

Beneficial ownership under tax treaties

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Beneficial Ownership – Introduction

Art. 10, 11 & 12 OECD Model :

- **restriction:** reduction source taxation on dividend, interest, royalty only if recipient is ‘beneficial owner’ of that income
- **apparent purpose:** source state not required to reduce source taxation in instances where recipient is not receiving for himself
- **problem:** where to draw the line: how to distinguish from cases where a person is receiving for himself ?

Beneficial Ownership – Introduction

Origin:

- 1966 Protocol to 1945 UK-US treaty
- 1966 UK-Canada treaty
- 1967 UK-Netherlands treaty
- 1977 OECD Model treaty (and preceding 1974 draft)

Beneficial Ownership – Introduction

John Avery Jones in 2012 :

Origin of the b/o requirement:

>> UK problem with 1963 OECD Model

- UK explained in the late 1960s in the OECD’s CFA :
‘... the Articles [10-12] 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.’
- This assumes that the ‘bare nominee’ is also for purposes of Art. 4.1 OECD Model a treaty resident for the given item of income.

Beneficial Ownership – Introduction

- In the 1960s the UK had an unusual provision in its domestic tax law: a UK resident person acting in a fiduciary capacity (agent, nominee) for another (UK-resident or nonresident) person (principal) is taxed by the UK on UK-source income (*not*: on foreign-source income) which the nominee is entitled to receive (and actually receives) for his principal. Under art. 4.1 of the 1963 OECD Model such an agent or nominee is therefore a UK resident for tax treaty purposes (without the 1977 Art. 4.1, second sentence, not being taxable on foreign source-income was irrelevant).
- As a result, the source country would need to reduce the wht on dividend, interest and royalty income paid to agent/nominee also in cases where the principal is a UK resident.
- To counter this unwanted effect, UK convinced the OECD to include in the 1977 OECD Model the requirement that the source country needs to reduce wht only if the *beneficial owner* [‘BO’] of the income (here: the principal) is a UK resident.

Beneficial Ownership – Introduction

- Ironically, the 1977 OECD Model update included another – unrelated – change: the addition of a 2d sentence to Art. 4.1:
 1. For the purposes of this Convention, the term “resident of a Contracting State” means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature,
This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein. [cf. *Velcro case* >>]
- >> *Consequently*: the UK nominee no longer is a resident for purposes of the treaty between his residence country and the source country, and the beneficial ownership requirement was not needed anymore to eliminate the UK issue.

Beneficial Ownership – Text Article 10

- In hindsight, introduction by UK/OECD of the – undefined – term ‘BO’ which had been used in UK trust law but not in UK tax law (and not in any other country’s tax law) was risky. Would replacing the expression ‘paid to’ by e.g. ‘derived by’ have been safer?

Article 10 OECD Model (Dividends)

1. Dividends **paid** by a company which is a resident of a Contracting State [*source state*] **to** a resident of the other Contracting State [*recipient’s state*] may be taxed in that other State [*recipient’s state*].
2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident [*source state*] and according to the laws of that State, but *if the beneficial owner of the dividends is a resident of the other Contracting State [recipient state]* the tax so charged shall not exceed:
 - (a) 5 per cent ...

Beneficial Ownership – History

OECD Commentary 1977 on Article 10

12. Under paragraph 2, the 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.
- >> *In historical (UK) perspective this is now understandable. Otherwise one wonders why one would consider to apply the treaty that the agent/nominee residence country has concluded with the source country.*

Beneficial Ownership – History

1986 OECD Conduit Report: Double taxation conventions and the use of conduit companies,

>> **expansion of the notion BO:**

para. 14.b : Articles 10 to 12 of the OECD Model deny the limitation of tax in the State of source on dividends, interest and royalties if the conduit company is not its "beneficial owner". Thus the limitation is not 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 (paragraphs 12, 8 and 4 of the Commentary to Articles 10, 11 and 12 respectively).

The Commentaries mention the case of a nominee or agent. The provisions would, however, apply also to 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. Thus a conduit company can normally not be regarded as the beneficial owner if, though the formal owner of certain assets, it 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).

Beneficial Ownership – History

OECD Commentary 2003 on Article 10

>> **Intro on beneficial owner (‘b/o’)**

12. The requirement of beneficial ownership was introduced in paragraph 2 of Article 10 **to clarify the meaning of the words “paid ... to a resident”** as they are used in paragraph 1 of the Article. It makes plain that the State of source is not obliged to give up taxing rights over dividend income merely because that income was immediately received by a resident of a State with which the State of source had concluded a convention. **The term “beneficial owner” is not used in a narrow technical sense, rather, it should be understood in its context and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.**

Beneficial Ownership – History

OECD Commentary 2003 on Article 10

>> **Agent / nominee**

12.1. [1] Where an item of income is received by a resident of a Contracting State acting in the capacity of **agent or nominee** it would be inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption merely on account of the status of the immediate recipient of the income as a resident of the other Contracting State. [2] 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.**

Beneficial Ownership – History

OECD Commentary 2003 on Article 10

>> **Conduit companies**

12.1 [3] It would be equally inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply **acts as a conduit for another person** who in fact receives the benefit of the income concerned. [4] For these reasons, the report from the Committee on Fiscal Affairs entitled “Double Taxation Conventions and the Use of Conduit Companies” concludes that a conduit company cannot normally be regarded as the beneficial owner if, **though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties.**

Beneficial Ownership – Definition

Occasionally a treaty contains a definition of BO:

Germany-Italy 1989 Protocol

9. With reference to Articles 10, 11 and 12

The recipient of the dividends, interest and royalties is the beneficial owner within the meaning of Articles 10, 11 and 12 if

- [a] he is entitled to the **right upon which** the payments are based [!/] and
- [b] the income derived therefrom is **attributable** to him under the tax laws of **both States**.

Beneficial Ownership – Definition

Definition in

Technical Explanation to US Model 2006

The term "beneficial owner" is not defined in the Convention, and is, **therefore**, defined as under the **internal law** of the country imposing tax (i.e., the source country).

The beneficial owner of the dividend for purposes of Article 10 is the **person to which the income is attributable under the laws of the source State**.

Beneficial Ownership – Definition

Definition by The Netherlands

-- **1980s: Parliament:** debates on tax treaty policy:
If the *income received is, under a contractual obligation, paid on to a large extent to another party under conditions which are (virtually) identical* to those under which the income was received, then the intermediary recipient is not the beneficial owner [*back-to-back: flow through*].

-- **2001: Div Tax Act:** dividend recipient is not the beneficial owner of dividend if *underlying securities* have been obtained by virtue of an arrangement under which the securities have been agreed *to be resold or (re-)transferred* [*dividend stripping*].

Beneficial Ownership *selected case law*

Royal Dutch Shell / Market maker (NL 1994)

Indofood (UK 2004)

Prevost Car (Canada 2007)

ISS A/S (Denmark 2011)

Velcro (Canada 2012)

A Bank A/S (Switzerland 2012, 2015)

NL Supreme Court

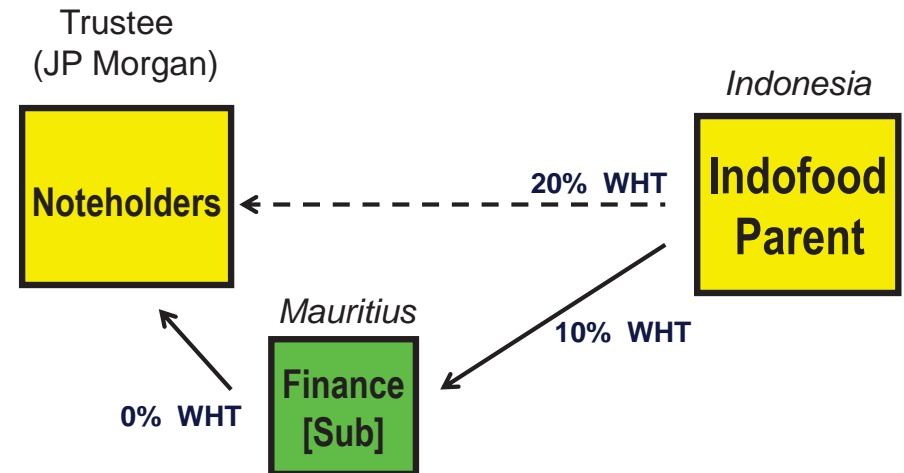
6 April 1994 -- *Royal Dutch Shell / Marketmaker*

A UK Ltd purchased Royal Dutch Shell (NL resident) dividend coupons (but not the underlying shares) from a Luxembourg shareholder who was not entitled to the benefits of the LUX-NL treaty, after the dividend had been declared but before it was made payable (*dividend stripping*).

Supreme Court: UK Ltd is entitled to the benefits (withholding tax reduction) of the UK-NL treaty. By purchasing the dividend coupons UK Ltd became the beneficial owner of those coupons. The treaty does not require that UK Ltd is also owner of the underlying shares.

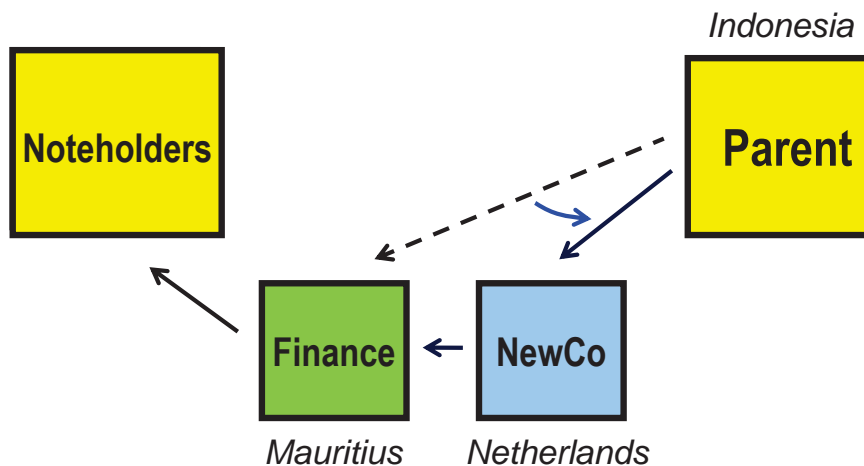
UK Court of Appeals

2 March 2006 -- *Indofood*



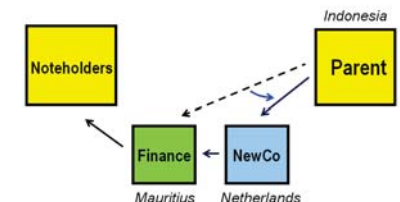
UK Court of Appeals

2 March 2006 -- *Indofood*

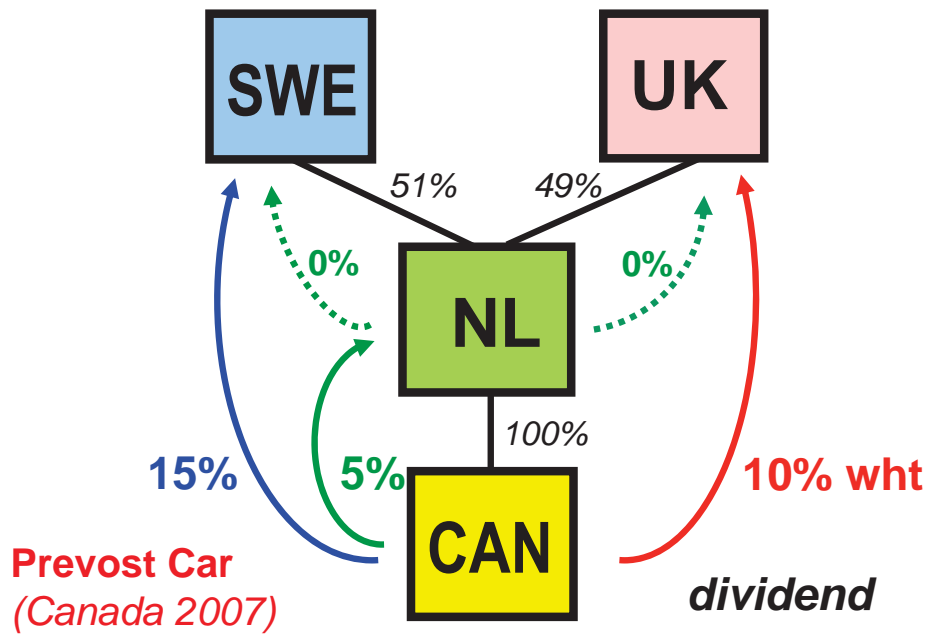


UK Court of Appeals

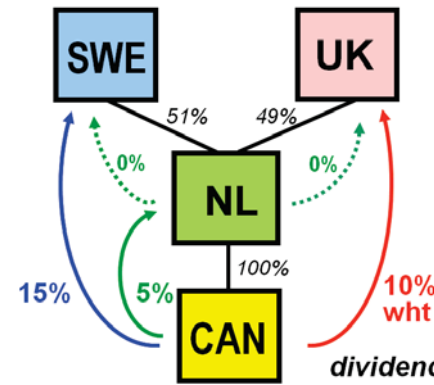
2 March 2006 -- *Indofood*



- NewCo is NOT the b/o because:
 - it is bound **to pay the full amount of interest received from Indofood on to the UK noteholders**, without a margin and also otherwise **on the very same conditions** on which it received the interest.
 - NewCo is a conduit company as it has no control over the income and derives no benefit from it.
- term 'beneficial owner' should be given an '**international fiscal meaning**' rather than a domestic interpretation.



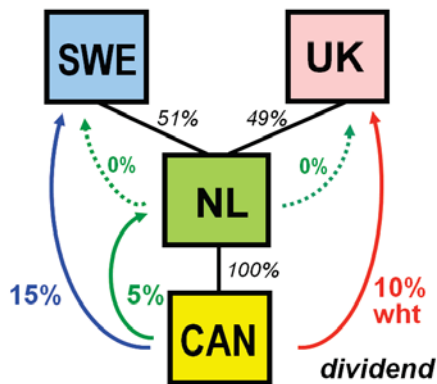
**CAN Federal Court of Appeal
26 February 2009 – *Prevoist Car***



– It is inappropriate to pierce the corporate veil, *unless* :

- >> the corporation is a conduit for another person and has *absolutely no discretion* as to the use or application of the relevant funds or
- >> has agreed to act on someone else's behalf pursuant to that person's instruction without any right to do other than what that person instructs it (e.g. a stockbroker who is a registered owner of the shares it holds for clients), i.e. *'puppet on a string'*.

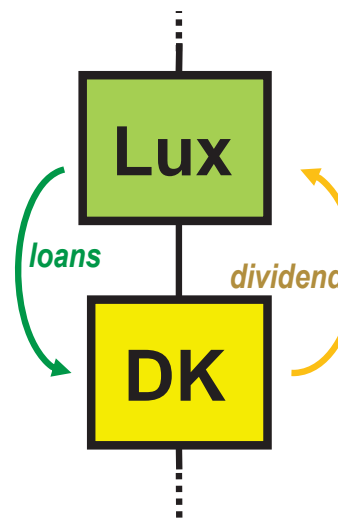
**CAN Federal Court of Appeal
26 February 2009 – *Prevoist Car***



– In its search for the meaning of the terms 'beneficial ownership' and "bénéficiaire effectif", the Tax Court closely examined "their ordinary meaning, their technical meaning and the meaning they might have in common law, in Québec's civil law, in Dutch law and in international law."

– On the main issue of who is the "beneficial owner," the CoA endorsed the Tax Court's view that "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".

**Denmark Eastern High Court
20 December 2011**



ISS A/S

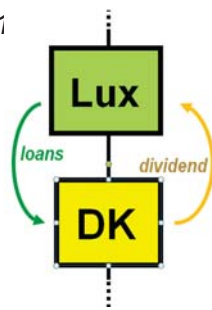
Luxembourg Holding Company receiving dividends from its Danish Sub and lending these funds back to the Lux HC.

Issue: is Lux HC the beneficial owner of the dividends ?

Denmark Eastern High Court 20 Dec 2011

1. The term b/o must be interpreted in an international context (cf. *Indofood*); therefore: OECD Commentary is relevant.

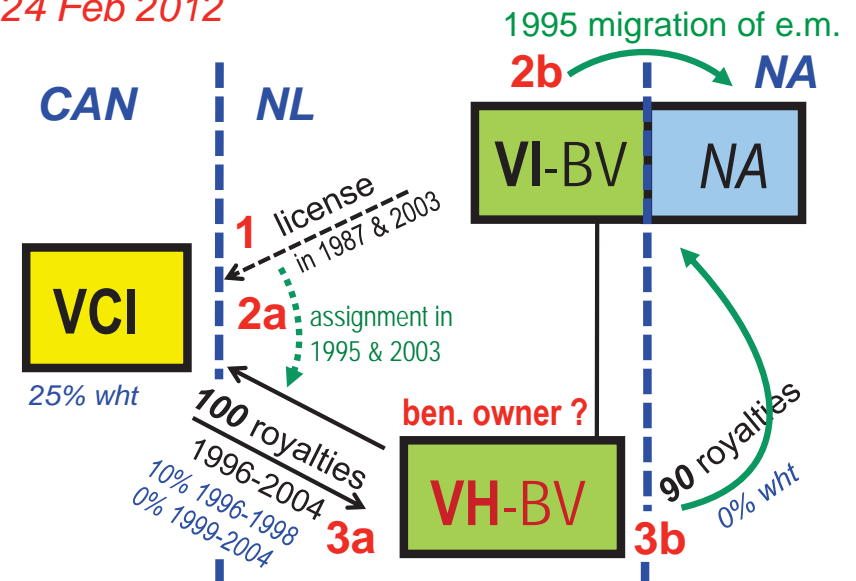
2. It cannot be assumed that the dividend receiving holding companies, whose management is authorized in terms of corporate law to dispose of the dividend from from underlying subsidiaries, should **not** normally be considered as the beneficial owners. This must also apply in cases in which one or multiple intermediary holding companies are established in a state with which Denmark [as source country] has entered into a double taxation treaty [such as Luxembourg] while the owner(s) of the intermediary holding company is/are resident in a third country without a double taxation treaty with Denmark [here: *Guernsey and Bermuda*]. In order to consider such an intermediary holding company not as the beneficial owner of the income, it must be *required that the company's owner(s) exercise control over the company that goes beyond the planning and management at the corporate group's top level that is common in international corporate groups.*



Tax Court of Canada

24 Feb 2012

Velcro Canada Inc



Switzerland

Federal Administrative Tribunal – 7 March 2012

Federal (Supreme) Court – 5 May 2015

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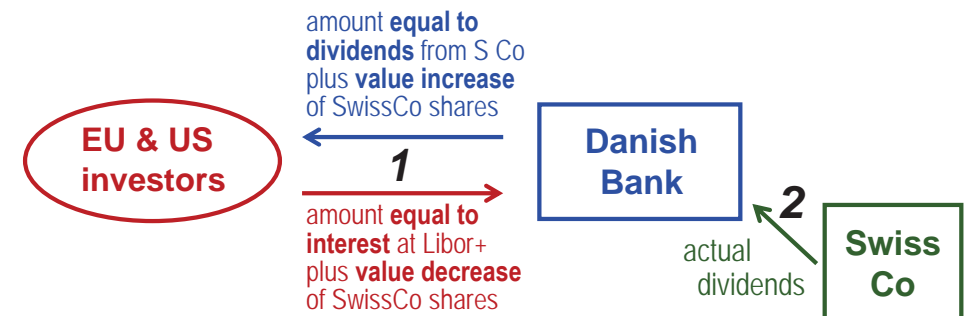
Danish bank :

- entered into Total Return Swaps (TRSs) with EU & US clients
- voluntarily hedged its position by obtaining Swiss shares: is it the B/O of dividends received thereon?

Danish bank: – entered into Total Return Swaps with EU & US clients
– voluntarily hedged its position by buying Swiss shares

Advantage for **investors:** no Swiss wht (as no treaty entitlement) and for **bank:** earning margin (spread)

>> is Danish Bank the B/O of the dividends received from Swiss Co ?



Tribunal: the purchase of shares is legally unrelated to TRSs: Danish bank has no legal obligation to forward to its clients the dividends received. **SC:** needs also to be *economically* unrelated; amount equivalent to dividends has been paid on.

Beneficial Ownership

2014 update

Background

The problem with the treaty concept of ‘beneficial ownership’ as it developed over the past years

- too little guidance in OECD Commentary
- countries came up in their domestic law and through their courts with their own definitions of b/o
- non-member States of OECD (*notably: China and Indonesia*) started using the B/O requirement as a broad treaty weapon against international tax avoidance

Beneficial Ownership

2014 update

OECD Comm on Art. 10 -- sec. 12.1 :

12.1. ... the term “beneficial owner” ... was intended ... not to refer to any technical meaning that it could have had under the domestic law of a specific country (in fact, when it was added to the paragraph, the term did not have a precise meaning in the law of many countries).

The term “beneficial owner” ... should be understood in its context, **in particular in relation to the words “paid ... to a resident”**, and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.

Beneficial Ownership

2014 update

Comm on Art. 10 -- sec. 12.4:

>> *three examples*

[1a] In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the recipient of the dividend is not the “beneficial owner” ...

- >> Indeed three categories of persons that are NOT beneficial owner:
- agent
 - nominee
 - conduit company acting as a fiduciary or administrator

Beneficial Ownership

2014 update

Comm on Art. 10 -- sec. 12.4 :

>> *(negative) definition of beneficial owner*

[1b] [the recipient of the dividend is] NOT the “beneficial owner”:

- *if that recipient’s right to use and enjoy the dividend*
- *is constrained by a contractual or legal obligation*
- *to pass on the payment received to another person.*

>> **obligation is contractual or legal; legal = statutory?**

>> **payment received: the dividend (etc.) as such?**

>> **to pass on: time frame, amount**

>> **(legal/factual) connection between obligation & payment received ?**

Beneficial Ownership

2014 update

Comm on Art. 10 -- sec. 12.4 :

>> *proof of obligation*

[2] *Such an obligation*

will normally derive from relevant legal documents

but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person

>> facts and circumstances : to be used only to prove the existence of an obligation, and NOT whether apart from a legal obligation the recipient should (not) be considered the beneficial owner.

Beneficial Ownership – 2014 update

Comm on Art. 10 -- sec. 12.4 :

>> *obligation to pass on specifically the payment received*

2012 text:

[3] This type of *obligation must be related to the payment received*; it would therefore not include contractual or legal obligations unrelated to the payment received even if those obligations could effectively result in the recipient using the payment received to satisfy those obligations.

[4] *Examples of such unrelated obligations* are those unrelated obligations that the recipient may have as a debtor or as a party to financial transactions or typical distribution obligations of pension schemes and of collective investment vehicles entitled to treaty benefits under the principles of paragraphs 6.8 to 6.34 of the Commentary on Article 1.

[3] *This type of obligation must be related to the payment received; it would therefore not include contractual or legal obligations unrelated to the payment received even if those obligations could effectively result in the recipient using the payment received to satisfy those obligations.*

[4] *Examples of such unrelated obligations are those unrelated obligations that the recipient may have as a debtor or as a party to financial transactions or typical distribution obligations of pension schemes and of collective investment vehicles entitled to treaty benefits under the principles of paragraphs 6.8 to 6.34 of the Commentary on Article 1.*

2014 text:

[3] This type of obligation would not include // contractual or legal obligations that are not dependent on the receipt of the payment by the direct recipient such as \ an obligation that is not dependent on the receipt of the payment and which the direct recipient has as a debtor or as a party to financial transactions, or // \ typical distribution obligations of pension schemes and of collective investment vehicles entitled to treaty benefits under the principles of paragraphs 6.8 to 6.34 of the Commentary on Article 1.

Beneficial Ownership

2014 update

Comm on Art. 10 -- sec. 12.4 :

>> *(positive) definition of beneficial owner*

[4] Where the recipient of a dividend does have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person,

>> the recipient is the “beneficial owner” of that dividend.

Beneficial Ownership

2014 update

Comm on Art. 10 -- sec. 12.4 :

>> *b/o of dividend v. of share*

[5] It should also be noted that Article 10 refers to the beneficial owner of a dividend

as opposed to the owner of the shares, which may be different in some cases.

>> beneficial ownership of the dividend does not require the legal ownership of the underlying shares

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Beneficial Ownership

2014 update

Comm on Art. 10 -- sec. 12.5 :

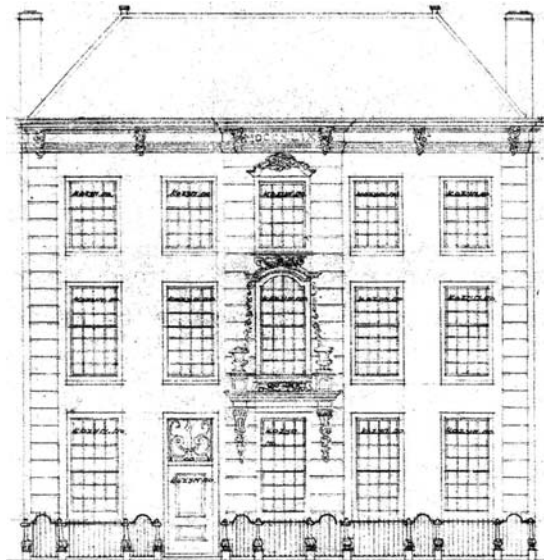
>> *b/o requirement v. broader anti-abuse rules*

The fact that the recipient of a dividend is considered to be the beneficial owner of that dividend does not mean, however, that the limitation of tax ... must automatically be granted [T]here are many ways of addressing conduit company and, more generally, treaty shopping situations. These include specific anti-abuse provisions in treaties, general anti-abuse rules and substance-over-form or economic substance approaches. ***Whilst the concept of "beneficial owner" deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on the dividend to someone else), it does not deal with other cases of treaty shopping*** [and countries are therefore suggested to apply such other approaches when they want to address those other cases of treaty shopping; those other approaches are not restricted by the presence of the beneficial ownership rules].

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- Dividends, interest & royalties and Immovable property income & capital gains under tax treaties
- Income from employment, pensions, etc. under tax treaties

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- Double taxation relief & non-discrimination
- Beneficial ownership and tax treaty anti-avoidance provisions
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>> Check for further details the website of the International Tax Center Leiden at www.itc-leiden.nl <<

>> Always feel free to contact Kees van Raad at: mail@vanraad.eu

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Further information

Feel free to contact Prof. Kees van Raad or Myrthe Doelman (staff, ITC Leiden) at

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