Clarity, Opacity and Beneficial Ownership

By

Richard Collier

***Reprinted from* British Tax Review**
Issue 6, 2011

Sweet & Maxwell
100 Avenue Road
Swiss Cottage
London
NW3 3PF
(Law Publishers)

SWEET & MAXWELL

Clarity, Opacity and Beneficial Ownership

Richard Collier*

To this author, David Oliver has been a major formative influence which has continued over a number of years, including after David's retirement from PricewaterhouseCoopers (PwC) in 2003. Working with David over a number of years was always a pleasure and always highly instructive. Particularly memorable is his indefatigable intellectual curiosity in getting to the right answer, his vast knowledge of tax treaties and matters of international tax and the sense of fun he instilled in those around him. He sets a lofty standard for those who seek to follow his footsteps.

The topic of beneficial ownership, which is the subject of this article, is one that is firmly associated with David Oliver, given his well-known interest and writing on the issue.[1] The topic has also been discussed on a number of occasions in this *Review*.[2]

Summary

The term "beneficial owner" is an important element of Articles 10, 11 and 12 on dividends, interest and royalties in the Organisation for Economic Cooperation and Development (OECD) Model Tax Convention on Income and on Capital (OECD Model)[3] given that those Articles apply only to the beneficial owner of the income concerned. The treaty concept of beneficial ownership is not straightforward and there has been much discussion and analysis of the beneficial owner test and specifically what it is that the beneficial owner test actually means or requires in the context of the OECD Model.[4] Unfortunately, almost the only thing on which there is widespread agreement is that the concept is not particularly well defined and could benefit from greater clarity. The particular focus in this article will be on how the OECD has explained the term over the last three and a half decades since it was first introduced in 1977, including the

* Barrister, Partner and Global Leader banking and capital markets tax, PwC, London.

[1] See, J. D. B. Oliver, J. B. Libin, S. van Weeghel, C. Du Toit, "Beneficial Ownership and the OECD Model" [2001] BTR 27; J. D. B. Oliver, R. Fraser, " Beneficial Ownership: HMRC's Draft Guidance on Interpretation of the Indofood Decision" [2007] BTR 39; J. D. B. Oliver, R.Fraser, "Treaty shopping and beneficial ownership: Indofood International Finance Ltd v JP Morgan Chase Bank NA London Branch" [2006] BTR 422.

[2] See, for example, C.Elliffe, "The Interpretation and meaning of 'Beneficial Owner' in New Zealand" [2009] BTR 276; J. Prebble, "Accumulation Trusts and Double Taxation Conventions" [2001] BTR 69; A. Rowland, "Beneficial Ownership in a Corporate Context: What Is It? When is it lost? Where does it go?" [1997] BTR 178.

[3] OECD Model Tax Convention on Income and on Capital, available at: *http://www.oecd.org/document/37/0,3746,en_2649_33747_1913957_1_1_1_1,00.html* [Accessed November 3, 2011].

[4] See, for example, in addition to the Articles cited in fnn.1 and 2 above, K. Vogel, *Double Tax Conventions. A Commentary to the OECD, UN and U.S. Model Conventions for the Avoidance of Double Taxation of Income and Capital, With Particular Reference to German Treaty Practice*, 3rd edn, (Kluwer Law International, 1997), Preface to Arts 10–12, [5] onwards. P. Baker, *Double Tax Conventions*, 3rd edn, (Sweet & Maxwell, 2011) in the commentary to Art.10; C. P. du Toit, "The Evolution of the Term 'Beneficial Ownership' in Relation to International Taxation over the Past 45 years" *Bulletin for International Taxation*, October 2010, 500; A. M. Jiminez, "Beneficial Ownership: Current Trends" (2010) WTJ 2(1) 35.

latest (and ongoing) attempt to provide further clarity on the concept. Much of the discussion is focused on the OECD's recent Discussion Draft, entitled "Clarification of the Meaning of 'Beneficial Owner' in the OECD Model Tax Convention" which was released on April 29, 2011[5] and which it is intended will in due course lead to finalised further guidance in the Commentary to the OECD Model. The original reason for wanting to introduce into the OECD Model the term "beneficial owner" and its intended purpose in the OECD Model was, at the time of the introduction of the term, relatively clear. However, looking back with the benefit of hindsight, greater clarification of the meaning of the term and the bounds of the ownership standard sought would have been highly desirable. As the "beneficial owner" concept now stands, there is some uncertainty as to what is required to meet that standard of ownership. This explains the past and current attempts by the OECD to add clarity to the term.

However, commenting as a practitioner dealing with this issue on a regular basis, it is hard for the author to resist the conclusion that an increasing number of tax authorities have seized on this lack of clarity to support a much more demanding interpretation of the term (inevitably leading to a restriction of treaty benefits). Further clarity of the term, if it can be achieved by the OECD, would therefore be timely and welcome.

Further clarification of the beneficial ownership concept in isolation by the OECD will, however, be difficult enough, but an important question is whether it is possible for the OECD to clarify the beneficial ownership concept in a manner which does not conflict with, first, the meaning of the term assigned to it in the Commentary and, secondly, the meaning of the term that a significant number of tax authorities seem to wish to assign to it on the basis of their approach in practice.

The conclusion reached is that further clarification of the concept in the Commentary may maintain the broad approach and meaning of the term as when first introduced in 1977. A future clarification may, alternatively, add support to the seemingly growing number of tax authorities which seem to wish to rely on the application of the term to impose material substance or economics-based requirements on the availability of the relevant treaty articles in which the term is used. These are, however, alternative and mutually exclusive outcomes. Either the expected OECD clarification of the term will, broadly, maintain the original meaning of the beneficial ownership concept yet clash with the current practice of many tax authorities or it will change the concept in a material way, moving the concept closer to a wide anti-treaty shopping rule which would support much current tax authority practice—but represent a very material shift from the original meaning assigned to the term.

The proposals in the recent OECD Discussion Draft[6] are largely consistent with the original purpose and scope of the "beneficial owner" requirement. On the most fundamental point, however, specifically, the explanation of what it is to be a beneficial owner, the proposed Commentary is rather vague and uncertain and therefore opens the door to the application of wider economics—based or substance requirements of the type argued for by some tax authorities. On the basis of the wording of the existing Discussion Draft, the outcome of the current work

[5] OECD, "Clarification of the Meaning of 'Beneficial Owner' in the OECD Model Tax Convention, Discussion Draft" (Discussion Draft) (April 29, 2011 to July 15, 2011), available at: *http://www.oecd.org/dataoecd/49/35/47643872.pdf* [Accessed November 3, 2011].
[6] OECD, Discussion Draft, above fn.5.

is likely to be that the OECD's work on the clarification of the term "beneficial owner" will not achieve its objective and will not therefore change the current unsatisfactory position. This would be of little help at a time when the uncertainty in the concept has so many practical implications.

The OECD has little option other than to seek better clarity on the meaning of the term given the scale of the current global dispute and uncertainty relating to the interpretation of the term. Given, however, that the primary voice at the OECD is represented by tax authorities, some of which seem, as a practical matter, to support an expanded view of the term, it is clear that the OECD is facing a challenging situation.

Background

It will be helpful, first, to survey briefly the relevant OECD historical background. The "beneficial owner" term seems to have been first introduced in double tax treaties in the 1966 protocol to the then existing 1945 US-UK double tax treaty where the term was introduced into revised dividend, interest and royalties Articles.[7] The term was also used in the UK-Netherlands double tax treaty of 1967,[8] again featuring in the dividend, interest and royalty articles.

It was not until 1968 that the term was discussed at the OECD and this was initially in a Working Party considering amendments to the OECD Model of 1963.[9] The focus of the discussion was based on concerns that, in the absence of any clarification to the contrary, treaty benefits might appear to be available to agents or nominees simply because of their legal right to the income concerned. This was because the treaty was framed to apply by reference to income "paid … to" recipients of income. To deal with this perceived weakness of the OECD Model, the UK delegation initially (in November 1968) proposed a "subject to tax" test but this was later (in June 1969) modified to being one of two alternative solutions, the second being the suggestion that the benefit of the interest and royalty articles should be restricted to "beneficial owners". It was this second solution that was proposed in the Revised Report of the Working Party of February 1970.[10].

[7] The Convention between the United Kingdom of Great Britain and Northern Ireland and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income April 16, 1945.

It is noted in C. Du Toit, "Beneficial Ownership and the OECD Model", above fn.1, that the term "Beneficial Ownership" was used earlier in some treaties on inheritance tax, such as the UK-US treaty on the estates of deceased persons, Article III. Supplementary Protocol signed on March 17, 1966, between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the United States, Amending the Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, signed at Washington on April 16, 1945. (SI 1966/188).

[8] Convention between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Kingdom of the Netherlands for the Avoidance of Double Taxation and the prevention of Fiscal Evasion with respect to Taxes on Income and Capital, signed in London on October 31, 1967. (SI 1968/577).

[9] The previously unpublished early material may now be seen on the database on the History of Tax Treaties available at: *http://www.taxtreatieshistory.org* [Accessed November 3, 2011].

[10] Fiscal Committee, OECD, *Report on suggested amendments to Articles 11 and 12 of the draft convention, relating to interest and royalties respectively*, Working Party No.27 (dealing with interest and royalties) of the Fiscal Committee (Paris: OECD, February 16, 1970).

The OECD Model and Commentary

In consequence of the 1968–1970 discussions at the OECD, the "beneficial ownership" term was introduced in the OECD Model draft issued in 1974 and this became the revised 1977 OECD Model. The term featured in the dividends, interest and royalty Articles (but not in the Other Income or Capital Gains Articles, where the "paid….to" wording did not appear).

The Commentary to the 1977 OECD Model reflected the earlier 1968–1970 discussions in clarifying that:

> "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"[11].

It is clear, therefore, that the original purpose—reflected in the Commentary clarification of the term—was simply to make it clear that intermediaries with minimal ownership rights such as agents and nominees should not be recognised as recipients for the purpose of applying reduced withholding tax rates under the double tax treaty concerned. It is sometimes stated by commentators that the major problem with the explanation of the beneficial ownership concept in the Commentary is that it does not say who *is* the beneficial owner—nor what the criteria of such ownership are—but merely says who is *not* the beneficial owner. It would certainly have been helpful to have had more explanation of what was intended and particularly of the circumstances in which intermediaries other than agents and nominees might also be regarded as failing the beneficial owner test, as well as how the beneficial owner test is applied in the case of trustees.[12] Having regard, however, to the purpose of the test introduced in 1977, the approach adopted is considered entirely comprehensible, if limited: the concept is intended broadly to exclude agents and nominees from treaty access and that is what it does.

Consideration of the beneficial ownership concept by the OECD

Prior to the current work in progress on clarifying the beneficial owner concept, the OECD has considered the term "beneficial owner" on a number of earlier occasions: in the 1986 Conduit Companies Report; in 1995 when the wording of the Dividend, Interest and Royalties Articles was changed; in the 1999 Partnership Report; in 2003, when the Commentary to Articles 10, 11 and 12 was amended by the insertion of new paragraphs; and in the recent work of the OECD on collective investment vehicles. Each of these is discussed below.

[11] See the 1977 OECD Model Tax Convention, [12] of the Commentary to Article 10 (a similar paragraph was inserted into the Commentary on the Interest and Royalties Articles also—[8] and [4] respectively).

[12] This article does not deal with the special position of trustees as beneficial owners. On that point, see J. Prebble, "Accumulation Trusts and double tax conventions", above fn.2. Somewhat ambitiously, the recent Discussion Draft seeks to deal with this difficult topic for the first time in the space of a footnote to the newly proposed guidance—see the Discussion Draft, above fn.5, 3.

1. The 1986 Conduit Companies Report

The 1986 Conduit Companies Report[13] was intended to address concerns on the improper use of tax treaties. The Report considered that the use of treaties is "improper" in this sense where a person acts through a legal entity created in a state primarily to obtain treaty benefits which would not be available directly to such person. The main body of the Report is given over to a consideration of potential solutions to this perceived problem of improper use of tax treaties and it is in that context that the beneficial ownership requirement is discussed.

The 1986 Report elaborated on the meaning of beneficial owner and the discussion in the Report sought to amplify the scope of the concept from the then existing Commentary to Article 10 as follows:

> "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)"[14].

However, this expansion of the position from that contained in the existing OECD Commentary was also subject to other comments. It was stated that the fact that the main function of a company is to hold assets or rights is not in itself sufficient to categorise it as a mere intermediary, although this may indicate that further examination is necessary. It was also recognised that, in practice, it will usually be difficult for the country of source to show that the conduit company is not the beneficial owner. The discussion goes on to state that for a source country to demonstrate by examination that a conduit company is not the beneficial owner it will be necessary to look at information available on the shareholders of the company; the company's relationship to the shareholders or other interested parties; and the decision-making process of the conduit company. The 1986 Report noted that the issue of conduit companies may be a serious flaw of the 1977 OECD Model. However, the overall conclusion was that the beneficial ownership test was not an adequate response to the perceived problem of conduit companies. Accordingly, the 1986 Report went on to consider other possible approaches. At this stage, therefore, there seemed to be no wish or attempt to interpret the beneficial ownership test as having a broad anti-treaty shopping function.

2. The 1995 amendment to the Commentary

To deal with a concern as to whether a shareholder is entitled to treaty benefits in a case where the dividend (or interest/royalty payment) was received by the shareholder's agent or nominee but not the shareholder directly (as would often be the case), the text of the OECD Model was amended in 1995. The relevant words changed from "if the recipient is the beneficial owner of the dividends" to "if the beneficial owner of the dividends is a resident …" The Commentary

[13] "Double Taxation Conventions and the Use of Conduit Companies", adopted by the OECD Council in Paris on November 27, 1986 (Conduit Companies Report).
[14] Conduit Companies Report, above fn.13, [14(b)] at R(6)-8.

was also amended to refer to the clarification "which has been the consistent position of all Member Countries". In the present context this change does not seem especially controversial and simply means that the extensive use of local nominees, agents, and custodians, etc. by investors will not frustrate the operation of double tax treaties.

3. The 1999 Partnership Report, The Application of the OECD Model to Partnerships[15]

The 1999 Partnership Report contains some discussion of the position of partners of transparent entities being in some cases the beneficial owners of the income of the partnership and there is a suggestion that a test for identifying the beneficial owner is whether the person concerned is liable to tax on the income in the state in which the partnership is established, and the partners are present.[16] There is, however, no detailed discussion of the beneficial owner test or the criteria which should be applied in assessing it.

4. The 2003 amendment to the Commentary of the OECD Model

In 2003, the Commentary to Articles 10, 11 and 12 was amended by the insertion of new paragraphs 12 to 12.2.

The 2003 amendment states (in a revised paragraph 12) that:

> "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 purpose of the convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance."

The wording inserted in 2003 goes on to incorporate the extension of the beneficial ownership concept set out in the 1986 Conduit Companies Report and the amended paragraph in the Commentary reads as follows:

> "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. 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. 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. For these reasons, the [Conduit Companies Report] 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

[15] OECD, *The Application of the OECD Model Tax Convention to Partnerships* (Paris: OECD, 1999), adopted by the OECD's Committee on Fiscal Affairs on January 20, 1999.
[16] The Partnership Report, above fn.15, [61] at 24.

> render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties (paragraph 12.1)."[17]

It might be argued that it is this 2003 amendment that has fuelled the uncertainty over the meaning of the beneficial owner concept. This 2003 amendment does introduce a new dimension to the beneficial owner test given that it is expressly going beyond the formal agency or nominee situation and introduces some relatively subjective terms such as the reference to a principal "who in fact receives the benefit of the income concerned" and the reference to the issue being assessed "as a practical matter". The term "benefit" in particular could perhaps be interpreted as importing some kind of wider economic test. Further, no criteria are given for assessing what is to count as the "benefit" of income or what the "practical" matters are that are to be considered. The introduction of the words "as a practical matter" has also been seen as a very significant change and as justifying an approach to the interpretation of the term by reference to an economic test rather than a test which looks at the legal powers of the recipient of the income.[18]

It is certainly the case that these terms as used in the 2003 amendment to the Commentary have not helped with improving the clarity or precision of the beneficial owner concept but it is not considered that they make profound changes to the meaning of the term. The terms should be interpreted in the context of the revised text as a whole. In particular, the terms should be read as constrained also by the references to the "very narrow powers"[19]…. "in relation to the income concerned" and the status of being a "mere fiduciary or administrator" acting on account of the "interested parties".[20] The use of the word "powers" is significant given that the term would seem to denote a legal test. Thus, the amended wording from 2003 does introduce some greater subjectivity and uncertainty into the beneficial owner test but does not seem to contemplate a materially different standard than that which had previously existed. It is also worth remembering that the original changes in the 1977 Commentary when the beneficial owner test was introduced were not directed exclusively at agents and nominees but rather at intermediaries "*such as*" agents or nominees and it is in that context that the 2003 wording should be interpreted so as to give the result that, functionally and legally, the circumstances contemplated by the amended 2003 wording should be close to those which would relate to agents and nominees as originally referred to. Given the very broad scope of an economic interpretation it would seem doubtful that such a change could have been intended without more (and much clearer) explanation given the description of the test in the Commentary up to that point. Further, if such a change had been intended, it would have made the retained references to "agent or nominee" otiose or inadequate given the vastly wider scope of an economic test.[21] It would also seem odd if, in drawing on

[17] Model Tax Convention, above fn.3, Comm. to Arts 10, 11 and 12 [12.1].
[18] See further du Toit, "The Evolution of the Term 'Beneficial Owner' in relation to International Taxation over the Past 45 Years", above fn.4, at 504. Du Toit seems to equate "practical" with "economic substance".
[19] The reference to "powers" in the text of the 2003 amendment to the Commentary is emphatic—not merely "narrow" powers but "very narrow" powers. For a discussion on "narrow powers" see N. Karve, "The Concept of Beneficial Ownership", a paper presented to the International Tax and Finance Conference, Udaipur, August 19 to 22, 2010.
[20] See text at fn.17.
[21] It might be objected that the relevant case law on the topic supports an economic approach. It is argued by Jiminez, "Beneficial Ownership: Current Trends", above fn.4, that one of the major problems of most of the decisions is their tendency to resort to "economic interpretation" when all that was needed in the cases they considered was probably no more than "legal interpretation"—see Jiminez , above, at 51–52 for discussion of whether beneficial ownership is an economic or legal concept. The well-known bankruptcy test proposed by Baker, *Double Tax Conventions*, above

wording from the 1986 Conduit Companies Report, its intended effect in the Commentary was to be so different to that originally intended given that the 1986 Report concluded that the beneficial owner test was not an appropriate response to the issues raised by conduit companies.

Whether such a balanced interpretation of the words has been applied in practice is a different matter, as discussed further below.

5. OECD work on collective investment vehicles

Some further consideration of the term "beneficial owner" has been given in the 2010 Report, The Granting of Treaty Benefits with Respect to the Income of Collective Vehicles. [22] There is some discussion in that Report on whether a widely held collective investment vehicle (CIV) should properly be regarded as the beneficial owner of income it derives.[23] The Report sets out certain arguments for and against that proposition. The discussion in the Report seems to assume that the Article 3(2) test in the OECD Model for interpreting terms that are not expressly defined applies with the result that the meaning of the term is to be decided under the law of the state applying the treaty. (This has been a point of some controversy in relation to the interpretation of the beneficial owner test and is discussed further below.) The discussion concludes[24] that a widely held CIV should be treated as the beneficial owner of the income it receives so long as the managers of the vehicle have discretionary powers to manage the assets on behalf of the investors (and subject to the vehicle being a "person" and "resident" as required by an applicable treaty). The basis of the conclusion drawn is that the investor has no right to the underlying assets (it is stated the investor has the right to receive an amount equal to the value of his allocable share of the underlying assets but this right is not the equivalent of receiving the assets as a commercial or tax matter) and also that income from a particular asset generally cannot be traced to a particular investor.

The striking feature of the discussion in this context is its emphasis on the status of the assets held by the CIV. Given the original 1977 wording and 2003 amendments dealing with the powers of an intermediary in relation to the income concerned, it might be thought that it is the status of the income in the hands of the managers that would be the more important issue (particularly in relation to any obligations to remit the income to investors in the vehicle).

Changes to the Commentary to address the position of CIVs have now been included in the 2010 update to the OECD Model.[25] There is no change to the existing Commentary to Articles 10, 11 and 12 beyond a reference to the particular issues affecting CIVs which are addressed in

fn.4, at note 1 [10B-15] is also an approach relying on the legal rights of the recipient rather than on a wider economic approach.

[22] OECD, *Report of the Informal Consultative Group on the Taxation of Collective Investment Vehicles and Procedures for Tax Relief for Cross-Border Investors on The Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles*, adopted by the OECD Committee on Fiscal Affairs on April 23, 2010.

[23] OECD, *The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles* (Paris: OECD, 2010), [31–35] at 9 and 10.

[24] See OECD, *The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles*, above fn.23, [35].

[25] See OECD paper, "The 2010 Update to the Model Tax Convention" (July 22, 2010).

the Commentary to Article 1.[26] However, a lengthy section[27] has been inserted into the Commentary on Article 1. The wide variety of vehicles used as CIVs is noted[28] and this leads to the recognition that states may need to clarify the operation of a treaty in relation to such vehicles on a bilateral basis.

On the beneficial owner issue, the new Commentary repeats the comments from the Report to the effect that the investor in a CIV differs from an investor who owns the underlying assets with the result that "it would not be appropriate to treat the investor in such a CIV as the beneficial owner of the income received by the CIV." It is then stated that "Accordingly, a vehicle that meets the definition of a widely held CIV will also be treated as the beneficial owner of the dividends and interest that it receives, so long as the managers of the CIV have discretionary powers to manage the assets generating such income (unless an individual who is resident of that state who would have received the income in the same circumstances would not have been considered to be the beneficial owner thereof)."[29] However, this bold conclusion is then somewhat diluted in the newly inserted Commentary: it is recognised that these principles are necessarily general and their application to any particular CIV may not be clear.[30] This leads to a discussion of the use of mutual agreements between states to clarify the treatment of some types of CIVs,[31] but it is then noted that such a mutual agreement process may lead to what are two wholly different outcomes—i.e. confirming the entitlement of a CIV to treaty benefits in its own right or alternatively to dealing with the administrative issues of looking through the CIV to address the position of treaty-eligible underlying investors.[32] The discussion goes on to note the possible need to consider whether existing treaty provisions are adequate to ensure CIVs are not used in a potentially abusive manner (i.e. for treaty shopping processes).

In summary, therefore, it seems doubtful that the discussion on CIVs in the OECD 2010 Report or the new Commentary to Article 1 helps more generally in clarifying the beneficial owner test. This is on the basis that the discussion is of relevance in the case of CIVs only and even in that context the conclusion adopted on beneficial ownership is one of "general principle" which does not seem to be readily applicable and it is recognised that it does not remove all uncertainties. Further, the reasoning on the term "beneficial owner" does not seem to fit well with the existing comments in the Commentary on Articles 10, 11 and 12 and the overall position seems in any event open-ended and to lead to the need for bilateral clarification in any particular case.

Based on the discussion so far (and leaving to one side the position of CIVs), it might be concluded that, whilst the meaning of beneficial ownership could be clearer (particularly in relation to parties which are to be regarded as acting in a similar manner to agents and nominees), the motivation for the use of that term and its purpose in double tax treaties is relatively clear,

[26] See OECD, "The 2010 Update to the Model Tax Convention", above fn.25, [29] and amended [59] of the Commentary to Art.10 on dividends.
[27] See new headings and [6.8] to [6.34] to the Commentary on Art.1.
[28] Model Tax Convention, Art.1, New [6.10] in the Commentary.
[29] See OECD, "The 2010 Update to the Model Tax Convention", above fn.25, [6.14].
[30] See OECD, "The 2010 Update to the Model Tax Convention", above fn.25, [6.15].
[31] To cater for such an event, draft wording is included in the Commentary for a provision that might be included in a treaty to confirm the CIV as, inter alia, the beneficial owner of income it derives—see above fn.28, [6.17].
[32] See Model Tax Convention, Art.1, [6.16].

given its application to deny treaty benefits to agents, nominees (and agents and nominees in all but name). On this basis, it might be difficult to see quite why the term has been proving to be so very problematic in practice.

Drawing such a conclusion, however, would seem possible only if no account were to be taken of the actual practice of various tax authorities in applying the term.

Before commenting further on tax authority practice, it is important to note also that the incidence of judicial cases on beneficial ownership seems to be increasing[33] (which is perhaps not surprising given the scale of dispute on the beneficial owner test in practice). It is also important to note that the decided cases do not present, by any means, uniform answers to the key questions raised by the beneficial owner test. Notwithstanding the very high profile of some of these cases, the case law relating to the meaning of the term beneficial owner is not pursued here. This is for two reasons. First, due to the high profile nature of these cases, there has been much discussion already relating to them.[34] Secondly, and perhaps more important here, it is considered by this author that the judicial process—let alone the decided cases on this topic—represents an extremely small part of the debate and dispute which is taking place in practice. Accordingly, it does seem useful to turn to tax authority practice and assess the implications of such practice for the OECD's current attempt to clarify the beneficial owner concept.

Tax authority practice on the interpretation of beneficial ownership

There has over recent years been a significant increase in the number of tax authorities wishing to challenge the applicability of treaties on the basis of the beneficial ownership test.[35] The practical experience of this author relates largely to the financial sector but it is clear that this experience is by no means limited to that sector.[36]

[33] The Dutch Hoge Raad case of April 6, 1994, no 28 638, BNB 1994/217, IBFD Tax Treaty Case Law Database summary was followed in 2006 by the French Bank of Scotland case (*Bank of Scotland v Ministre de l'Economie des Finances et de l'Industrie*, December 29, 2006, no 283314, IBFD Tax Treaty Case Law Database summary) and at about the same time, by the *Indofood* case (*Indofood International Finance Ltd v JS Morgan Chase Bank NA* [2006] EWCA Civ 158; [2006] STC 1195 and two years later by the Canadian *Prevost Car* case (*Prevost Car Inc v HM The Queen* [2008] TCC 231; 10 ITLR 736; and *HM The Queen v Prevost Car Inc* [2009] FCA 57; [2009] DTC 5053 (FCA); [2010] 2 FCR. 65. Further litigation on the topic of beneficial ownership is in progress in a number of countries including Switzerland and Canada.

[34] For example, on the *Indofood* case, above fn.33, [2006] EWCA Civ 158 see the articles by David Oliver cited at fn.1.

[35] It is recognised that commentaries on tax authority practice can be unreliable given that they tend to rest on particular experiences of perhaps only a small number of individuals and therefore may not be wholly representative of a wider policy stance of the tax authority concerned. However, in the case of the beneficial ownership issue, this potential disadvantage is at least to some extent reduced by the breadth and consistency of practical experience and, in a number of cases, a well-known position adopted by the authorities in practice. A perspective on tax authority practice in Canada, France, Germany, the Netherlands, Switzerland and the UK is contained in, L. Verdoner, R.Offermanns and S.Huibregtse, "A Cross-Country Perspective on Beneficial Ownership Parts 1 and 2" *European Taxation*, September 2010, 419 and October 2010, 465.

[36] See for example, Discussion Draft, above fn.5: Response by J. Avery Jones, R. Vann and J. Wheeler at 3: "The additions to the Commentaries on the beneficial owner concept in 1992 and 2003 are already causing considerable uncertainty for taxpayers around the world leading to extreme claims by tax authorities in the form of denying treaty benefits to holding companies." A similar point is made by B J. Arnold: "More on Beneficial Ownership" *Bulletin for International Taxation*, May/June 2009, 175. "The concept of beneficial ownership … continues to be a hot topic.

In broad terms, such challenges tend to consist of two main approaches. First a challenge may be made based on the physical substance of the direct investor (e.g. offices, number of staff, etc.). Secondly, there may be a challenge based on the economic position of the direct investor. This is typically on the basis that the economic benefit of the relevant payment flows through to a third party. The challenge is often made on the basis that there is an on-payment of a similar character (as in the situation where a treasury function receives interest on funds it has lent and pays interest on funds it has borrowed) or on the basis that the income payment received has been passed on through a payment which is equivalent to the income received (as in the situation where a financial trader receives a portfolio dividend on a security but pays away a dividend equivalent under a swap or other derivative contract).

It is obviously not possible to capture all instances of tax authority practice so the discussion that follows is inevitably selective (but considered nonetheless reflective of a wider pattern of activity).

Korea has no definition of the term "beneficial owner" for the purposes of its double tax treaties but has for a number of years applied the beneficial owner concept as a broad anti-treaty shopping provision. The Korean tax authorities' challenge based on beneficial ownership was initially mounted in situations involving private equity investments into Korea, most notably in the *Lone Star* case (on which there has been a lower court decision[37] with the matter now proceeding to the Supreme Court). The tax authorities seem currently to be expanding the focus of their challenge to holding companies of large multinational corporations (MNCs). The Korean tax authority position pays particular attention to the physical substance of any corporate entity investing in Korea which claims the benefit of a double tax treaty and there is also a strong emphasis on documentation. This means that much attention is placed on the relevant employee numbers, type of office accommodation, etc. of the relevant non-resident. There have been situations where a holding company with its own offices and a small number of employees may be found to lack the required substance and therefore fail to be regarded as the beneficial owner for treaty purposes. The Korean tax authorities will typically also wish to consider the business purpose of any holding company and how it is funded and how the funding is priced, etc. Where it is determined there is a conduiting of funds the beneficial owner requirement will typically be regarded as not met.

The approach of the Korean tax authorities is aptly summarised in a representation made on the recent OECD Discussion Draft, although the country is not expressly referred to:

> "… certain jurisdictions have applied the beneficial ownership requirements test and derived tax treaty benefits on the basis that the income recipient was a conduit company or formed primarily for the purpose of tax avoidance. In nearly all of these cases, there is a presumption that a holding company that only owns shares in another company and without physical

Some tax authorities want to turn the concept which in my opinion is a basic concept relating to the identification of the appropriate person to tax, into an anti-avoidance rule." The same position applies in Asia where as a practical matter almost all countries have regard to the OECD's explanation of the term "beneficial owner" even though only Japan, Korea, Australia and New Zealand are OECD Member States—see, for example, the letter of July 13, 2011 of the Capital Markets Tax Committee of Asia to Jeffery Owens in response to the Discussion Draft, above fn.5, [3.2]: "There is a growing propensity for the tax authorities in Asian jurisdictions to use the concept of beneficial ownership as an anti-avoidance tool."

[37] *Lone Star* Seoul Administrative Court case, 2007 Guhap 37650.

> substance (such as employees and office equipment) is an artificial arrangement that cannot result in the holding company being a beneficial owner of the income in question."[38]

The Canadian tax statute does not contain express rules on the meaning of "beneficial owner", although the term is used frequently in the taxing statutes, and there is case law in the domestic context examining the meaning of beneficial ownership. The Canadian tax authorities have attempted to challenge perceived treaty abuse using different means, one of which is the beneficial owner concept. The first beneficial ownership challenge was in the well known *Prévost Car* case,[39] in which case the tax authorities sought to argue for an interpretation of the beneficial owner test based on the relevant practical and commercial (i.e. economic) arrangements, rather than just the legal ownership of the income.[40] The case of the Crown also sought to show that the intermediate holding company involved in the case had very little substance. The nature of the challenge is being potentially widened in the dispute in *Velcro Canada Inc v HM The Queen (Velcro)* where royalty payments are concerned. The case was heard in the Tax Court of Canada in the spring of 2011 but a decision has not been rendered at the time of preparation of this article.[41] The issue at stake in that case is whether the existence of contractually predetermined royalty payments under a head license will lead to a finding that an intermediate entity, which is receiving similar royalties under a sub-license, is not to be regarded as the beneficial owner of the royalty payments it receives under the sub-license. The point of principle is presumably equally applicable in the case of treasury operations (where interest payments might be received and paid on by a treasury vehicle) and in the case of hedged portfolio investments (where interest on dividends received may be hedged by a derivatives contract under which income-equivalent payments are made). Depending upon the outcome of the *Velcro* case, these situations may come under scrutiny from the Canadian tax authorities in future.

With regard to the UK, there is no statutory definition of the term "beneficial owner" but there is a considerable body of case law dealing with the concept. The approach of the tax authorities to the requirements of the term has been developed into guidance following the *Indofood* case.[42] This has been considered previously in this *Review*.[43] In summary, the UK approach as stated indicates that the beneficial owner test will be applied based on the *Indofood*[44] decision (such that the concept is positively defined in the UK tax authority guidance as "the sole and unfettered right to use, enjoy or dispose of" the asset or income in question[45]) to counter cases of perceived treaty shopping using conduit vehicles where the structure results in a reduction of UK withholding

[38] Letter to the OECD from Kim & Chang of July 14, 2011 entitled "Comments on Clarification of the Meaning of 'Beneficial Owner' in the OECD Model Tax Convention Discussion Draft", available on the OECD website at: *http://www.oecd.org/dataoecd/49/35/47643872.pdf* [Accessed November 3, 2011].

[39] *Prevost Car Inc v HM The Queen* [2009] DTC 5053 (FCA); affirming [2008] DTC 3080 (TCC), above fn.33.

[40] The tax authorities position is set out in the Crown's Memorandum of Fact and Law in the Prevost appeal, above fn.33, see especially [84] at 23 and [91] and [92] at 25.

[41] *Velcro Canada Inc v HM The Queen*, 2007–1806 (IT) G.

[42] *Indofood*, above fn.33, [2006] EWCA Civ 158. See HMRC Manual INTM332000, "*Double Taxation claims and applications: Beneficial ownership: contents*."

[43] Oliver, Fraser, "Beneficial Ownership: HMRC's Draft Guidance on Interpretation of the Indofood Decision", above fn.1.

[44] *Indofood*, above fn.33, [2006] EWCA Civ 158.

[45] See HMRC INTM332010, above fn.42.

tax.[46] Although the UK tax authority guidance draws the distinction between the beneficial owner of the asset and the beneficial owner of the income concerned, the bulk of the emphasis of the guidance is on the identity and location of the parties involved, described in one example involving the lending of funds into the UK as the "real" beneficial owner who is the underlying lender and the intermediate lender. On the basis of this guidance, the UK tax authorities have taken a broad approach in arguing that recipients who in commercial or practical terms pass on income cannot be regarded as beneficial owners of the income. This means that economic as well as legal factors are considered. However, at a practical level, the point is not take as routinely or pressed as firmly as it was in the aftermath of the *Indofood*[47] decision.

The practice of the Swiss tax authorities in relation to interpretation of the beneficial ownership test in the context of financial sector transactions has changed markedly in recent years in relation to portfolio positions in Swiss equities. The current practice of the tax authorities reflects a trend first seen approximately seven years ago when the Swiss tax authorities began to challenge purely domestic situations involving the beneficial ownership test. The challenge was then—and is still—based on the view that where a direct recipient of income subject to Swiss withholding tax has an obligation to pass on that income (or an amount corresponding to that income) to another party, then that direct recipient cannot be regarded as the beneficial owner of the income for Swiss tax purposes. This type of challenge was initially raised in relation to situations where Swiss-based financial traders held Swiss equity positions (on which income would be received subject to withholding tax) but hedged those positions by a combination of put and call options or cash settled futures.

It took approximately another three years before a similar challenge, again based on the beneficial ownership test, was raised in a cross-border context. Initially, the challenge was made in relation to claims for refunds of tax witheld under the Switzerland-Denmark treaty (presumably on the basis that the 0 per cent withholding rate in that treaty was being exploited) but the challenge of the tax authorities quickly spread to claims for withholding tax refunds under other Swiss treaties such as those with the UK, France, Germany and Italy. It should be noted that the term "beneficial ownership" is not included uniformly in Swiss treaties. For example, it is not included in the Denmark treaty but is included in the treaties with the UK, France, Germany and Italy. As a practical matter, however, the beneficial ownership test seems to be applied by the Swiss tax authorities to all Swiss treaties.

The current position is that if the direct recipient of income subject to Swiss withholding tax has hedged the relevant income, that recipient will not be regarded as the beneficial owner of the income for the purposes of any treaty reduced rate in the level of withholding tax and therefore any treaty-based reclaim of withholding tax will not be accepted. [48] The Swiss position is of

[46] See HMRC INTM332080, "Double Taxation applications and claims: Indofood: Examples of application". See also the discussion of example 7 involving a Luxembourg Conduit company.

[47] *Indofood*, above fn.33, [2006] EWCA Civ 158.

[48] After initially accepting that a "price swap" (i.e. where the swap hedges market price movements but does not hedge the relevant income arising on the security) would not be problematic, the Swiss tax authorities seem to have adopted the view that here the dividend amount might be priced into the swap in other ways—e.g. through reduced payments made to the recipient of the real dividend on the financing leg of the swap. For this reason, such financial instruments would still have the potential to trigger the beneficial ownership challenge by the Swiss tax authorities. This suggests material further uncertainty and scope for controversy as it is not clear how far this "economic look through" approach

particular relevance to the financial sector taxpayers and currently there is very significant uncertainty as to the scope of the economics-based test which is applied by the tax authorities.

Some countries have taken a highly prescriptive approach by adopting criteria for determining if a recipient is to be recognised as a beneficial owner. One of the best examples of this is China in its Circular 601 which was released by China's State Administration of Tax (SAT) on October 27, 2009,[49] with the purpose of clarifying whether an entity may be regarded as a "beneficial owner" of an item of income under China's tax treaties. Circular 601 states that an entity will not be regarded as a beneficial owner if it is considered as a "conduit company", a company which is described as set up for the purpose of avoiding or reducing tax or transferring or accumulating profits.

Circular 601 seems to assume conduit companies can never exist other than for tax-avoidance purposes and that necessarily means they have no substance and will therefore fail the beneficial owner test. The Circular sets out specific factors to assist in determining an applicant's status as beneficial owner. Specifically, the Circular states that the presence of certain factors could negatively affect the applicant's status as the beneficial owner. There are seven factors as follows:

1. the applicant is obliged to distribute most of its income (e.g. more than 60 per cent) within 12 months from the date of receipt;
2. the applicant has no or minimal business activities other than the ownership of the assets or rights that generate the income;
3. for a corporate entity; its assets, scale of operations and employee numbers are not commensurate with its income;
4. the applicant has no or minimal control and decision-making rights and does not bear any risks;
5. the income of the applicant is non-taxable or;
6. in the case of interest income, there is a loan or deposit contract between the applicant and a third party, the terms of which (i.e. the amount, interest rate, signing dates) are similar or close to those of the loan contract under which the interest income is received; and
7. in the case of royalty income, there is a license or transfer agreement between the applicant and a third party, the terms of which are similar to the terms under which the royalty income is received.

When a taxpayer applies for treaty benefits it is required to provide documentation (although it is not explained what this should consist of) to the tax authorities to support its claim as being the beneficial owner of the relevant income and that it does not fall within the scope of any of the above factors.

is to be taken by the Swiss tax authorities. In common with various other tax authorities, the Swiss tax authorities are requesting very detailed information from tax payers relating to current—and past—treaty-based tax filings for refunds of withholding tax. The sort of information requested includes purchase and sale dates of investments, whether and how the investments were hedged, the commercial reasons for entering into the transactions, historic holding patterns, whether there are on-payments of amounts corresponding to the dividends received, transaction pricing information, etc.

[49] Guoshuihan [2009] No.601 (Circular 601). China is of course not an OECD Member State but clearly takes account of—and participates in—the work of the OECD and OECD Model.

The SAT has delegated the assessment and determination of whether an entity is a beneficial owner to the local level tax bureaus, although complex cases may be referred to the International Tax Department of the SAT. In practice this arrangement does not always work well given: the strict application of the Circular 601 criteria by local-level tax bureaus (such that the presence of any one of the seven criteria will normally lead to a rejection of a treaty claim); the lack of experience of these offices in dealing with tax treaties; the imprecise guidance on what documentation is to be presented; and, in some cases, the reluctance of the local-level tax bureaus to pass the matter to the SAT's International Tax Department so that it can deal with difficult points.

Unlike the country examples referred to above, the Netherlands has enacted legislation on beneficial ownership.[50] The approach of the law is to apply an economic interpretation to the term. Under this legislation, a recipient of a dividend is not considered to be a beneficial owner when it has in conjunction with the dividend received (the proceeds) given a consideration as part of a series of structured transactions, and it is likely that the proceeds, either wholly or partially, have benefited another person who would have been subject to greater dividend withholding tax, and this person has directly or indirectly retained the same or a similar position in the underlying equity instruments. A structured transaction may also include a transaction through a regulated stock exchange.

The thrust of this beneficial ownership approach is that if there is an on-payment to a person (wholly or partially) of dividends and that person has retained a position in the underlying stock the recipient is no longer treated as beneficial owner. From a tax authority perspective the legislation has served a purpose as cases of perceived dividend stripping have been markedly reduced since its introduction in 2001. The use of derivative financial instruments, such as total return swaps on stock market indices that are hedged with cash equity positions, may fall within the rules causing material uncertainty. It has now become clear that where the Dutch tax authorities see any deficiencies in this legislation, they will readily supplement their position to achieve the same goal with arguments based on the treaty beneficial ownership requirement.

Overall trend

There does seem to have been a material shift of practice by a number of tax authorities over the last 10 years, particularly in relation to tax authority approaches being increasingly based on an economic meaning of the term.[51]

[50] Dutch Dividend Withholding Tax Act s.4(3). The law was enacted in response to two Dutch Supreme Court cases which upheld a broad interpretation of beneficial ownership (Hoge Raad, April 1994 no. 28 638, BNB 1994 / 217 and Hoge Raad, February 2001, no. 35 415 BNB 2001/196).

[51] In the discussion of a seminar panel at the Annual Congress of the International Fiscal Association in Eilat in October 1999 (summarised in Oliver et al, "Beneficial Ownership and the OECD Model", above fn.1) three possible meanings of the term "beneficial owner", none of which relates to a possible economic meaning, are put forward. In summing up the discussion, David Oliver comments "Interestingly we have excluded [i.e. from the three possible interpretations canvassed] the idea that there might be an economic meaning. It just really never entered our minds and we have not had time anyway to give reasons why it did not enter into our minds." If a similar panel were organised now it would seem likely, in response to the practice and disputes around the world, that the relative merits of an economic meaning would feature in the discussion.

The previous discussion recognises that the precise bounds of the beneficial ownership standard sought remain unclear in all cases, especially in relation to persons who are to be regarded as acting in a similar capacity to agents and nominees.

Notwithstanding, however, that some tax authorities may find it attractive to construe the beneficial owner test as a general anti-treaty shopping test (particularly given that relatively few states have introduced into their treaties limitation of benefits clauses such as those seen in a number of US treaties[52]) there are various reasons why this increased use of a wide economics-based interpretation of the beneficial owner standard is a cause for concern. Most fundamentally, as the earlier discussion has attempted to show, a wider economics-based reading of the beneficial owner test cannot readily be reconciled with the meaning originally assigned to the term or the meaning from the Commentary as subsequently amended. Secondly, the ensuing uncertainty (and gridlock, in some cases) means double tax treaties are not functioning as they ought to across a broad range of situations (involving holding companies, treasury vehicles, hedged portfolio investments, etc.).

One of the consequences of this situation is the impact on pricing of financial instruments, a point already recognised by the OECD in relation to the uncertainties of treaty availability to CIVs.[53] Further, if this trend continues, with an ever-increasing application of an economics-based interpretation of the beneficial owner test then it may not be an exaggeration to say that it will lead ultimately to the wholesale ineligibility of the corporate sector from benefiting from double tax treaties, given that in that sector all income flows are sooner or later paid on in some form. If this is putting the point too strongly, it is not obvious (if the matter is judged in economic terms) by what tests some situations might be judged as acceptable whilst others are not.

Against the background of these issues it seems apparent that further clarity in the meaning of the term is clearly desirable.

Current OECD work on beneficial ownership—the April 2011 Discussion Draft

It was announced in late 2008 that the OECD would be working on a further clarification of the beneficial ownership concept with a view to amending the commentary to the OECD Model.[54] Work on this topic has been carried out by Working Party 1 of the Committee on Fiscal Affairs. Some initial public discussions on this topic were held at the OECD public meeting in September 2008 but, apart from that meeting, relatively little had emerged as to the progress of this work

[52] The OECD Commentary on Art.1 notes that "it will often be useful" for Member States to add provisions focusing on specifically identified avoidance techniques—see [9.6] of the Commentary on Art.1.

[53] Model Tax Convention, Art.1, above fn.3, [6.15]. There is also, ultimately, an adverse effect on market volumes and liquidity which might need to be considered.

[54] The announcement was made during the 50th anniversary of the OECD Meeting in Paris on September 8–9, 2008. It is likely any clarification would be of wide application to treaties given that the UN Model Tax Convention also uses the "beneficial owner" term and draws on the OECD explanation for its meaning. The UN Committee of Experts on International Cooperation in Tax Matters has recently discussed beneficial ownership—see the paper "Concept of Beneficial ownership: Discussion of Key Issues and Proposals for changes to the UN Commentary" E/C. 18/2010/CRP.9 October 12, 2010. That paper set out proposals for revisions to the Commentary to the UN Model Tax Convention but these are not extensive but in broad terms draw upon the language of the Model Tax Convention and incorporate changes similar to those adopted by the OECD in 2003, with specific reference to the Conduit Companies Report, above fn.13, being made in the proposed provisions to the UN Commentary.

until the release on April 29, 2011 of a discussion draft entitled "Clarification of the Meaning of 'Beneficial Owner' in the OECD Model Tax Convention".

There are four main changes proposed by the Discussion Draft to the Commentaries to Articles 10, 11 and 12 of the OECD Model.[55] The newly proposed Commentary is repeated separately for each Article. These changes are as follows.

First, added emphasis is given both to explaining the original purpose of the term "beneficial owner" (i.e. to address potential difficulties arising from the words "paid ….to a resident") and also to explaining that the term does not have a precise meaning in the law of many countries and so should not be interpreted by reference to any technical meaning it could have had under the domestic law of a specific country.[56] This is an important clarification as the term is often argued to have the meaning available under either the applicable domestic law or under common law, such as in the UK.[57] The proposed Commentary goes on to say that this does not make the domestic law meaning of the term "beneficial owner" automatically irrelevant for the interpretation of the term in the context of the Article concerned, but rather that the domestic law meaning is applicable to the extent that it is consistent with the general guidance included in the Commentary. This seems a tactful way of saying that domestic law will not add fundamentally to the meaning of the term.

The general issue at stake here is whether it is right to apply a state's domestic law in interpreting the term, or whether it should be given a more general treaty-based meaning. Both

[55] OECD, Discussion Draft, above fn.5.

[56] A proposed new footnote to the Commentary that trustees of a discretionary trust may be regarded as beneficial clarifies owners notwithstanding that the relevant trust law of the territory concerned might distinguish between legal and beneficial ownership—see also fn.12.

[57] Arguments to support the relevance of UK domestic law may include: 1. the long-established UK legal meaning of the beneficial owner concept; 2. its long-standing use in UK tax law; 3. the fact that the UK was the first country to introduce the term into its tax treaties in advance of the OECD's use of the term; and 4. the leading role taken by the UK in the internal OECD discussions that led to the adoption of the term by the OECD. However, it seems evident that a technical UK law definition of the term is not appropriate given the following points. 1. Tax treaties are to be given a liberal interpretation complementing the true intentions of the Contracting States. The Vienna Convention on The Law of Treaties at Art.31(1), states that "a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose". It is unlikely that Contracting States with civil law systems would intend to import a technical UK law meaning to the term. 2. The historical discussions and reasons for the use of the term discussed above do not support the generally intended use of a strict UK legal meaning of the term. 3. For some years it has been expressly provided in the Commentary discussion that "The term 'beneficial owner' is not used in a narrow technical sense, rather, it should be understood in its context and in the light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance." 4. The term in the French version of the OECD Model (which is to be accorded equal status to the English version is) "le beneficiare effectif" and this does not convey the strict UK legal meaning of the term. 5. In addition, the actual practice of states in using the term in their treaties seems inconsistent with a strict UK legal meaning of the term (e.g. even in the UK treaty with France the term has been used in a manner which seems to assume that a pension fund can be the beneficial owner of dividends (see Art.9(3) of the UK-France treaty of 1968)). The depth of common law guidance on the meaning of the term that is available in UK law is therefore not necessarily of relevance to interpreting the term in its international tax (i.e. treaty) context. It is also worth noting that at the time of the adoption of the beneficial owner test in 1977, the OECD was comprised of 24 Member States, 6 of which were common law jurisdictions and 18 of which operated civil law legal systems. Given that the beneficial owner concept would have been alien to those civil law countries and the fact that the changes were adopted in the official English and French versions of the OECD Model, the argument that a common law meaning was intended is not readily sustained.

interpretations have been followed—for example, in well-known cases such as *Prevost Car*[58] in Canada and *Indofood*[59] in the UK—and opinions on this issue are clearly divided.[60] This is, essentially, a debate over the interpretation of Article 3(2) of the OECD Model, which indicates that where a term is not defined in the OECD Model, unless the context requires otherwise, it should take on the meaning that it has under the domestic law of the state applying the treaty. The key question here has been whether the words "unless the context otherwise requires" are intended to require a treaty-based interpretation of the term. The proposed Commentary wording is in effect signalling that they are.

The second main change proposed relates to the description of what it is, fundamentally, to be a beneficial owner. The existing wording to the effect that conduit entities should not generally be regarded as "beneficial owners" where they have "very narrow powers" in relation to the income concerned is retained. In the new text, an attempt has been made to clarify why agents, nominees and companies acting in a similar capacity are not beneficial owners. It states that the recipient in such cases does not have the "full right to use and enjoy the dividend" (i.e. the powers of the recipient are constrained, as the recipient is obliged to pass the payment on to another person). The text goes on to state that the beneficial owner, on the other hand, has the "full right to use and enjoy" the income unconstrained by any contractual or legal obligation to "pass on the payment" to another person. The proposed text also states that it is normally possible to tell if there is any obligation to "pass on payment" from the relevant legal documentation. However, "facts and circumstances" may also be relevant in showing that, "in substance", the recipient clearly does not have the full right to use and enjoy the income. It is also emphasised that the relevant test relates to the income itself, and not to the underlying corpus or asset from which it is derived (e.g. shares which give rise to a dividend).

It does not seem likely that this new wording will remove, or materially reduce, disputes in this area. It is assumed that the proposed text is intended as a (non-controversial) amplification of the position of agents, nominees and those acting in a similar role—i.e. as an explanation or clarification of the existing test. The intention of the wording, however, is not clear and the major concern is that these words may be interpreted as an additional or alternative test to assess beneficial ownership and requiring a materially different level of ownership rights. In that case, the meaning of the term would have been very significantly altered. In particular, the test of having "the full right to use and enjoy the income unconstrained by a contractual or legal obligation to pass the payment received to another person" is likely to prove difficult to interpret in practice—especially given the wording in the Discussion Draft text that states that this may be determined based on the "substance" of the relevant facts and circumstances. The nature of the requisite "obligation" is left open and there is no attempt to address what amounts to "passing on" income. In this context, there is admittedly a helpful reference to the need normally to look at legal documents to determine if such an obligation exists but unfortunately this is immediately supplemented by a reference to looking at "facts and circumstances" and the "substance" of the

[58] *Prevost Car*, above fn.33, [2008] TCC 231; 10 ITLR 736; and *Prevost Car (FCA)*, above fn.33, [2009] FCA 59.
[59] *Indofood*, above fn.33, [2006] STC 195.
[60] Compare, for example, Vogel, *Double Tax Conventions*, above fn.5, Preface to Arts 10–12 on why an interpretation based on the domestic law is not attractive with a view that it is not attractive to apply a treaty-based approach—S. M. Edge, "Legal Esparanto", *Tax Journal Issue* 833 (April 17, 2006) 11.

matter. The OECD may object that this is a misinterpretation of the reading that is intended but it is hard to resist the conclusion that, however intended, the proposed language is not sufficiently clear. More importantly, given the experience with certain tax authorities over the last few years, it is understandable that practitioners and taxpayers will be concerned that the proposed wording lends itself to being cited selectively by tax authorities in supporting substance-based and economics-based interpretations of the term "beneficial owner" that are hardly reconcilable with the proper treaty meaning of that term.

In the examples considered above (a treasury vehicle receiving interest on one loan it has made but paying interest on funds it has borrowed and a financial trader receiving a portfolio dividend but paying an amount equivalent to a dividend under a swap or other derivative contract), the ownership of the income concerned is retained by the recipient on the basis that the recipient is entitled under the law to decide how that income will be dealt with. However, the suggestion in the Discussion Draft that it is possible to look at the "substance" of the facts and circumstances to determine whether there is an obligation to "pass on" the payment, may encourage some tax authorities to take a different (and presumably non-Commentary compliant) approach based on ultimate economic ownership.

As a general matter, the existence of either on-payments or payment equivalents (as in derivative contracts) should not disrupt the beneficial owner status of the recipient of the income concerned. Thus, a recipient of income would normally remain the beneficial owner of that income irrespective of whether such arrangements exist because of its entitlement to use the income as it wishes.[61] It would be helpful to state this point expressly in the Commentary, making it clear that the beneficial ownership concept is not addressing ultimate economic ownership (since that would seem to be sharply in contrast to the historical purpose and interpretation of the term and make the concept completely unworkable). Given the history of the term "beneficial owner" and the various attempts to clarify its meaning by the OECD, together with the variety of practical situations that may test the boundary of the concept, it is likely that there will be a limited number of situations in which the dividing line between agents, nominees, etc. and beneficial owners is not easily drawn. Given that facts and circumstances are relevant to the analysis, it would seem that the obvious step to take is to incorporate various examples into the Commentary discussion of the term, particularly as the use of examples is already a feature elsewhere in the Commentary where a dividing line must be drawn but where facts and circumstances are highly relevant to the analysis.[62]

A third change relates to the interaction of the beneficial owner test with other anti-avoidance measures that may be relevant to treaty shopping. It is further clarified in the newly proposed wording that the fact that the recipient is considered to be the beneficial owner of the income concerned does not mean a limitation of tax provided for by the treaty concerned must be granted: the new text then draws attention to the many ways of addressing treaty-shopping situations,

[61] The response to the OECD Discussion Draft by Avery Jones, Vann and Wheeler, see above fn.36, proposes simple principles that might be applied to address the application of the beneficial owner test: first, (and developing a criterion from the 1999 Partnership Report, above fn.15) if the country of residence of the person to whom the income is paid does not attribute it to that person, that person should not be the beneficial owner of that income. Secondly, if the country of residence does attribute the income to that person, then that person should be treated as the beneficial owner of the income except in a very limited number of situations (see above fn.36 at 5).

[62] See, for example, the Commentary to Art.5

cross referencing the section on "Improper use of the Convention" in the Commentary on Article 1. It is then stated that the concept of "beneficial owner" deals with some forms of tax avoidance (explained as those involving the interposition of a recipient who is obliged to pass on the relevant income concerned to someone else) but it does not deal with other cases of treaty shopping and "must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases."[63] Given the increased use of the term by certain tax authorities for the purpose of broad-based anti-treaty shopping challenges, it might, in the interests of balance, have been useful also to state expressly that neither should the beneficial owner concept be used as such a broad-based anti-avoidance tool by the tax authorities, although this is implicit in the comments made in the proposed amendment.

Finally, and the fourth main change to be made, a new paragraph is also proposed to make it clear that the meaning of the term "beneficial owner" is to be distinguished from the meaning of that term when used in other contexts where the goal is to identify the persons (typically individuals) that exercise ultimate control over entities or assets as in anti-money laundering measures, for example. It is not clear that this comment adds much to the discussion of the beneficial owner term (given that an interpretation of the term for the purposes of Articles 10, 11 and 12 and by reference to such standards of ultimate control would seem clearly wrong). There can, however, be no objection to putting the matter beyond doubt in this way.

Conclusions

The "beneficial owner" term was introduced into the OECD Model for a specific (but limited) purpose which it achieved. Given the reason for the introduction of the term and the fact that agents and nominees were illustrative of the type of persons targeted but did not represent an exclusive target, it is understandable that the OECD wishes to expand on the guidance given on the term. This is in part what the 2003 amendments sought to achieve. Whether because the 2003 amendments have been interpreted inappropriately or because certain tax authorities have, in any event, felt at liberty to do so, the beneficial owner concept has been interpreted by some tax authorities as requiring broad substance or economics-based tests, notwithstanding that these do not seem to be contemplated by the OECD guidance on the term in the Commentary. In consequence, some double tax treaties are not functioning as intended.

The OECD work currently in progress to address this matter is important. The proposed wording in the Discussion Draft[64] is, on the key point of what it is to be a beneficial owner, vague and uncertain. The wording needs to be made clearer so that there is no uncertainty as to its meaning and intended application and the inclusion of examples is likely to help with this task. The matter is complicated by the fact that tax authorities are the primary drivers of the process at the OECD and in some cases take a different approach in practice and may therefore be drawn to maintaining the existing (or similar) wording.

[63] OECD, Discussion Draft, above fn.5, Commentary on Art.10 [12.5].
[64] OECD, Discussion Draft, above fn.5.

The tax authorities of OECD Member Countries are accustomed to acting together to regulate the activities of tax payers. The question posed by this article is whether they will act together to regulate themselves.

Anti-avoidance; Beneficial ownership; Dividends; Double taxation; Interest; OECD; Royalties; Tax authorities