept of 'beneficial owner' is a self-sufficient anti-treaty-shopping provision[101] it seems quite logical that it should be given an autonomous treaty meaning. As Luc De Broe mentioned:

> If one leaves it to each State to define the term 'beneficial owner' through recourse to its domestic law, there may be significant risk that the meaning emerging from domestic law goes well beyond the ordinary meaning of the term used in the treaty, especially if the meaning under domestic law is established under anti-avoidance provisions giving wide discretionary powers to tax authorities to disregard entities; re-determine the taxpayer who receives the income, etc.; with a view to curtail tax avoidance in general. In other words, the door to treaty override is wide open.[102]

Finally, by excluding the domestic definition and reinforcing the harmonization in international tax matters, the international community would create certainty for the taxpayers performing international tax planning worldwide. As Luc De Broe pointed out:

> If it is left to each State to construe the term under its domestic law, one abandons the principle of reciprocity, a fundamental cornerstone on which each tax treaty is built, and no longer strives to achieve a uniform application and interpretation of tax treaties, which is one of the goals pursued by the OECD. Certainty to the taxpayer becomes illusory.[103]

In view of the above mentioned arguments it can be concluded that there is indeed an absolute necessity to clarify the meaning of 'beneficial ownership' on international level; and the recourse to domestic law of the contracting states following Art 3(2) OECD-MC does not provide a solution.

This view was shared in the latest Discussion Draft, which suggested some clarifications of the term to be added into the OECD Commentaries. Pursuant to the latter the 'beneficial owner' was intended not to refer to any technical meaning that it could have had under the domestic law of a specific country, though this does not mean that the domestic law meaning is automatically irrelevant for the interpretation. The latter is applicable to the extent that it is consistent with the general guidance included into the Commentary. This amendment suggests that the definition of 'beneficial owner' in domestic law of the contracting state could be applied provided it is designed for the purposes of the DTTs interpretation and is not contrary to the latest OECD Commentaries.

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[100] Vogel, K. (ed.), Klaus Vogel on Double Taxation Conventions: a commentary to the OECD-, UN- and US model conventions for the avoidance of double taxation on income and capital with particular reference to German treaty practice, 3rd edn. (London, Boston: Kluwer Law International, 1997), p. 562.
[101] This conclusion has been made above; see discussion on the *Royal Bank of Scotland* case.
[102] Luc de Broe, supra, note 25, p. 670.
[103] Ibid., p. 671.

The Discussion Draft[104] also refers to the issue of a possible attribution of the common-law meaning to the term, explicitly specifying that the treaty concept is not used in the meaning that it has under trust law of many common law countries[105].

Another argument in support of the autonomous meaning of the concept under the treaty law is confirmed in para. 10.4 of Commentaries to Article 10 OECD-MC provided in the Discussion Draft. The latter specifies that the tax treaty meaning of the concept must be distinguished from the different meaning given to the term in the context of other instruments. As an example the Draft specified that it would be inappropriate to consider the definition provided, for instance, in the international anti-money laundering standard of the FATF Forty Recommendations for the purposes of DTTs. Following the above discussion the same conclusion could be made with regard to the EU Interest and Royalties and Savings Directives.

6.2. Legal vs. Economic Approaches

There are basically two schools of thoughts on whether the term 'beneficial owner' should be interpreted in a strict legal sense to mean only "legal conduit" or more practically in a business or economic sense to include "factual conduit".[106] We could have seen the difference between these approaches in the case-law studied.

The legal approach[107] focuses on the legal rights possessed by the intermediary, while the economic approach is usually applied to determine the factual circumstances indicating whether the intermediary in fact gets the income for its own benefit[108]. The former tends to be applied in countries that do not recognize the form over substance doctrine.[109]

In practice, however, the said tests are in no way mutually exclusive or incompatible. To some extent the analysis of economic substance of the arrangement is impossible without its legal analysis. As Martín Jiménez mentioned it is arguable whether the judgments on 'beneficial ownership', some of which have been considered above, were based on a pure economic/substance-over-form analysis:

> At first sight they mention that beneficial ownership should be interpreted economically, applying various different tests (correlation between income received and paid; powers of the intermediate vehicle; whether the income flowed through the intermediary or not, etc.), but in the end, in our view, what all the judgments (including *Prevost*), with the exception of *Royal Bank of Scotland*, did is a legal analysis of the factual circumstances: facts – and especially legal arrangements between the parties – were scrutinized to conclude in most of the cases (excluding *Prévost*) that the recipient's position is that of an agent/nominee and not that of a legal owner of the income. [110]

At the same time in *Prévost Car*, known for its "narrow legalistic" approach, the Canadian Tax Court made an analysis of the factual circumstances, such as the real intentions of

[104] Para. 12.1 of the Commentary on Art 10, which was reiterated in the Commentaries to Interest and Royalties Articles.
[105] The same conclusion has been made in subchapter 2.2. hereof.
[106] Jinyan Li, supra, note 44.
[107] Applied in *Prévost Car.*
[108] The economic substance of the transactions has become central in the rest of cases considered herein.
[109] Jinyan Li, supra, note 44.
[110] A. Martín Jiménez, supra, note 78.

the shareholders behind the contested interposition of the Dutch SPV. This allows making a conclusion that the legal and economic tests applied when defining the 'beneficial owner' of the income are interrelated. While the analysis of the legal rights of an intermediary over the income could be put onto the first place, the examination of the economic substance of a transaction would be rather a secondary or complementary stage of the concept qualification.

This view is also supported in the Discussion Draft, which implies that both tests are not prevented to be applied simultaneously. Thus, it specifies that the contractual or legal obligation to pass the payment received to another person could be derived from relevant legal documents, but also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient does not have the full right to use and enjoy the income.[111]

6.3. The OECD-MC Definition in the Pipeline

It is interesting that the Discussion Draft specifically indicates the form of treaty shopping, which the concept of 'beneficial owner' addresses, as those involving the interposition of a recipient who is obliged to pass the income to someone else. The document also confirms the opinion previously expressed by many commentators that the examples of persons, that do not fall under the 'beneficial owner's' concept given in previous editions of the Commentaries, namely the agent, nominee, conduit company acting as a fiduciary or administrator, should not be construed in a strict sense. Some guidance on the factors to be considered in determining whether the intermediary has characteristics of a conduit and should be excluded from the 'beneficial owner' definition could also be found.

If the Draft is adopted the OECD Commentaries will for the first time provide a positive meaning of 'beneficial owner' for the DTT purposes. According to the Discussion Draft the 'beneficial owner' of the income is a recipient of the income, which:

1) has the full right to use and enjoy the respective income;
2) has the powers over the income, which are not constrained by a contractual or legal obligation to pass the payment received to another person.

It is quite unclear what exactly is meant under "the full right". In this regard the Discussion Draft has only mentioned that this right must be distinguished from the legal ownership and from the use and enjoyment of shares on which the dividend is paid, the debt-claim with respect to which the interest is paid, or the right or property in respect of which the royalties are paid (as concerns the respective type of passive income). The latter statement implies that the beneficial owner should not necessarily be a legal owner of the income in order to qualify for treaty benefits; a usufructuary also comes under the term 'beneficial owner' within the meaning of the OECD-MC. In addition, it implies that what matters for the concept qualification is the real/economic ownership as opposed to legal ownership over the income.

The right to use and the right to enjoy property/income according to the civil law tradition are two of three essential components of the notion of ownership. The new Commentaries, however, seem to ignore the third not less important component, which is the right to dispose, implying the privilege to determine the "legal" future of the property/income.

[111] Para. 12.4. of the Commentaries on Art 10 OECD-MC.

The importance of this right for the determination of 'beneficial owner' was pointed out by Vogel. He defined a 'beneficial owner' as a person who is free to decide (i) whether or not the capital or other assets should be used or made available for use by others, or (ii) on how the yields from them should be used, or (iii) both[112]. Another aspect of the ownership, a risk of loss of the property/income, which was pointed in the US case-law, appears to be also ignored.

Interestingly, the meaning proposed in the Discussion Draft has not also taken into account the definitions of the concept, suggested by other legal scholars before. The common-law meaning of 'beneficial owner' as "the person whose ownership attributes outweigh that of any other person"[113] proposed by Charl du Toit seems either not to be regarded. The control-of-attribution test, according to which the beneficial owner is "a person who legally, economically or factually has the power to control the attribution of income"[114] suggested by Robert Danon seems also not to play any role in the new definition.

Probably the nearest contextual meaning of 'beneficial owner' of those mentioned in the present paper is one provided in *Indofood* by the Indonesian tax authorities', identifying 'beneficial owner' as "the actual owner of income... either individual taxpayer or business entity taxpayer that *has the full privilege to directly benefit from the income*" (emphasis added). Except for this, it seems that the proposed "full right to use and enjoy" test corresponds to the criteria of "the command over property and enjoyment of its economic benefits" mentioned in the US case-law discussed above.

The second criterion of the Discussion Draft definition seems to have been derived from the *Indofood* and *Royal Bank of Scotland* judgments, where the obligation to pass on the income was found to be crucial for the qualification of the predetermined/predestined character of the payments. In regard of this criterion it has been concluded earlier, that it is much easier to get the evidence of an obligation to pass on the interest and royalty payments, while in case of dividend the commitment to pass on the profits to third parties is quite difficult to prove due to the non-contractual character of these payments. As Vogel wrote even a one hundred percent interest in a subsidiary does not necessarily preclude the latter's 'beneficial ownership' in the assets held by it. There would have to be other indications of the fact that the subsidiary's management is not in a position to make decisions differing from the will of the controlling shareholder.[115]

Therefore, although the second component has a practical importance as it indicates at least one factor which has to be considered when defining the 'beneficial owner' of the passive income for the DTT purposes, it would be reasonable to elaborate the "pass-on-the-income" criterion specifically with regard to the dividends income.

It should also be mentioned that the Discussion Draft specifies that the fact that the 'beneficial owner' test is passed does not mean that the person should automatically be granted tax treaty benefits. "[T]he limitation of tax" should not be applied in cases of "abuse of this provision". This wording seems to imply that 'beneficial ownership' provision is not aimed to be

[112] Vogel, note 15, p. 562.
[113] Charl du Toit, supra, note 28.
[114] Robert Danon, *Taxation of Savings Income* (European Association of Tax Law Professors – Budapest, June 2006), pp. 19-22.
[115] Vogel, supra, note 15, p. 563.

a broad anti-avoidance measure, which could be used for attacking any form of conduits. This opinion was elaborated earlier by Martín Jiménez, who wrote:

> Although it is true that Para. 10 of the 1977 OECD Commentary on Art. 1 also pointed out that some situations of improper use of DTCs can be tackled with the concept of beneficial ownership, it seems that its original function was closer to that of an internal attribution-of-income rule, which determines who the person is that should be taxed … because income can be attributed to them. Therefore, originally not any form of treaty shopping could be attacked with the term "beneficial owner" and it had more to do with an analysis of legal substance of ownership than with a clause aimed at finding the economic owner of dividends, interest or royalties.[116]

The Discussion Draft also provides that since the concept 'beneficial owner' addresses specific forms of tax avoidance, it does not preclude the application of other treaty anti-abuse provisions, such as general anti-abuse rules and substance-over-form or economic substance approaches in other cases of treaty shopping.

7. Concluding Remarks

After the analysis of the evolution of the term 'beneficial owner' in international tax treaty law one may conclude that the introduction of the term known only in common-law jurisdictions was rather a rash and hasty decision[117]. All opposing views as for the giving the term a common or civil law meaning as well as existing uncertainty could have been precluded from the very beginning should the 'beneficial owner' have been given another "neutral" wording, such as factual, real or ultimate owner. Now the countries, which usually mechanically include the term into their DTTs following the OECD-MC, have to deal with it as is, and the OECD's efforts to put some clarity are not always as effective as wished.

The latest clarifications of the concept of 'beneficial owner' released on 29 of April 2011 by the OECD have been awaited by international community for a long time. However, have they indeed put an end to existed uncertainty?

The Discussion Draft contains some certainly positive developments. The first one is that it explicitly specified the type of treaty shopping targeted by the beneficial ownership limitation. Another achievement is that it clarified that the Commentaries should not be construed in a strict sense, whereby an agent, nominee and conduit company are not the exhaustive list of persons not falling under the definition of 'beneficial owner'. The good point was made when emphasizing the importance of factual, economic evidence along with legal evidence for proving the beneficial owner's status.

At some point, however, the Draft brought up even more uncertainty. Thus, referring to the domestic law, which according to the Discussion Draft "is applicable to the extent that it is consistent with the general guidance included in this Commentary", the OECD has not determined whether the term should be construed according to the laws of the source or residence state. Besides, the meaning of the "full right to use and enjoy" the income used in the

[116] A. Martín Jiménez, supra, note 78.
[117] Although it seems quite late to say this due to the fact that it happened 45 years ago.

context of the definition is quite unclear. From the context one might guess that the economic/real ownership as opposed to a legal/formal ownership is concerned. The factor for separating the "real" beneficial owner from the formal one was specifically named[118]. However, it would be better if such factors are further clarified.

Thus, it would be reasonable to add, for instance, the criterion of substantial business activities performed by an intermediary; the right of control or disposal of the income/property and risk-of-loss test. The mentioned objective criteria could also be complemented by subjective ones, for instance, the presence of prevailing tax intentions of the taxpayer for entering into the transaction.

Following *Prévost Car's* implications it may also be helpful to separate the factors indicating the conduit character of the dividends payments, which are relevant especially for the Article 10 as compared to interest or royalties income due to the substantial differences in proving, which have been described above.

All in all, even though there are obvious signs of the evolution of the term 'beneficial owner' in international tax treaty law, it appears that the OECD should continue improvements in order to uphold the latter's status of a self-sufficient autonomous anti-treaty-abuse instrument.

[118] The obligation to pass on the income received to another person mentioned in the Discussion Draft is meant.

TABLE OF ABBREVIATIONS

OECD ……Organization for Economic Co-Operation and Development

OECD-MC……. The OECD Model Tax Convention on Income and on Capital

DTT…….Treaty on Avoidance of Double Taxation

CJEU…… Court of Justice of the European Union

HMRC…… Her Majesty's Revenue & Customs

SPV…….Special Purpose Vehicle

RBS …… Royal Bank of Scotland

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