Master thesis

# Beneficial Ownership

## An evaluation of the concept of Beneficial Ownership in light of Dutch conduit companies.

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## Preface

Before you lies my thesis, the closure of my Master curriculum in Fiscal Economics attended that Tilburg University. In the process of finding a challenging research subject, I came across the concept of Beneficial Ownership. Intrigued by the theme, my topic was found.

As I started my research, Sonja Dusarduijn became my supervisor. To her, I owe much gratitude. She always readily provided me with comments on the chapters I submitted, advice relating troubles I ran into and always kept an eye out for opportunities for me to enhance my knowledge on the subject. Although contact was mostly through e-mail, her criticism and comments provided me with insight which kept me going. As such, this thesis would never have become what it is without her help.

The vast majority of this thesis is written at the office of Ernst & Young Belastingadviseurs LLP, where I have found an inspiring and challenging environment which really kick started the writing process of my thesis. Whenever I hit a wall or felt I lost control of the writing, advice was readily found. Therefore, my second word of thanks goes out to my colleagues at Ernst & Young, starting with Jack, who supplied me with an interesting and challenging angle for my thesis and supported me wherever he could. Then, I also like to thank Jean-Paul and Christian, for providing their comments and thoughts on problems I ran into. They never hesitated to take time to answer my questions and exchange thoughts on issues of various nature.

Third, I would like to say a word of thanks to my parents as their support over the years, both motivational and financial has been invaluable.

Last, but certainly not least, I would also like to offer a special word of thanks to my girlfriend Anneloes for helping me whenever I needed it most. Her support was invaluable in the completion of this thesis.

To all of you, thanks for everything!

Mark Weterings

## List of Abbreviations

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| APA | Advanced Pricing Agreement |
| ATR | Advanced Tax Ruling |
| BNB | Decisions in Tax Affairs |
| | *Beslissingen in Belastingzaken* |
| CITA | Corporate Income Tax Act 1969 |
| | *Wet op de Vennootschapsbelasting 1969* |
| CIV | Collective Investment Vehicle |
| | *Collectief Investeringsvehikel* |
| TC | Canada Tax Court |
| DTA | Dividend Tax Act 1965 |
| | *Wet op de Dividendbelasting 1965* |
| DTC | Double Taxation Convention |
| FTC | Federal Tax Court |
| IBFD | International Bureau of Fiscal Documentation |
| HR | Dutch Supreme Court |
| | *Hoge Raad* |
| OECD | Organization for Economic Cooperation and Development |
| OECD Discussion Draft | OECD Discussion draft: Clarification of the meaning of Beneficial Ownership in the OECD Model Tax Convention |
| OECD MC | OECD Model (Tax) Convention |
| NTFR | *Nederlands Tijdschrift Fiscaal Recht* |
| V-N | *Vakstudie Nieuws* |
| WFR | *Weekblad Fiscaal Recht* |
| WTJ | World Tax Journal |

## Table of Contents

## Introduction

Since its introduction in the OECD Model Tax Convention of 1977,[1] the concept of beneficial ownership is used to determine whether a recipient of a payment of dividends, interest or royalties, is entitled to the treaty benefits with respect to that payment.[2] Although not legally binding for Member States, the concept and the interpretation given in the OECD MC and its accompanying Commentary is of relevance to the interpretation of treaty provisions.[3] The concept as included in the OECD MC sees to the distribution of dividends, interests and royalties, which are included in the respective Articles 10, 11 and 12 of the OECD MC. It aims to deal with treaty abuse regarding the allocation of income by means of interposing an entity in a tax-favorable jurisdiction with the sole purpose of gaining access to the treaty benefits, which an organization otherwise would not be able to claim. The beneficial ownership requirement, in short, limits access to treaty benefits for an entity that acts as an intermediary between beneficiary and the payer. Such an intermediary could be an agent, nominee or a conduit company with very narrow powers regarding the income received.[4]

### Relevance

Although the concept of beneficial ownership has been in place ever since its introduction in the OECD MC of 1977, the Commentary on the OECD MC contained – and contains – very limited guidelines on the interpretation of the concept. Over time – and by the development of intricate organizational structures covering the globe – it is apparent that the concept of beneficial ownership is in need of further clarification to benefit the application of the concept by Member States and tax payers. The lack of guidance on the concept of beneficial ownership gave rise to different interpretations by courts and tax administrations, resulting in considerable risks of double taxation and/or double non-taxation for cross-border transactions.[5] The spectrum of interpretations of the concept is wide. At the one end there is the view that beneficial ownership is merely a statement of the obvious, functioning as a base under the various treaty articles. This implies that the concept in itself cannot form a ground for denying treaty access to a conduit company regardless of any constrains through legal and

[1] Further: OECD MC.
[2] OECD Commentary on the Article 10 of the Model Tax Convention (28 January 2003), para. 12, Models IBFD.
[3] I will further touch upon this aspect in paragraph 1.2 of this thesis.
[4] OECD Commentary on the Article 10 of the Model Tax Convention (28 January 2003), para. 12.1, Models IBFD.
[5] For an example, see figure one and the methods named in para. 1.3 of this thesis.

factual obligations.[6] A prime example of this view is the Dutch Supreme Court (in Dutch: *"Hoge Raad"* ), which adheres to the view that the beneficial ownership test cannot result in denial of the treaty benefits in the situation that a conduit company (which qualifies as resident in the Netherlands for tax purposes) is formally the legal owner of the received income.[7]

At the other end, one finds the interpretation of the concept where the beneficial ownership test in itself provides sufficient ground to deny treaty benefits in situations of outbound payments. A prime example of this is the Indofood case in which the UK Court of Appeals decided that the beneficial owner had to have "the sole and unfettered right to use, enjoy or dispose of" the income or asset.[8]

The different – and often contradictory – ways of interpreting the concept results in much debate on the intended interpretation by the OECD, even though the OECD MC merely serves as a model for tax treaties. Most treaties are based on the OECD MC, and include the Commentary (with or without small deviations). As such, the concept of beneficial ownership ideally should be clear as glass, as discrepancies in the interpretation work opposite to the goal of the OECD.[9] By utilizing these deviating interpretations companies could gain an unwarranted edge on their competitors, simply by interposing an entity in jurisdiction that has a beneficial interpretation for the tax payer. Recently the OECD proposed various changes to the Commentary on articles 10, 11 and 12 of the OECD MC, aiming to further clarify the concept of beneficial ownership.[10] As the OECD published the Discussion draft, it came clear that the proposed changes could potentially have a significant impact the interpretations and views on the concept of beneficial ownership as they currently are.

Aside from tax professionals and the business community, the interpretation of the concept – and thus, the concept in itself - is of great social relevance as well. In the Netherlands, on several occasions the issue with conduit companies and tax avoidance has seen the news. In 2009, Zembla broadcasted a documentary in which the Netherlands were regarded as a tax

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[6] Administrative Tribunal of Lille, 18 March 1999, Decision Nos. 95-5403and 96-738, Fountain Industries France, Tax Treaty Case Law IBFD.

[7] Hoge Raad 6 April 1998, Decision No. 28.638, BNB 1994/217 and Hoge Raad 21 February 2001, Decision No. 35 415, BNB 2001/196.

[8] Court of Appeals, 2 March 2006, Indofood International Finance ltd vs. JS Morgan Chase Bank NA, (2006) 8 ITLR 653, STC 1 195.

[9] The OECD aims to enhance global trade and economic co-operation. It does not fit in that goal to have an undefined anti-abuse provision in the Commentary, which could potentially lead to double taxation, or double non-taxation.

[10] OECD Discussion draft: Clarification of the meaning of Beneficial Ownership in the OECD Model Tax Convention.

haven. Following various articles in newspapers, Member of Parliament Braakhuis posed various questions to the State Secretary of Finance regarding Facebook and multinationals in Southern Europe relating to tax avoidance, which shows the social interest that exists with regard to the issue of beneficial ownership.[11]

## Objective

This research aims to evaluate the concept of beneficial ownership in view of the proposed changes to the Commentary and tries to find improvements to the proposals so that more clarity is gained on the concept of beneficial ownership. Scrutinizing the comments and the proposal gives insight in the issues with the proposals and therewith, the issues with the concept of beneficial ownership. In particular, emphasis will be placed on the impact of the proposed changes on the treatment of conduit companies for Dutch tax purposes. To this end, the following research question is defined, which will serve as guidance throughout this research.

> *"How do the proposed changes to the OECD Commentary impact the concept of beneficial ownership? Does this impact meet the aim of clarifying the concept as intended by the OECD? How could the proposal be improved to better serve its purpose of clarifying the concept of beneficial ownership and what are the consequences of both the current and improved proposed changes for Dutch conduit companies in international structures?"*

## Structure

In order to be able to answer the research question defined above, the research will be constructed as follows.

Chapter 1 will provide a historical analysis of the concept of beneficial ownership. By means of this analysis an understanding of evolution of the concept of beneficial ownership is gained against which the intended effects of the proposed changes can be determined.

[11] Kamervragen Braakhuis over het bericht "Facebook geen vriend meer van de fiscus", 9 March 2012, IFZ/2012/110 U; Kamervragen Braakhuis over grote bedrijven in Zuid Europa, 9 March 2012, IFZ/2012/126 U;The questions that Member of Parliament Braakhuis posed cover a wide range of avoidance, including the concept of beneficial ownership. The questions specifically see to the possibility to gain a limitation on tax by routing intergroup cash flows through the Netherlands.

In Chapter 2 the proposed changes of the OECD Discussion draft to the OECD Commentary will first be examined in light of the historical analysis of the previous chapter, through which an understanding of the intended effects is gained. Then, the potential (side) effects of the proposed changes will be analyzed. In doing so, an in-depth evaluation can be made by which the potentially occurring effects can held against the effects intended by the OECD. Following this evaluation, I will attempt to formulate improvements to the proposals so that they better meet the purpose of clarifying the concept of beneficial ownership, should there prove to be shortcomings in the current proposals.

Chapter 3 aims to provide an understanding of the Dutch approach to the concept of beneficial ownership and how this interpretation relates to that of other nations. In order to do so, I will analyze key domestic and international case law and the various domestic anti-avoidance provisions regarding the concept of beneficial ownership. As a result, an understanding is gained on the various interpretations of the concept based on important case law, as well as a framework on the historical evolution of the concept of beneficial ownership.

In Chapter 4 the treatment of a conduit company is contemplated. First, I will evaluate the issues with conduit companies in light of the OECD Model. Then an analysis of the Dutch legislation and regulations regarding conduit companies is made, which also touches upon the substance requirements provided by the State Secretary of Finance.[12] Then, in Chapter 5, I will provide a practical evaluation, based on the application of the results found to a fictitious case, creating an elaborate overview on the impact of the proposed changes regarding the treatment of conduit companies, both for international as well as for Dutch tax purposes. As such the impact of the proposals comes clear, which leads to a practical understanding of the issues that come with the proposed paragraphs. Finally, Chapter 6 will contain the conclusion and the answer to the research question, as well as a summary of the findings throughout the research and recommendations I have formulated as a result of these findings.

## Choice of language

This thesis is written in English. I have chosen to use the English language not only because in my opinion it is the best suited language for a research of international nature, but also to become more proficient with the English terminology used in international taxation in order to better prepare myself for the globalizing economy we live in and for my future career.

[12] Whilst aiming to be a research with an international scope, for reference purposes the Dutch system will be used as starting point.

# 1. History of the concept of Beneficial Ownership

## 1.1 Background on the OECD

As stated in Article 1 of the Convention on the OECD, the primary and foremost goal of the OECD is to enhance economic growth and employment for the OECD Member States as well as non-Member States.[13] In order to do so, the OECD Member States have agreed to eliminate restrictions on international trade, by facilitating the free traffic of goods, services and capital, as far as possible.[14] As double taxation – and double non-taxation - forms an obvious restriction on international trade, States engaged in bi-lateral tax treaties to counteract this problem.[15] The OECD then published its first Model Tax Treaty in 1963, with aim of further smoothing the negotiation and interpretation of tax treaties between her Member States.[16] Some decades later, the OECD Council recommended the Member States to use the Model as a base for their treaty negotiations, which resulted in the current situation where a vast majority of the treaties negotiated between Member States are based on the OECD MC and the accompanying Commentary.[17] Therefore, both the Model and the Commentary are of great importance in interpreting treaty provisions. Changes on interpretations are therefore usually published in an update of the Commentary, so that the changes also have effect on existing treaties.[18] In the following sections, the historical development of the concept of Beneficial Ownership in the OECD Models and the accompanying Commentaries is considered. However, before conducting an in depth analysis of the proposed changes to the Commentary on the OECD MC, I will first consider the legal position of the Commentaries in bilateral treaty situations.

## 1.2 The legal position of the OECD Model Convention and the Commentary

As I have mentioned above, the OECD MC serves as a benchmark for treaty negotiations. Considering the OECD Commentary contains the policies of the OECD – and therefore, those of its Member States – with respect of international tax issues, it is necessary to establish the influence of the Commentary with the interpretation of bilateral tax treaties.

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[13] Article 1, Convention on the OECD.
[14] Article 2, sub d, Convention on the OECD.
[15] Which were also negotiated before the institution of the OECD.
[16] OECD MC 1963, published on 30 July 1963.
[17] OECD Recommendation of 23 October 1997.
[18] De Graaf, Kavelaars and Stevens 2011, p. 78.

### 1.2.1 OECD perspective

The OECD MC and its accompanying Commentary is established and amended by the OECD Council, which makes recommendations. These recommendations of the Council have no legal binding effect on the Member States.[19] As I have mentioned above, the Council has recommended that the OECD Member States adopt the OECD MC and its accompanying Commentaries when applying and interpreting provisions of their bilateral tax treaties. From that recommendation, it can be derived that the Commentary is not intended to be binding for the Member States.[20] This is confirmed in the introduction to the OECD Commentary:

> *"[…]Although the Commentaries are not designed to be annexed in any manner to the conventions signed by the Member countries, which unlike the Model are legally binding international instruments, they can nevertheless be of great assistance in the application and interpretation of the conventions, in particular, in the settlement of any disputes."*[21]

The introduction also considers that the Commentary could be utilized by the Member States at interpreting provisions of a treaty, when that treaty is based on the OECD MC. As the changes to the Commentary are a direct result of the policies drafted as a result of consensus amongst the Member States, the OECD Commentary states that the newest version of the Commentary should be used at interpreting the provision of a tax treaty. This holds also true in case the treaty was negotiated under a different Commentary than the one that is in effect at time of a dispute. The introduction gives the following considerations to this:

> *"(…) At that time, the Committee considered that existing conventions should, as far as possible, be interpreted in the spirit of the revised Commentaries, even though the provisions of these conventions did not yet include the more precise wording of the 1977 Model Convention (…). The Committee believes that the changes to the Articles of the Model Convention and the Commentaries that have been made since 1977 should be interpreted similarly. Needless to say, amendments to the Articles of the Model Convention and changes to the*

[19] Article 5(b), Convention on the OECD.
[20] De Broe 2008, Part III, para. 2.3.1.
[21] OECD Commentary 2010, Introduction, para. 29.

> *Commentaries that are a direct result of these amendments are not relevant to the interpretation and application of previously concluded conventions where the provisions of those conventions are different in substance from the amended Articles. However, other changes or additions to the Commentaries are normally applicable to the interpretation and application of conventions concluded before their adoption, because they reflect the consensus of the OECD Member Countries as to the proper interpretation of existing provisions and their application to specific situations."*[22]

However, as the view of the OECD is merely an opinion on how the OECD MC and its Commentary should be utilized, the legal aspects of the position of the OECD MC and its Commentary also have to be examined.

### 1.2.2 Legal aspects relating the position of the OECD Commentary

Although the subject has been discussed thoroughly, it seems that there is no consensus amongst authors as to which legal role the OECD Commentary has in the process of interpreting a tax treaty provision.[23] Argumentation as to why the Commentary should be used for the interpretation of tax treaty provisions often refers to articles 31 and 32 of the Vienna Convention. In short, these provisions state that a treaty should be interpreted in accordance with an ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.[24] Furthermore, article 32 lists which supplementary means of interpretations could be used. According to De Broe, as the Vienna Convention sees to treaties that are in effect, applying these provisions on the OECD Commentary is farfetched for two reasons.[25] The first is that the Commentary does not see to an actual treaty but to the OECD MC. As I have mentioned above, the OECD MC is not intended to have binding effect but rather to serve as a benchmark for treaty negotiations. Furthermore, as seen in the previous paragraph, the Commentary explicitly states that it is not intended to have binding effect either. As article 31 of the Vienna Convention lists which instruments are to be taken into consideration when interpreting a treaty, listing the OECD Commentary under this provision would imply it gains binding effect under international law. Furthermore, the

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[22] Ibid. paragraphs 33-35; De Broe 2008, Part III, 2.3.1.
[23] E.g. Van Brunschot 2005, Martin Jiménez 2004, Wattel and Marres 2003, Vogel 2000.
[24] Vienna Convention on Law of Treaties, articles 31 and 32, http://untreaty.un.org/ilc/texts/instruments/english/conventions/1_1_1969.pdf.
[25] De Broe 2008, Part III, section 2.3.

Vienna Convention sees to interpreting specific provisions whereas the Commentary provides guidelines of a more generic nature, seeing to fundamental issues arising from the relation of the Model treaty versus domestic legislation (for example, on the concept of beneficial ownership). Even though fitting the Commentary under the provisions of the Vienna Convention seems very difficult, this does not prevent the Commentary from having a relevant role in the interpretive process of tax treaties.[26] When the OECD MC is used as a benchmark for a negotiated treaty and the Contracting States have not explicitly excluded elements of the OECD MC and/or its Commentary, it should be obvious that, when interpreting the provisions of that treaty, referring to the Commentary is beneficial when it provides clarity to the meaning of a provision of the tax treaty.

### 1.2.3 Conclusions

Since the OECD MC and its Commentary are not intended to have immediate legal binding, in my view, the appropriate way to treat the Commentary in an interpreting situation would be to use it merely for clarification purposes. This does not prevent however that in complex situations the Commentary could provide a main definition for concepts. One of those concepts should be the concept of beneficial ownership, considering the elaborate debate on how the concept should be interpreted. As I would like to think of the Commentary as an additional tool at interpreting the treaty provisions, it seems logical that updates to the Commentary should be of effect in interpreting treaties agreed upon before the Commentary was updated. However, in the situation where treaty partners purposely deviate from the OECD MC and its accompanying Commentary, the Commentary should obviously have no effect.

## 1.3 Origin: OECD Model Tax Convention 1977

The concept of beneficial ownership was first introduced in the OECD MC of 1977.[27] It applied to the Dividends, Interest and Royalty articles (respective: art. 10, 11 and 12) of the convention. The beneficial ownership requirement was implemented to deal with a specific form of treaty abuse, regarding the source state. This abuse took place by means of transferring income, subject to a treaty provision, to a third state. As a result a more favorable taxation rate was applicable. This abuse could be realized through two methods, the first of which is the "stepping stone strategy" and the second of which is the "direct conduit

[26] De Broe 2008, para. 2.3.2.
[27] OECD Model Tax Convention on Income and on Capital (11 April 1977), Models IBFD.

strategy". The stepping stone strategy utilized the payment of deductible expenses to an interposed entity in the resident state, whereas the direct conduit strategy involved a subsequent dividend distribution through the interposed entity.[28] These schemes are further explained in section 1.5 and Chapter 4 of this thesis.

## 1.4 Interpreting the concept of Beneficial Ownership

Whilst implemented in the OECD MC of 1977, there was very little clarification given on the meaning and interpretation of the newly imposed requirement. The Commentary on article 10 under OECD MC (1977) (which is also applicable for articles 11 and 12, since the concept of beneficial ownership is the same in those articles) merely stated the following:

> *"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."*[29]

This lack of clarification leaves room for discussion. The Commentary on article 10 only mentions several components that form the test. It speaks of an 'intermediary', a 'beneficiary' and a 'payer'. The broad nature of those terms leads to discussion as to when exactly one qualifies as such under the Commentary. The interpretation of these terms is vital, since it could decide whether or not an entity has access to the limitation of taxation under the Treaty. Whilst the Commentary in itself is no binding law, the OECD MC, and its Commentary serve as a base for Treaties negotiated between States. Having the function of a benchmark against which treaties are negotiated, it is desirable that the definitions of the Model and the accompanying Commentary are the first to be cleared of any uncertainty in respect to the interpretation of their provisions. As the OECD makes recommendations to update the Commentary, the Fiscal Committee is, in my view, the most appropriate party to clear the Commentary of uncertainty.

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[28] OECD, Double Taxation Conventions and the Use of Conduit Companies, in International Tax Avoidance and Evasion, Issues in International Taxation Series No. 1, 98 (1986), *Annex I* , Intl. Orgs. 'Docn. IBFD.

[29] OECD Model Tax Convention on Income and on Capital: Commentary on Article 10 (11 April 1977), para. 12, Models IBFD.

## 1.5 OECD reports

The lack of clarity on the concept of beneficial ownership was first assessed in the 1987 report of the OECD, which evaluated the use of conduit companies in international structures.[30] As I have briefly mentioned above, the Conduit Report distinguishes two types of abuse of tax treaties, which will be described more in depth in the following section.

### 1.5.1 Issues arising from conduit companies

The issues with the use of conduit configurations arises from the residency provisions of the treaty and domestic legislation. As resident for treaty purposes, the conduit company has access to the treaty benefits and can thus take advantage of the treaty provisions regarding income derived from the State of source. As in such configurations the economic benefit of the received income by the conduit lies with an entity that is resident of a third State and is thus not entitled to the applicable tax treaty, a net tax advantage is gained by the ultimate beneficial owner. This advantage results from application of the tax treaty provisions and domestic law of the conduit's State of residence, under which usually little or no tax is levied on the received income. Since the source country normally would levy withholding tax on the distribution, based on its domestic laws, the issue at hand is created by the implementation of the tax treaty and can therefore only be dealt with under the treaty.[31]

The Committee on Fiscal Affairs considers the situation, as described above, unsatisfactory as the act of interposing entities for the purpose of gaining access to treaty benefits breaks with the principle of reciprocity.[32] The Committee also sees issues with relation to the incentive for the third State to enter in a tax treaty with the State of source. If it is possible to gain access to the treaty benefits through an artificially created configuration, there is no incentive for the State of residence of the beneficial owner to engage in a tax treaty. If that State were to engage in a tax treaty, sacrifices would have to be made in order to attain the benefits, whereas such would not be the case when access can be gained through said structure.

Lastly, the Committee considers that these issues could also arise with existing treaties when treaty partners were not aware of such structures at the time of negotiations. In this respect, the Conduit Report provides examples of two different Conduit strategies by means of which tax could be avoided.

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[30] OECD, Double Taxation Conventions and the Use of Conduit Companies, in International Tax. Avoidance and Evasion, Issues in International Taxation Series No. 1, 98 (1986), Intl. Orgs. 'Docn. IBFD.
[31] Ibid.
[32] Ibid. para. 6.

### 1.5.2 Direct Conduit Strategy

Under the direct conduit strategy, the conduit company – a company resident of contracting State A – receives dividends, interests or royalties from the source company, resident of contracting State B.[33] The conduit company then claims full or partial exemption from the withholding taxes of State B, as rightfully so under the applicable tax treaty between A and B. However, the conduit is wholly owned by a resident of a third state, which otherwise would not be entitled to the benefit of the treaty between States A and B. In this situation the conduit in State A has been interposed with the purpose of taking advantage of the applicable treaty.

By implementing this strategy, it is achieved that the income is transferred from the source company to the conduit on a tax free basis, be it by virtue of a parent-subsidiary regime provided under the domestic laws of State A, or through an exemption based on the treaty between States A and B.

### 1.5.3 "Stepping stone" conduits

The essence is the same as with the direct conduit strategy explained above. However, in this situation the interposed conduit in state A is fully subject to tax in that country, through which the received dividends, interest or royalties would be taxed. To counter this, a second conduit company is set up in State C. The conduit in State A pays high interest, service fees and/or similar expenses to the second conduit in State C. For tax purposes, these payments are deductible in State A and tax-exempt in State C. It is important to note that in both situations, the conduit companies are not entitled to benefits arising from the received dividends, interests or royalties.

Through both methods taxation of the received income is avoided, which is the goal of implementing the strategies. In the situation where taxation on the received income would be levied after all, no added benefit would be gained by interposing the conduits.

[33] An overview is provided in figure one on page 19.

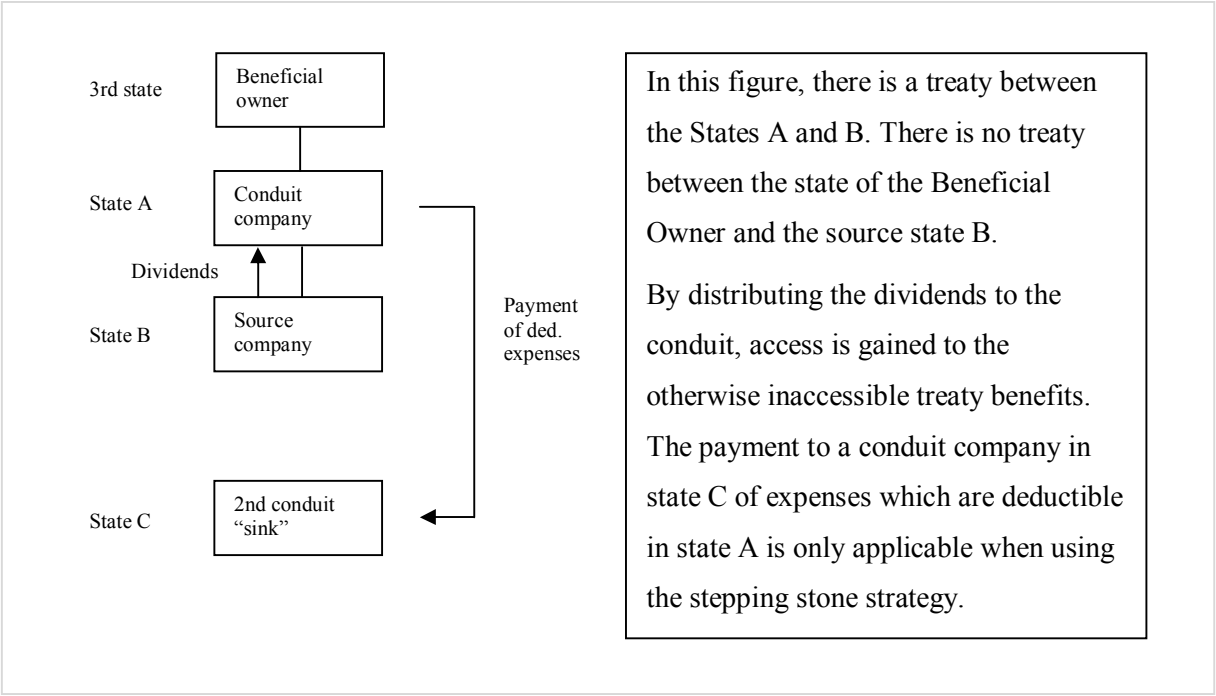


**Figure 1 – Stepping Stone and Direct Conduit strategy**

## 1.6 OECD Model Tax Convention 2003, Commentary

Ultimately the 1987 report of the OECD resulted in further clarification on the meaning of beneficial ownership in the Commentary on Article 10 of the OECD MC (2003).

> *"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."* [34]

Hence, a contextual approach was introduced under which definitions developed by individual countries through legislation and case law could still be applicable for the purposes of tax treaties. However, such would only be the case if Article 3.2 – which gives guidance on

[34] Comments by Robert J. Danon on the Clarification of the meaning of "Beneficial Ownership" in the OECD Model tax Convention; and OECD Model Tax Convention on Income and on Capital: Commentary on Article 10 (28 January 2003), para. 12.

interpretation of the tax treaty – was properly constructed and applied.[35] The definitions would be applicable only to the extent that there was no difference to the essence of the beneficial ownership as laid down in the OECD Commentary. Paragraph 12.1 of the OECD Commentary on article 10 (2003) elaborates on the factual interpretation of the beneficial ownership requirement:

> *"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, through 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."* [36]

With the above additions to the Commentary, it is now possible to exclude such artificial structures from the treaty benefits, even when they meet all requirements to have access to the benefits.[37] It can be concluded that the amended definition essentially broadens the concept of beneficial ownership to include conduits acting merely as an administrator or a fiduciary. In my opinion this amendment is justified, considering the plethora of tax driven structures utilizing an interposed entity. As stated though, uncertainty remains as to when one is in fact deemed conduit. Therefore, clarification on the subject is required.

## 1.7 OECD Model Tax Convention 2010, Commentary

The last amendment to the OECD Commentary regarding beneficial ownership is found in the OECD Commentary on Article 1 of the OECD MC (2010). Article 1 sees to the persons covered by the treaty and as such determines treaty access. Even though the amendment sees upon the application of the beneficial ownership requirement to collective investment vehicles, it shows that a substance-over-form approach is adopted for interpreting the concept

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[35] I.e. the provision should sufficiently determine how the meaning of treaty concepts is established in case of deviating interpretations.

[36] OECD Model Tax Convention on Income and on Capital: Commentary on Article 10 (28 January 2003), para. 12.1.

[37] Which deviates from the opinion of the Hoge Raad, as decided in, for example, Hoge Raad 6 April 1998, Decision No. 28.638, BNB 1994/217 and Hoge Raad 21 February 2001, Decision No. 35 415, BNB 2001/196, in which was decided that the beneficial ownership requirement alone did not provide sufficient base to limit the treaty benefits.

of beneficial ownership.[38] Therefore, as the interpretations of national courts and legislators on the concept of beneficial ownership still varies vary greatly and the lack of clarity on the implementation pertains,[39] Philip Baker has advised against extending the use of the beneficial ownership requirement to further provisions of the UN Model.[40]

## 1.8 OECD Discussion Draft

In 2011, the Working Party I of the OECD Committee on Fiscal Affairs submitted proposals to amend the Commentary aiming to further clarify the interpretation that should be given to the concept of beneficial ownership under the Commentaries.[41] Released in April, these proposals take shape of a discussion draft on which various parties involved were invited to provide comments. By inviting professionals to comment on the proposed changes a thorough scrutiny of the proposals took place. Assuming these comments are thoroughly analyzed by the Committee, the proposals can then be adjusted to criticism ventilated in those comments. Therefore, the result from the Discussion Draft should end up being beneficial to the eventual amendment of the Commentary.[42]

## 1.9 Conclusion

It has come clear that a lot of uncertainty pertains on the concept of beneficial ownership. While it is a very important concept in international tax law and Tax Treaties, the various interpretations that are adopted by courts all over the world have led to discussion on the application of the concept. Regardless of the effective legal position of the OECD MC and its Commentary not being undisputed, the Commentary is of great importance in interpreting the treaties between Member States. The concept as it is leads to risks on double taxation, or double non taxation, depending on the interpretation that is adopted by Contracting States. With the Discussion Draft, the OECD aims to clarify the concept, and give guidelines on the interpretation of the requirement, aiming to take away the uncertainty around the concept of beneficial ownership.

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[38] OECD Model Tax Convention on Income and on Capital: Commentary on Article 1 (22 July 2010), para. 6.14, Models IBFD.
[39] A more in-depth overview is given in Chapter 3 of this thesis.
[40] Baker 2008.
[41] OECD Discussion draft: Clarification of the meaning of Beneficial Ownership in the OECD Model Tax Convention.
[42] This thesis will evaluate the proposals and the comments further on.

# 2. The proposed changes in the OECD Discussion Draft

As seen in Chapter 1, the OECD has followed up on the extensive discussion on the beneficial ownership requirement by means of proposals by the Committee on Fiscal Affairs, aimed at clarifying the interpretation that should be given to the beneficial ownership requirement in context of the OECD MC and the accompanying Commentaries.

The beneficial ownership requirement included in Articles 10, 11 and 12 is the same. The proposed changes in the Discussion Draft to the respective paragraphs of the Commentaries on those articles are identical as well. For practical reasons, I will therefore only evaluate the changes to the Commentary on Article 10, since the conclusions are of direct relevance to the other Articles.

## 2.1 Proposed Changes to the Commentary on Article 10

For sake of readability of this thesis, the below sections first show the relevant parts of the Discussion Draft after which a summary and analysis is given.[43] The proposed paragraphs are grouped on general subject and are evaluated as such. Furthermore, the full text of the proposed changes to the Commentary on Article 10 has been included in Annex I. In order to clearly distinguish between the old text and the new text, additions are in ***bold italics*** and deletions are in ~~strikethrough~~.

### 2.1.1 General Interpretation Principles – Proposed paragraphs 12, 12.1 and 12.6

#### *2.1.1.1 Proposed text in the Discussion Draft*

> 12. The requirement of beneficial owner was introduced in paragraph 1 of Article 10 to clarify the meaning of the words "paid … to a resident" as they are sued 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~~***paid direct to*** a resident of a State with which the State of source had concluded a convention. *[the rest of the paragraph has been moved to new paragraph 12.1]*

[43] The text is copied from the official OECD Discussion draft: Clarification of the meaning of Beneficial Ownership in the OECD Model Tax Convention.

> ***12.1 Since the term "beneficial owner" was added to address potential difficulties arising from the use of the words "paid to … a resident" in paragraph 1, it was intended to be interpreted in this context and 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" is ***therefore*** not used in a narrow technical sense ***(such as the meaning that it has under the trust law of many common law countries),*** rather, it 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. ***This does not mean, however, that the domestic law meaning of "beneficial owner" is automatically irrelevant for the interpretation of that term in the context of the Article: that domestic law meaning is applicable to the extent that it is consistent with the general guidance included in this Commentary.***
>
> 12.6 The above explanations concerning the meaning of "beneficial owner" make it clear that the meaning given to this term in the context of the Article must be distinguished from the different meaning that has been given to that term in the context of other instruments that concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of "beneficial owner" cannot be applied in the context of the Article. Indeed, that meaning, which refers to natural persons (i.e. individuals), cannot be reconciled with the express wording of subparagraph 2 a), which refers to the situation where a company is the beneficial owner of a dividend. Since, in the context of Article 10, the term beneficial owner is intended to address difficulties arising from the use of the word "paid" in relation to dividends, it would be inappropriate to consider a meaning developed in order to refer to the individuals who exercise "ultimate effective control over a legal person or arrangement".

#### *2.1.1.2 Analysis*

As discussed in Paragraph 1.3, the reference to a conceptual interpretation of the concept of beneficial ownership was first implemented in the Commentary of 2003. As the Commentary of 2010 is unchanged in this respect,[44] the addition in paragraph 12.1 of the Discussion Draft should in my opinion be interpreted as an attempt to further clarify that the concept of

[44] OECD Model Tax Convention on Income and on Capital: Commentary on Article 10 (22 July 2010), para. 12.1.

beneficial ownership is to be interpreted in light of the object and purposes of the Convention. This amendment is therefore in line with the OECD thoughts regarding the subject.[45] The contextual interpretation of the concept also was accepted by the UK Court of Appeal in the Indofood case, which considered that the beneficial ownership concept "*is to be given an international fiscal meaning not derived from the domestic laws of the Contracting States*".[46] Therefore, and also following from other significant case law, the last sentence of the proposed paragraph 12.1 seems misplaced.[47] Basically the proposed paragraph 12.1 first tells us to interpret the concept of beneficial ownership in a contextual way, irrespective of any technical meaning the concept may have under domestic laws. The opening for the concept under domestic laws to be used with the interpretation potentially poses a problem, as there is such a wide variety on interpretations of the concept of beneficial ownership. By allowing those domestic interpretations to be applied in the process of interpreting the concept, problems arise as to which domestic definition prevails in case of conflicting interpretations. As Robert Danon concludes, this opens the way for a domestic characterization that potentially exacerbates the risk of diverging interpretations.[48] From the public comments on the Discussion Draft that regarded this aspect, it can be derived that there is consensus that the used language of the last sentence of the proposed paragraph 12.1 does not help in clarifying the concept, as the effect described by Danon is the exact opposite of the aim the OECD has with the proposed changes. Furthermore, the shift from the wording *"received by"* to *"paid direct to"* in the proposed paragraph 12 clarifies where the concept of beneficial ownership should be tested. The wording *"paid to"* stipulates a first-line payment.

The proposed paragraph 12.6 further elaborates on what attributes should be included in the meaning of 'beneficial ownership' under Article 10. The proposed changes help in clarifying the subject by means of explicitly stating that the context of identifying the persons that exercise ultimate control is *not* the intended context in which the concept under Article 10 should be interpreted.[49] In my opinion, as the proposed text clarifies which interpretation should *not* be used, discussion on this subject is effectively avoided through this amendment.

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[45] OECD Model Tax Convention on Income and on Capital: Commentary on Article 10 (28 January 2003), para. 12.1.
[46] Indofood (2006).
[47] See Chapter 3 of this thesis.
[48] Comments by Robert J. Danon on the OECD Discussion Draft, para. 2.3; For an elaborate overview of all comments, be referred to Annex III of this thesis.
[49] OECD Discussion draft, para. 12.6; The Discussion Draft notes that, since intended to address difficulties arising from the word "paid", it is inappropriate to consider a meaning which was developed in order to refer to the individuals who exercise ultimate effective control over a legal person or arrangement.

### 2.1.2 Beneficial owner test regarding agents, nominees and conduit companies – Proposed paragraphs 12.2, 12.3 and 12.4

#### *2.1.2.1 Proposed text in the Discussion Draft*

12.1*2* Where an item of income is ~~received by~~*paid to* 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 te status of the ~~immediate~~ *direct* recipient of the income as a resident of the other Contracting State. The ~~immediate~~*direct* recipient of the income in this situation qualifies as a resident but no potential double taxation arsis 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. [*the rest of the paragraph has been moved to new paragraph 12.3]*

***12.3*** 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 of nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned. 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.

***12.4 In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the recipient of the dividend is not the "beneficial owner" because that recipient does not have the full right to use and enjoy the dividend that it receives and this dividend is not its own; the powers of that recipient over that dividend are indeed constrained in that the recipient is obliged (because of a contractual, fiduciary or other duty) to pass the payment received to another person. The recipient of a dividend is the "beneficial owner" of that dividend where he has the full right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass the payment received to another person. 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 full***

> ***right to use and enjoy the dividend; also, the use and enjoyment of a dividend must be distinguished from the legal ownership, as well as the use and enjoyment, of the shares on which the dividend is paid.***

#### *2.1.2.2 Analysis*

The proposed paragraphs 12.2 and 12.3 of the Discussion Draft are essentially the current paragraph 12.1. The change of view to the "direct recipient" and the payer instead of the receiver of the income does not impact the concept of beneficial ownership. It merely clarifies the intended subject of the beneficial ownership test. By adjusting the wording to the direct recipient and the payer, more consistency is gained with Article 1 of the OECD MC, attempting to further qualify 'paid… to'. The addition of the word 'direct' clarifies which cash flows are included in the provision. With the use of the wording 'paid to' additional emphasis is put on the primary cash flow. The proposed paragraph 12.4 however, potentially impact the concept quite a bit. In fact, the OECD has attempted to come with a general definition of the concept of beneficial ownership:

> *"The recipient of a dividend is the "beneficial owner" of that dividend where he has the full right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass the payment received to another person. 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 full right to use and enjoy the dividend; also, the use and enjoyment of a dividend must be distinguished from the legal ownership, as well as the use and enjoyment, of the shares on which the dividend is paid."*[50]

Following the view – already present in the current Commentary – that the concept of beneficial ownership should not be interpreted in any narrow technical form,[51] the OECD now explicitly adopts a substance-over-form approach by stating that an obligation can be found on basis of facts and circumstances in the proposed paragraph 12.4. Following the substance-over-form approach in relation to beneficial ownership seems reasonable. As the concept of

[50] OECD Discussion Draft, para. 12.6.
[51] See proposed paragraph 12.1.

beneficial ownership serves as an anti-abuse method, a formal approach would open an easy way to evade the provision by means of simply arranging that interposed companies meet all formal requirements posed by the Contracting States. The language used further implies that the concept of beneficial ownership sees strictly to the ownership characteristics of the recipient of the income as opposed to those further on in the chain.[52] Hence, the concept is tested in the primary level of payment. Both of these additions are of value in the clarification of the concept of beneficial ownership. However, potential practical issues arise from the requirement that one needs to have the *"full right to use and enjoy… unconstrained by a contractual or legal obligation"*. The Commentary is unclear as to how far this requirement goes, yet states that it should be derived from the use and enjoyment an entity has in regards to the received dividends, interests and royalties. Therefore, it can be concluded that legal (formal) ownership of the received dividends is not required to qualify as beneficial owner for the treaty benefits. An usufructuary could, for example, also qualify for the beneficial owner requirement, as long as that usufructuary (which not has the formal ownership of the dividends) has sufficient use and enjoyment of the received income. In that situation, the right to use and enjoy lies with the usufructuary as opposed to the bare owner. Therefore, the bare owner would then not qualify as beneficial owner. Furthermore, that implies that emphasis is put with the economic ownership of the income, a substance-over-form approach. In this respect, it is odd that the ownership 'test' does not include the power to freely dispose of or avail assets.[53] The importance of this attribute also is embedded in Klaus Vogel's definition on beneficial ownership. He defined a beneficial owner as a person who is free to decide on whether or not the capital or other assets should be used or made available for use by others, or on how the yields from them should be used, or both. [54]

In my opinion, the current text of the proposed paragraph 12.4 creates confusion as to how far the requirement of 'use and enjoyment' goes. For example, a company that uses the received income to repay on obligations it has, could be argued to have enjoyed that income. However, economically that company has no power over the income. As such, it cannot freely use the income. In my view, the wording of proposed paragraph is thus too broad. Furthermore, the attribute 'unconstrained by contractual or legal obligation' is not further explained either. It merely states that such an obligation should be considered based on legal documents and the facts and circumstances. While one could assume that the obligation has to see to the received payment,

[52] OECD Discussion Draft, para. 12.4: second sentence. The proposal considers that an obligation can normally be derived from legal documents or on the basis of facts and circumstances.
[53] As follows from the Hoge Raad's decision in BNB 1994/217c.
[54] Vogel 1997, note 15, p. 562.

the Commentary is not clear on this. When interpreted textually, the proposed paragraph leaves room to argue that when a company has obligations to repay on intercompany loans unrelated to the received income, yet uses that income to repay on those loans, that repayment could be seen as an constraint on the received income. In my opinion, further clarification on this aspect is required as well.

### 2.1.3 Remarks regarding treaty abuse – Proposed paragraph 12.5

#### *2.1.3.1 Proposed text in the Discussion Draft*

> ***12.5 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 provided for by paragraph 2 must automatically be granted. This limitation of tax should not be granted in cases of abuse of this provision (see also paragraphs 17 and 22 below). As explained in the section on "Improper use of the Convention" in the Commentary on Article 1, there are many ways of addressing conduit company and, more generally, treaty shopping situations. These include specific treaty anti-abuse provisions, 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 the dividend to someone else), 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.***

#### *2.1.3.2 Analysis*

The implementation of this paragraph is a logical way to prevent unwanted restrictions on the possibilities the Contracting States have fight treaty abuse. Issues could arise though when there are multiple anti-abuse provisions that could be applied to the same case.[55] In the OECD MC this could be the case with the beneficial ownership concept and the "guiding principle".[56] The guiding principle is first found in the Commentary of 2003, and states the following.

[55] For example: the guiding principle, Limitation of Benefits provisions and domestic anti-abuse provisions.

[56] Comments by Robert J. Danon on the Clarification of the meaning of "Beneficial Ownership" in the OECD Model tax Convention, para. 5.2.

> *"... the benefits of a double taxation convention should not be available where a main purpose for the entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions."*[57]

If the concept of beneficial ownership were to be tested against both the beneficial ownership requirement and the guiding principle, the possibility could occur that when an interposed entity passes the extensive beneficial ownership test, the State of source could test against the guiding principle – which contains much less elaborate testing attributes – and still deny the access to the treaty benefits. A claim that the entity is interposed for purposes of gaining a more favorable tax position is sufficient to do so. This then would raise the question as to who has the burden of proof and of when ones 'main purpose' is the avoidance of taxation. Basically this would lead to the situation where one is granted the treaty benefits under a specific treaty provision, yet is then denied those benefits based on a general provision. This would imply that a literal reading of the Commentaries is impossible, as that would lead to the conclusion that one provision grants the treaty benefits and another provision denies the same benefits. It is obvious that this possibility is contradictory to the aim of the OECD to enhance the internal market. Therefore should, as Robert Danon suggests[58], the guidance principle be regarded to be of subsidiary nature. In this respect, one part of the proposed paragraph 12.5 is of particular interest:

> *"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 the dividend to someone else), 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."*[59]

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[57] OECD Commentaries on Article 1 of the Model Tax Convention (28 January 2003), para 9.5.
[58] Comments by Robert J. Danon on the Clarification of the meaning of "Beneficial Ownership" in the OECD Model tax Convention, para. 5.2.
[59] OECD Discussion draft: Clarification of the meaning of Beneficial Ownership in the OECD Model Tax Convention. para. 12.5.

The above quote basically states that the concept of beneficial ownership looks exclusively to 'some forms' of tax avoidance. Therefore, the guidance principle could only apply to those elements of a fact pattern that do not see to the tax avoidance. As a result, the risk of applying multiple anti-avoidance provisions on the same fact pattern is effectively avoided.

### 2.1.4 Interposed conduit companies – Proposed paragraph 12.7

#### *2.1.4.1 Proposed text in the Discussion Draft*

> 12.7 Subject to other conditions imposed by the Article, the limitation of tax in the State of source remains available when an intermediary, such as an agent or nominee located in a Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State (the text of the Model was amended in 1995 to clarify this point, which has been the consistent position of all Member countries). States which wish to make this more explicit are free to do so during bilateral negotiations.

#### *2.1.4.2 Analysis*

The text is equal to the existing paragraph 12.2 of the Commentary on Article 10.[60] The Discussion Draft does not propose any changes on the text. Based on the new paragraph 12.7, limitation of tax in the State of source remains available when a conduit is interposed between the payer and the beneficiary, but the beneficial owner is a resident of the other Contracting State. The paragraph leaves room for bilateral negotiations.

## 2.2 Evaluation of the public comments on the Discussion Draft

In this section, I will evaluate the various comments on the Discussion Draft. For sake of readability this evaluation is done in the same setup as above, resulting in an overview of all returning relevant comments and remarks regarding the proposed paragraphs. Herewith an insight is gained in the most pressing issues with the Discussion Draft. An overview of the particular issues per paragraph, stated by respondents on the Discussion Draft is provided in Annex III.

[60] OECD Commentaries on Article 10 of the Model Tax Convention (22 July 2010), para. 12.2.

### 2.2.1 General Interpretation Principles – Proposed paragraphs 12, 12.1 and 12.6

In the comments that reviewed these paragraphs, general consensus exists that the proposed paragraph, which allows domestic law to be used to interpret the concept of beneficial ownership to the extent that is consistent with the general guidance included in the Commentary, risks creating differences in the interpretation per country. The wording is too broad, resulting in the possibility that the proposed paragraph could be used by tax authorities to further pierce through corporate structures, raising more discussion.[61] Furthermore, it is also touched upon that the closing sentence of the proposed paragraph 12.1 creates additional confusion by allowing domestic anti-abuse provisions to be utilized in the interpretation of the concept.[62]

### 2.2.2 Beneficial owner test regarding agents, nominees and conduit companies – Proposed paragraphs 12.2, 12.3 and 12.4

#### *2.2.2.1 Language issues*

The most pressing issues in all public comments relate to the proposed paragraph 12.4. In the current wording, it is felt that the proposal could be interpreted as a change to the concept of beneficial ownership rather than additional clarification on the term. In current state, this leads to more – instead of less – uncertainty. If tax authorities interpret the proposals as a change, it could allow source States to claim lack of beneficial ownership randomly, except maybe the most obvious cases. Consensus is therefore that the OECD should make sure the clarifications are beyond a doubt presented as such, so that the scope of beneficial ownership as anti-abuse is not expanded of cases that do and do not fall under the provision.[63]

#### *2.2.2.2 Overkill*

Furthermore, the proposed wording implies that an obligation to pass on income is enough to not be deemed beneficial owner. As has been explained above, the public parties feel that this potentially contains unintended overkill, considering that nearly every company has legal obligations to make payments. It is unclear when exactly the attribute of *'a contractual or legal obligation'* is met. In various public comments there is a call to clarify or amend this

[61] For an elaborate overview of the Comments on the Discussion Draft, be referred to Annex III.
[62] Comments on the Discussion Draft by Taxand and Robert J. Danon.
[63] Comments on the Discussion Draft by Ernst & Young and in same respect the comments of: Deloitte, Taxand, IBFD, Kim & Chang, The City of London Law Society, PricewaterhouseCoopers and Jones, Vann and Wheeler.

sentence, or to provide examples.[64] Although examples would, in my opinion, help in clarifying the intended effect of the proposed text, a comprehensive definition would be more beneficial. As such, I disagree with the suggestion to provide examples, also because it's unlikely that these cover every possible situation/structure.

### 2.2.3 Remarks regarding treaty abuse – Proposed paragraph 12.5

It is stated in various comments that the ratio behind the proposed paragraph 12.5 is laudable. However, in the current wording, it is possible that States who adhere a substance-over-form test in their domestic law regarding beneficial ownership will solely use the provisions in paragraph 12.5 to test whether a company is a conduit, and not the other way around. Therefore, the phrase *"some forms of tax avoidance"* in the proposed paragraph 12.5 should be clarified and it should be made clear that, in relation to the provisions of articles 10, 11 and 12 of the OECD MC, the beneficial ownership test is applied separately of any other anti-abuse provisions.[65]

### 2.2.4 Interposed conduit companies – Proposed paragraph 12.7

Regarding this paragraph Deloitte noted that there is uncertainty regarding the application to conduit companies acting as a fiduciary or administrator. It is suggested that tax authorities should look through agents and nominees as well as conduit companies acting as a fiduciary or administrator.[66] It is further considered that any amendment to proposed paragraph 12.7 to create more certainty regarding the application to conduit companies, should be consistent with the scope of the proposed paragraph 12.4.

## 2.3 Improving the proposed Commentary on Article 10

Through the comments on the Discussion draft, the bottlenecks in the text of the proposed paragraphs have become clear. Through this, it is now possible to attempt to create a version of the proposed changes that takes in account the concerns of all involved parties while still meeting the goal of clarifying the concept of beneficial ownership. For sake of readability the full text of the improved proposal is found in Annex II. As a base the text of the Commentary as proposed in the Discussion draft is taken, in which my additions are in ***bold italic*** whilst deletions appear in ~~strikethrough~~.

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[64] See, for example, the Comments on the Discussion Draft by Deloitte. An elaborate overview is found in Annex III.
[65] See, for example, the Comments on the Discussion Draft by Kim & Chang, Robert J. Danon and Taxand.
[66] Comments on the Discussion Draft by Deloitte.

### 2.3.1. Considerations regarding the changes to the proposal

#### *2.3.1.1 Changes to paragraph 12.1*

> 12.1 Since the term "beneficial owner" was added to address potential difficulties arising from the use of the words "paid to … a resident" in paragraph 1, it was intended to be interpreted in this context and 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" is therefore not used in a narrow technical sense (such as the meaning that it has under the trust law of many common law countries), rather, it 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. ~~This does not mean, however, that the domestic law meaning of "beneficial owner" is automatically irrelevant for the interpretation of that term in the context of the Article: that domestic law meaning is applicable to the extent that it is consistent with the general guidance included in this Commentary.~~
>
> ***12.1A To achieve an internationally recognized concept, Contracting States are to interpret the concept against the intentions of the OECD (laid out in paragraph 12.3 and 12.4) as shows from this Commentary, irrespective of their domestic law.***

By removing the above sentence, which stated that domestic interpretations of the concept of beneficial ownership could be used to interpret the concept under the Convention, from the proposal, I aim to achieve an uniform interpretation by means of the additions done to paragraph 12.4. By means of this, the concept in the Commentary is given the international meaning as provided in the *Indofood* case. [67]As the majority of courts already seem to be disregarding domestic anti-abuse provisions in treaty situations,[68] the uniform concept should be achievable, assuming the legislators follow the courts in this matter. However, it is clear that achieving an uniform concept is likely to be long and hard to reach considering it touches the sovereignty of the Member States.

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[67] Indofood (2006), which considered that the concept of beneficial ownership *"is to be given an international fiscal meaning not derived from the domestic laws of the Contracting States."*

[68] See Chapter 3 of this thesis.

### *2.3.1.2 Changes to paragraph 12.2*

> 12.2 Where an item of income is paid ***directly*** to 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 direct recipient of the income as a resident of the other Contracting State. The direct recipient of the income in this situation qualifies as a resident but no potential double taxation arsis 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.

A very minor addition, that should help clarify the subject of the beneficial ownership test is. With the construction *"paid directly to a resident of a Contracting State"* it shows that the beneficial ownership is tested on the primary payment and does not consider secondary payments. This clarifies that indirect payments are not included in the applicable treaty. Herewith, more clarity is gained on the cash flows that fall under Articles covered by the Commentary.

### *2.3.1.3 Changes to paragraph 12.4*

> 12.4 ***In*** ~~these various examples~~ ***the examples given in paragraph 12.3*** (agent, nominee, conduit company acting as a fiduciary or administrator), the recipient of the dividend is not the "beneficial owner" because that recipient does not have ~~the full~~ ***any legal, factual or economical power to*** ~~right to use and enjoy~~ ***exercise control over*** the dividend that it receives and this dividend is not its own; the powers of that recipient over that dividend are indeed constrained in that the recipient is obliged (because of a contractual, fiduciary or other duty) to pass the ***full*** payment received to another person ***in the same legal form***. ***The examples given in paragraph 12.3 are not to be interpreted in any restrictive manner and this paragraph is applicable to any entity that meets the attributes listed.***
>
> ***12.4A*** The recipient of a dividend is the "beneficial owner" of that dividend where he has ~~the full right to use and enjoy~~ ***any legal, factual or economical power to exercise control over*** the dividend unconstrained by a contractual or legal obligation to

> ***immediately*** pass the ***full*** payment received to another person ***in the same legal form***. 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 ***any*** right to use and enjoy the dividend; also, the use and enjoyment of a dividend must be distinguished from the legal ownership, as well as the use and enjoyment, of the shares on which the dividend is paid.

These changes see to the criticism of the public parties on the proposed paragraph 12.4 of the Discussion Draft. By means of these changes, I aim to clarify the concept of beneficial ownership. The changes remove the overkill of the provision and establish attributes against which an entity can be tested for beneficial ownership purposes. By explicitly linking to paragraph 12.3, it is now clear that the provision sees to any person mentioned in paragraph 12.3. In order to make sure that no restrictions are posed by that sentence, I have amended the proposal with a clarification on the applicability of the paragraph. Further, I have sharpened the attributes of the beneficial owner test. It now states that the ***full*** payment received should be passed on to a third ***in the same legal form***, which eliminates unwanted side effects as pointed out in paragraphs 2.1.2.2 and 2.2.2.2 of this thesis.

Also the replacement of 'the full right to use and enjoy' with '***any legal, factual or economical power to exercise control over'*** gets rid of any subjective elements of the test, which should make an uniform application of the concept easier. By using power to control, instead of the right to use and enjoy, the focus of the provision is shifted to factual circumstances instead of another multi-interpretable term as 'enjoyment'. By implementing this change I have basically combined the definition of the Discussion Draft with the control-of-attribution test that Robert Danon proposed.[69] Furthermore, I have replaced the wording "full" with "***any***". This replacement also sees to the overkill stated in paragraph 2.2.2.2, as it is now sufficient to have some rights to the received income.

#### *2.3.1.4 Changes to paragraph 12.5*

> 12.5 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 provided for by paragraph 2 must automatically be granted. This limitation of tax should not be granted

[69] Danon 2006, pp. 19-22.

in cases of abuse of this provision (see also paragraphs 17 and 22 below). As explained in the section on "Improper use of the Convention" in the Commentary on Article 1, there are many ways of addressing conduit company and, more generally, treaty shopping situations. These include specific treaty anti-abuse provisions, general anti-abuse rules and substance-over-form or economic substance approaches. Whilst the concept of "beneficial owner" ***exclusively*** deals with ~~some~~ forms of tax avoidance ***under articles 10, 11 and 12 of the Convention***~~(i.e. those involving the interposition of a recipient who is obliged to pass the dividend to someone else)~~, 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.

This change is intended to make clear beyond any doubt that the provisions of Articles 10, 11 and 12 are solely subjected to the beneficial ownership test for anti-abuse purposes. This is to prevent multi-layer anti-abuse tests, potentially leading to the situation where one passes the first test, fails the second (perhaps broader) test and is denied the treaty benefits. This should improve the legal certainty Contracting States and taxpayers derive from the OECD MC. Furthermore, it is clarified that the beneficial ownership test is applicable for *all* tax avoidance related to the articles mentioned, as opposed to 'some forms'.

#### *2.3.1.5 Changes to paragraph 12.7*

12.7 Subject to other conditions imposed by the Article, the limitation of tax in the State of source remains available when an intermediary ***on which paragraph 12.3 and 12.4 could be applicable***, ~~such as an agent or nominee~~ located in a Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State (the text of the Model was amended in 1995 to clarify this point, which has been the consistent position of all Member countries). States which wish to make this more explicit are free to do so during bilateral negotiations.

This replacement is to ensure consistency throughout the Commentary. By referring back to paragraphs 12.3 and 12.4, it comes clear which intermediaries are intended to be included by the provision.

## 2.4 Conclusion

In my opinion, the proposals provide some much needed clarifications regarding the concept of beneficial ownership, although the final concept is not comprehensive. The comments given by the public parties all contain roughly the same concerns, which are mainly related to the (potential) uncertainty that could arise due to the use of broad language. Even though the Commentary officially serves as a base for treaty negotiations, it is very relevant in interpreting those treaties. Therefore, the use of broad language and vague terms could potentially give tax authorities the opportunity to apply the beneficial ownership test at will.[70] Furthermore proposed paragraph 12.4 contains potential overkill which would deny entities, that exist for perfectly legit business purposes, the benefits of the treaty. In this chapter, I have attempted to tackle these concerns by means of improvements to the current text of the Discussion draft.

[70] Comments on the Discussion Draft by Robert J. Danon and Kim & Chang.

# 3. Beneficial Ownership: The Netherlands in light of international case law

As seen above, the Netherlands have a wide spread treaty network. As such, it is inherently popular to interpose conduits for international tax structuring. Therefore, an understanding on the effect that the proposed changes in the Discussion Draft have on domestic provisions is essential to be able to answer the research question of this thesis. In order to gain that understanding, this chapter provides an analysis between the Dutch domestic anti abuse provisions, relevant case law and international case law, with emphasis on the concept of beneficial ownership as an anti-abuse provision. As such, an overview is gained of the various views countries adhere to, which in turn helps in establishing the value of the proposed changes in the Discussion Draft as published by the OECD.

## 3.1 The Dutch approach to the concept of Beneficial Ownership

Up until recently, the Dutch tax system did not contain specific anti-avoidance involving the concept of beneficial ownership. Instead, the normal way to deal with avoidance situations was through the *fraus legis* doctrine,[71] developed by the court. *Fraus legis* serves as a general anti-avoidance doctrine which takes shape of a substance-over-form rule. The doctrine of *fraus legis* allows to 'see through' fact patterns when they are conjured with aim to avoid taxation. It should be noted that application of the *fraus legis* doctrine does not automatically result in the so-called fiscal redetermination of the facts. In order to re-determine a fact pattern, one first has to meet the *fraus legis* requirements:

1. tax avoidance is the predominant motive of the taxpayer in concluding the legal transactions (also known as the motive test); and
2. the effects of the fact pattern are contrary to the object and purpose of the applicable tax law (the objective test).

As the application of *fraus legis* to create a fictitious fact pattern could have severe effects in international (treaty) situations, the application of such a fiction is only warranted if the treaty faith (in Dutch: *verdragstrouw*) is not compromised. Jurisprudence of the Hoge Raad has defined the following attributes to test whether or not the treaty faith is compromised by

[71] With its equivalent that sees to treaty abuse: *fraus conventionis*.

application of a fictitious fact pattern. A domestic fiction cannot be applied in an international situation if the following – cumulative – attributes of reciprocity are met:

1. The introduction of the domestic provision results in a potential shift in the allocation of rights to levy taxes between States;
2. The treaty has been engaged in before the domestic provision was introduced;
3. There is no reciprocity; the other State has no equivalent provision in its own domestic legislation; and
4. The treaty contains no specific provision through which posterior domestic provisions can be applied regardless of the previous.

Following various decisions of the Hoge Raad regarding *fraus legis*,[72] statutory anti-avoidance provisions were implemented in the domestic law.[73] These provisions partly codify the rules set out by the Hoge Raad, and partly function as a measure to deal with issues that arose from *fraus legis* cases the State lost before the Hoge Raad.

Then the Hoge Raad – and the tax authority – also has the ability to provide an independent fiscal determination of the facts (In Dutch: *fiscale kwalificatie*). Such a determination is made when the legal appearance of a transaction does not match the economic reality, resulting in a discrepancy between, for example, civil law and tax law. With regards to conduit companies such could be the case when a transaction is presented as a loan, while in reality it is a dividend distribution.

### 3.1.1 Domestic anti abuse provisions

Aside from the judicial *fraus legis* doctrine, the Dutch system also contains a considerable amount of codified anti-abuse provisions. As this research has a focus on the concept of beneficial ownership, I will only analyze the provisions from that perspective. In respect of the effect that Dutch domestic law has in treaty situations, it should be noted that the provisions of tax treaties take precedence over conflicting domestic provisions, as codified in the Dutch Constitution.[74] The Constitution stipulates that statutory provisions are not applied

[72] The concept of *fraus legis* was first introduced by the Hoge Raad on 26 May 1929, *NJ* 1926/723 and further defined in Hoge Raad 21 November 1984, nr. 22092, BNB 1985/32; Hoge Raad 8 March 1961, nr. 14368, BNB 1961/133 and Hoge Raad 16 September 1992, nr. 27162, BNB 1993/223.
[73] See paragraph 3.1.1.2 of this thesis.
[74] Article 94 of the Constitution.

when they are of conflict with treaty provisions, which are legally binding upon all.[75] The Dutch domestic anti-abuse provisions can be separated in two categories. Firstly, the general anti-abuse provision of *fraus legis* and secondly, the specific anti-abuse provisions.

#### *3.1.1.1 General anti-abuse provisions*

In 1990, the Hoge Raad ruled on the continuation of the case HR BNB 1986/127.[76] The ruling HR BNB 1990/45 concerned a dividend payment of a Dutch company to a Canadian company.[77] Right before the payment, an Antillean conduit company was interposed. By means of this conduit it was possible to evade Dutch taxation on the dividends. The conduit filed a request for the repayment of the withholding tax levied on the dividends, which was rejected by the tax inspector on grounds of the *fraus legis* doctrine as the structure was in conflict with the object and purpose of article 11 Tax Regulations for the Kingdom (*in Dutch: "Belastingregeling voor het Koninkrijk"*).[78] The Hoge Raad agreed with the tax inspector that, instead of the interposed conduit company, the Canadian company was the actual beneficiary of the dividends. With this judgment the Hoge Raad disregarded the civil and formal reality and judged based on the circumstances of the case. Consideration 4.2 of the judgment states that, regardless of the factual payment of dividends to the Antillean conduit, the Canadian company retained her interest in the dividends. The Canadian company engaged in a transaction with the other shareholder of the conduit, so that the fact pattern implied that in reality the Canadian company retained control over the dividends. The Hoge Raad further considered that interposing the conduit merely served the purpose of evading Dutch taxation on dividends. Applying the *fraus legis* doctrine, the Hoge Raad considered the motive test to be fulfilled. Furthermore, the Hoge Raad ruled that the transactions were not in coherence with the purpose and spirit of the BRK. As a result, instead of the Antillean company, the Canadian company was established to be the beneficiary of the dividends. However, the Hoge Raad disagreed with the Court of Appeal that application of *fraus legis* implied that the Dutch company should also be denied the refund that it could have achieved under the treaty between the Netherlands and Canada. As a result, refund dividend taxation was granted up to 10% of the dividend payment, which was the applicable rate under the treaty between the Netherlands and Canada. With this judgment, the Hoge Raad opened the door for the *fraus*

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[75] Tax treaty provisions have this binding effect, and as such they take precedence over the Dutch domestic law.
[76] Hoge Raad 8 January 1986, nr. 23 031, BNB 1986/127.
[77] Hoge Raad 28 June 1989, nr. 25 451, BNB 1990/45*.
[78] Further: BRK.

*legis* doctrine to be applied in treaty situations. Furthermore, by granting the benefits, which it would have been entitled to without the structure, to the Dutch company a boundary is set to the extent on which *fraus legis* has effect. This was however refined in the decision of 15 December 1993, HR BNB 1994/259.[79] In this case, the Hoge Raad judged on a so called 'cash-box' structure. The essence of the case is the following:

Previous tax law taxed capital gains derived by substantial interest holders at a lower rate than dividend taxes. As such, there was an incentive to be deemed substantial interest holder. In order to be deemed as such, a structure was conjured through which the reserves of a company could be distributed to the shareholder in form of a sale profit. As a result, the income would be taxed to the lower capital gains rate as opposed to the rate that would be applicable to a dividend distribution. Normally, when the *fraus legis* doctrine would be applied, the capital gains would be redefined into dividends. However, in HR BNB 1994/259, the Hoge Raad applied the Capital Gains provision of the NL-US treaty, as it didn't show the intention of the Contracting States to include income that is redefined by *fraus legis* as dividends under the Dividends article to redefine the capital gains into dividend. As such, only when treaty partners apparently are in disagreement as to how a provision of a treaty should be applied, domestic provisions could be applied.[80]

In another case regarding the application of *fraus legis* in treaty situations, HR BNB 1994/252, the Hoge Raad ruled on a case in which a company located in the Netherlands repurchased its own shares.[81] Prior to the planned repurchase, a Netherlands Antilles company was interposed between a Netherlands company and its Belgium shareholders with the goal to escape Dutch dividend withholding tax. In respect to the repurchase, the Hoge Raad agreed with the Court of Appeal that the Belgian shareholders should be assumed to have interposed the Netherlands Antilles company solely for the purpose of enabling the repurchase of shares by the Dutch company, without ever having the intention to let the Netherlands Antilles company obtain the factual and economical ownership of the shares.[82] In this case, the Hoge Raad appears to have adopted an independent fiscal determination of the facts on which the treaty is to be applied. As this is a factual determination and does not substitute the factual

[79] Hoge Raad 15 December 1993, nr. 29 296, BNB 1994/259.
[80] See consideration 3.4 of the judgment, in which the Hoge Raad considers that nor from the text of the Treaty, nor from the protocol shows that the contracting parties had the common intention to also include income that is considered dividends through the application of the *fraus legis* doctrine as embedded in the domestic law of the State that redefined the income.
[81] Hoge Raad 18 May1994, nr. 28 293, BNB 1994/252.
[82] Hoge Raad 22 June 1994, nr. 29 802, BNB 1994/242, consideration 3.3.1.

circumstances for fictitious fact pattern, as is the case in the *fraus legis* doctrine, the independent determination is not affected by the treaty provisions.[83] As such, following the Constitution, the fiscal determination of the facts could be applied to the case, whereas *fraus legis* probably could not. The decision resulted in taxation of dividend taxes as if the Netherlands Antilles company was not interposed. As such, it can be derived that the application of the *fraus legis* doctrine in (tax) treaty situations is very limited. Only when there is clear disagreement between Contracting States on the interpretation of a provision, *fraus legis* could be of effect.[84]

It is interesting to put this in perspective with the current OECD Commentary regarding abuse through using a base company.[85] The commentary states that domestic anti-avoidance rules determine which facts result in a tax liability. It further states that those rules are not addressed in tax treaties and should not be affected by them. Following the introduction of these paragraphs in 2003, the Netherlands made an observation to the Commentary, in which it disagreed with the view that domestic anti-avoidance rules do not conflict with the provisions of tax conventions. Arnold and Weeghel see the *fraus legis* doctrine as a provision that goes far beyond determining which facts give rise to a tax liability,[86] as the doctrine basically redefines a fact pattern which results in a fictitious fact pattern. Therefore, when *fraus legis* could be applied in treaty situations, redefining income based on the *fraus legis* doctrine potentially leads to problems in treaty situations.[87] When the redefinition of income is not followed by the contracting state, hazards for double taxation or double non-taxation could occur. As such, the view that the Hoge Raad adheres to seems beneficial for the application of treaties.

#### *3.1.1.2 Specific anti-abuse provisions*

The Dutch legislation regarding beneficial ownership is scarce. As the Dutch definition of the concept evolved from case law, which in itself does not provide a clear definition of the concept, neither the Corporate Income Tax Act 1969 (in Dutch: *Wet op de Vennootschapsbelasting 1969*),[88] nor the Dividend Tax Act 1965 (in Dutch: *Wet op de*

[83] Arnold and Van Weeghel 2006, pp. 112-113.
[84] As follows from BNB 1994/259, consideration 3.4.
[85] 2010 OECD Commentary on Article 1, paragraph 22 and 22.1.
[86] Arnold and Van Weeghel 2006, p. 113.
[87] These problems would not arise if the domestic law of both Contracting States contains similar anti-avoidance provisions through which the redefined fact pattern can be accepted by the contracting partner.
[88] Hereinafter: CITA.

*Dividendbelasting 1965*),[89] provide an explicit definition of the concept. Article 25, CITA, links the concept of beneficial ownership to the exemption of taxation on dividends that fall under the Dutch participation exemption regime and fiscal unity regime.[90] Paragraph 2 states that the exemption is not granted when the recipient of the dividends is not the beneficial owner of those dividends. Paragraph 2 further provides the (negative) definition of the concept:

> *"a recipient of dividends is deemed not to be beneficial owner when that recipient, in relation to the enjoyed income, performed a consideration as part of a complex of transactions in which it is plausible that:*
>
> *a. the yield totally or partially direct or indirect benefitted a natural person or entity which is in lesser amount entitled to the limitation, refund or settlement of the taxation on dividends than the one who performed the consideration; and*
>
> *b. said natural person or entity directly or indirectly holds or acquires a position in shares, profit coupons or loans as meant in article 10, section 1, sub d CITA, which is comparable to his position in similar shares, profit coupons or loans prior to the moment on which the complex of transactions has commenced."*[91]

Irrespective of the advice of the Council of State (in Dutch: *Raad van State)* to codify a positive formulation on the concept of beneficial owner,[92] such a definition is not implemented in legislation. Therefore, the case law ruled by the Supreme Council on the concept of beneficial ownership is guiding in the positive interpretation of the concept.

In the Dutch parliamentary discussions on the subject, the State Secretary of Finance has stated that the effect of the domestic concept of beneficial ownership in international situations is unclear. Nonetheless, he seems to adopt the view that the domestic approach to

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[89] Hereinafter: DTA.
[90] Article 4, paragraph 7 DTA contains a similar definition.
[91] Translation of article 25, section 2 CITA. Similar provisions are included in the Income Tax Act (article 9.2) and the DTA (article 4).
[92] Additional report, Lower Chamber 2001/1, 27 896, B, 1.

the concept of beneficial ownership has international relevance as well.[93] The State Secretary of Finance bases this position from the fact that concepts that un defined in a treaty, are to be interpreted based on domestic law, unless the context requires otherwise.[94]

The provision above contains the – more restrictive – codification of the decision of the Hoge Raad in BNB 1994/217c*, in which the Hoge Raad judged on the case which concerned a company located in the United Kingdom (further: X Ltd.), which purchased dividend coupons in *Koninklijke Olie*.[95] The underlying dividends were declared at the time of purchase, however they had yet to be cleared. Once the dividends were cleared, X Ltd collected the dividends and filed a request for the reimbursement of 10% taxation on dividends based on the treaty between the United Kingdom and the Netherlands. The Netherlands imposed 25% taxation on the dividends, where the Treaty allowed a taxation of 15%.[96]

The issue brought to court was the position of X Ltd for the purpose of Article 10, section 2 of the treaty. The tax inspector discarded the request for reimbursement of the levied withholding tax under Article 10 of the treaty, based on the reasoning that X Ltd could not be deemed beneficial owner to the dividends, since she did not acquire the underlying shares. The inspector based his argument on the previous treaty, which contained the ownership requirement. There also was no reason to conclude that any alterations were intended regarding this requirement in the current treaty. Alternatively, the tax inspector claimed that X Ltd's appeal failed because when the dividend was settled, X Ltd was not the owner of the dividend coupons.

X Ltd argued that the ownership requirement regarding the underlying shares does not show from the Treaty, nor from the ratio of the provision. Furthermore, X Ltd. stated that the fact that the dividend coupons were acquired after the declaration of the dividends, but before the clearing of the dividends, did not prevent application of the Treaty.

From the decision of the Hoge Raad, several attributes to establish beneficial ownership can be derived. A person qualifies as beneficial owner when he cumulatively meets the following requirements:

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[93] NV, Kamerstukken II 2001/02, 27 896, nr. 5, p. 3; MvA, Kamerstukken I 2001/02, 27 896 and 28 246, nr. 117b, p. 4 and pp. 6-7.
[94] Ibid. pp. 4-5.
[95] Hoge Raad 6 April 1994, nr. 28 638, BNB 1994/217c*.
[96] Article 10, paragraph 2, sub b, of the 1980 NL-UK Income Tax Treaty.

- he is owner of the dividend coupons at the time of clearing;
- he has the ability to freely avail and dispose the dividend coupons;
- he can freely use the amount distributed, after redemption;[97] and
- he did not act as an agent or intermediary at time of cashing the coupons.

Furthermore, the Hoge Raad gave guidance for the definition and interpretation of the concept 'beneficial ownership', which also sees to the question whether or not the applicant for the refund should also be the owner of the underlying shares. The Hoge Raad also answered the question regarding when the requirement of beneficial ownership should be tested. The Hoge Raad considered the following:

1- The requirement that the concerned party has to have ownership of the underlying shares has to show from the Treaty; and
2- The beneficial ownership requirement is tested at the time the dividends are cleared.

On 21 February 2001, the Hoge Raad decided in the case BNB 2001/196,[98] where a company located in the Netherlands (further X NV) acted as market maker on the Amsterdam Options Exchange. X NV purchased a large quantity of put options and an equal amount of shares, right before the dividends were determined. When the dividends were declared, she sold the shares utilizing the put options. The tax inspector refuses deduction of the withheld taxation on dividends, mainly because X NV had to be aware that the transaction concerned dividend stripping by foreign shareholders. He finds ground for his reasoning with the *fraus legis* doctrine. The Hoge Raad rules that the motive of tax evasion of the foreign shareholders cannot be held against X NV. The fact that X NV cooperated gives no ground to the assumption that the evasion of taxation on dividends was the main purpose of the transaction for X NV, as opposed to achieving the related profits. By cooperating in the evasion of taxation X NV did not have the motive of evading taxation on dividends herself. As such, application of the *fraus legis* doctrine failed.

From these decisions, it can be derived that interpretation with respect to the concept of beneficial ownership of the Hoge Raad is more refined than that of the Dutch legislator as the Dutch legislation merely contains negative formulations and adopts substance requirements to determine beneficial ownership. Based on the Hoge Raad, in order to be deemed beneficial

[97] HR BNB 1994/217, consideration 4.16 of the conclusion by A-G van Soest.
[98] Hoge Raad 21 February 2001, nr. 35 415, BNB 2001/196.

owner, one should not act as an agent or intermediary for another party,[99] i.e. one cannot be regarded as beneficial owner if he is legally obliged to pass on the dividend to another person.[100] Furthermore, one has to be owner of the dividend coupons and has to be able to freely use the dividend payments. As seen in the previous chapters, this interpretation is in line with the OECD commentary on article 10 which denies beneficial ownership to a person when he acts as an agent, nominee or conduit acting as a mere fiduciary.[101]

#### *3.1.1.3 Conclusions*

The interpretation of the Hoge Raad generally considers the tax treaty to be autonomous. As such, the treaty context and provisions are predominant in decisions and less importance is attributed to the domestic provisions and definitions. Therefore, aside from situations where the intention of the Contracting States on the interpretation of a treaty provision is unclear, the effect of domestic provisions on tax treaty situations is minimal. From the international nature of treaty situations, adhering to the treaty above domestic provisions seems right. The *fraus legis* doctrine can only be applied in such situations and it seems that the Dutch Constitution prevents the domestic anti-avoidance provisions to take effect in international treaty situations.

### 3.1.2 Significant international case law on Beneficial ownership

In order to compare the Dutch interpretation of the concept of beneficial ownership to the concept in the Discussion draft and the OECD MC, it is important to put the findings in the previous section in international perspective. This section will therefore analyze the most significant case law regarding the concept of beneficial ownership in the United Kingdom, France and Canada, as I feel these decisions provide a representative overview of the various interpretations. Furthermore, the selected case law functions as reference jurisprudence on beneficial ownership cases.

#### *3.1.2.1 Indofood (United Kingdom)*

In the United Kingdom, the Court of Appeals (Civil Division) gave its decision in the *Indofood* case on March 2, 2006.[102] The case concerns an Indonesian parent company (active in the food market), which intended to issue bonds in order to finance its activities. In order to

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[99] This interpretation is in line with the OECD commentary on article 10 which denies beneficial ownership to a person when he acts as an agent, nominee or conduit acting as a mere fiduciary. See also the Conduit Report, paragraph 14, under b.
[100] Van Weeghel 1998, pp.75-77 and De Broe 2008, margin nos. 475-476.
[101] See also the Conduit Report, paragraph 14, under b.
[102] Federal Court of Appeal, 2 March 2006, nr. [2006] EWCA Civ 158 (*Indofood*).

reduce the Indonesian taxation on interest, a Mauritian subsidiary was established. This subsidiary would issue bonds and fully loan the acquired yield to Indofood. Indofood acted as guarantor for all obligations of the subsidiary in respect to her shareholder(s). By means of this structure, the Indonesian withholding tax on the interest paid by Indofood was lowered. On the level of Mauritian subsidiary, no withholding tax would be levied.

When Indonesia ended the DTC with Mauritius, an alternative solution had to be found by the intermediary between the bondholders and Indofood, JP Morgan Bank, in order to prevent Indofood from executing its right to repay early on the contracts, which were based on English law. In front of the English Judge, JP Morgan suggested that interposing a company, established and located in the Netherlands, would prevent a higher Indonesian withholding tax. In response, Indofood argued that in such a structure, the Dutch entity would not be regarded as beneficial owner by the Indonesian authorities, which would prevent the limitation of Indonesian withholding tax based on the DTC between Indonesia and the Netherlands. In its judgment, the Court finds that:

1. The term "beneficial owner" "*is to be given an international fiscal meaning not derived from the domestic laws of the Contracting States*".[103] Essentially, this part of the decision ruled out application of the English common law system in respect of the concept of beneficial ownership.[104]
2. The concept of "beneficial owner" is "*incompatible with that of the formal owner who does not have 'the full privilege to directly benefit from the income*"'.[105]
3. While interpreting the concept of "beneficial owner", the Court looked at the substance of the matter. Therefore, the Court concludes that the loans are tied and that the interposed entities are obliged to directly forward any income it receives to its parent company. Hence, it is impossible to conceive a situation in which either the Issuer (Mauritian company) or the Newco (the Dutch entity) derives any direct profit from the interest received from Indofood, apart from repaying on its obligations to Indofood. Hence, in the Court's view, "*such an exception can hardly be described as the 'full*

[103] *Indofood*, para. 42.
[104] Scholars have applauded the application of an international meaning to the concept as opposed to a domestic approach. See for example the Comment on the Discussion Draft of Robert J. Danon; and Baker 2007, p. 23.
[105] *Indofood,* para. 42.

*privilege' needed to qualify as the beneficial owner, rather the position of the Issuer and Newco equates to that of an 'administrator of the income".*[106]

4. As a final observation, the Court considers that the conclusion reached is consistent with the object and purpose of the DTCs concerned. A main consideration herewith is that the limitation on withholding tax would not be granted in case the loan was directly allocated to Indofood. Therefore, the transaction fell outside the object and purpose of the DTC.

With the decision in Indofood, the English Court seems to adopt an economic approach to the concept of beneficial ownership, which uses a substance-over-form approach as compared to the approach of the Hoge Raad which attributes more value to the civil facts than its English counterpart. While the Hoge Raad adhered to the intentions of Contracting States as written down in the tax treaty concerned, the English Court redefined the circumstances and disregarded the formal circumstances. As such, it was established that Newco could not be deemed beneficial owner, as it shows from the circumstances of the case that Newco factually was required to pass on the derived income to Indofood. It is interesting that the English Court put aside the domestic legislation, much like the Hoge Raad seems to do. The English Court, however, goes one step further by indicating that the concept of beneficial ownership should have an international fiscal meaning not derived from the domestic law of Contracting States. In other words, the concept of beneficial ownership should be globally defined, rather than between Contracting States.

#### *3.1.2.2 Prévost cases and Velcro (Canada)*

Canadian case law in relation to the concept of beneficial ownership includes three major cases, the two *Prévost* cases[107] and the recently ruled *Velcro* case.[108] Both *Prévost* cases see to the situation in which a Dutch holding receives dividends from a Canadian subsidiary over the period 1996 to 2011. The Dutch holding was held by shareholders located in the United Kingdom and Sweden. Following a shareholders contract, the holding was obliged to pass on at least 80% of its profits to these shareholders. The holding, located in the Netherlands, had just enough activities to be deemed resident of the Netherlands for tax purposes. The

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[106] *Indofood,* para. 42.
[107] *Prévost Car Inc. V. The Queen,* 2008 TCJ 231 (TCC) (*Prévost)* and *The Queen v. Prévost Car Inc.,* 2009 FCA 57 (*Prévost II).*
[108] *Velcro Canada Inc. v The Queen* 2012 TCC 57 (*Velcro).*

participation in the Canadian subsidiary was the only asset on the balance sheet of the holding company and the directors of the holding controlled the Canadian subsidiary as well. The remarkable aspect of both cases is that the Canadian Tax Court (hereinafter: CTC) relied heavily on the opinion of two Dutch tax experts, Van Weeghel and Raas. Based on their findings, it was obvious for the CTC that the Dutch holding company would qualify as beneficial owner based on the Dutch tax- and company law. Furthermore, for Dutch tax purposes the shareholder contract was ignored, so the holding company had no recognized obligation to pay 80% of the gained profits to the shareholders. The CTC gave a definition of the concept of beneficial owner in the first *Prévost* case: *"the person who enjoys and assumes all the attributes of ownership"*,[109] essentially posing the question whether the Dutch company enjoys possession, use, risk and control of the amounts it received from the Canadian corporation, and whether or not it acts as an agent, conduit or nominee in relation to that income. Based on Dutch law,[110] the holding qualifies as beneficial owner, which leaves the ultimate recipient of the dividends irrelevant for the beneficial ownership requirement. This definition is confirmed in the second *Prévost* case, ruled by the Canadian Federal Court of Appeal.[111]

Then, on 24 February, 2012, the Canadian Court decided in the *Velcro* case. The case involved royalties paid by Velcro Canada Inc. (VCI), to a related Dutch company. These royalties were due under a license agreement regarding the usage of certain intangibles which were put at the disposal of VCI by the Dutch company. The royalties used to be paid directly to Velcro Industries BV (VIBV), a resident of the Netherlands. Then VIBV's tax residency was moved to the Netherlands Antilles. Canada has no treaty with the Netherlands Antilles, so as a result, VIBV assigned its rights regarding the license agreement to Velcro Holdings BV (VHBV), a resident of the Netherlands and a subsidiary of VIBV. When VHBV received royalties, they were deposited into its own bank account for the 30-day period. As a result, the royalties mixed with other funds, converted in other currency, and were used at will by VHBV for business purposes.

The issue in *Velcro* was whether VHBV could be deemed the beneficial owner of the royalties it received from VCI. When VHBV was in fact the beneficial owner, it would have access to the reduced rate of Canadian withholding tax under the DTC between Canada and

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[109] *Prévost,* para. 99.
[110] Article 2, paragraph 1 CITA.
[111] *The Queen v. Prévost Car Inc.,* 2009 FCA 57.

The Netherlands. Testing against the beneficial owner test as described in Prévost I, the CRA stated that VHBV was not the beneficial owner because of the assignment contract. The CRA considers that, in case VHBV was not interposed, a withholding tax of 25% would have been applicable. Therefore, the CRA claimed that VHBV was merely acting as an agent for VIBV.

The Court rejected the claims of CRA and ruled that VHBV was in fact the beneficial owner of the received royalties. The Court considered that, even though VHBV was contractually required to pay money onward to VIBV, it retained some discretion as to the use of the royalties for the time they were in VHBV's bank account. Hence, the beneficial ownership test was passed by VHBV and could not be considered a conduit, as the beneficial ownership test of *Prévost* required a full lack of discretion as to the use of the royalties.[112]

In essence, this means that the Canadian Tax Court puts particular emphasis on the element of legal control over the income, as by the Velcro case, even some discretion is enough to qualify as beneficial owner. As such, in comparison to the Netherlands – the Hoge Raad takes treaty provisions as predominant, but also endorses a substance-over-form approach – the Canadian Tax Court adopts a much more restrictive approach on when one does not qualify as beneficial owner: *some* discretion to the income is sufficient to qualify as beneficial owner. When a connection is made between the Canadian view and the OECD Discussion Draft, it comes obvious that the requirement is virtually the opposite of that of the Discussion Draft, as the Discussion Draft requires *"full right to use and enjoy the dividend that it receives"*.[113]

#### *3.1.2.3 Royal Bank of Scotland (France)*

In 2006, the French Court, *Conseil d'Etat*, decided in the well known *Royal Bank of Scotland* case.[114] This decision sees to the case in which a parent company in the United States granted the temporary usufruct on several *'preferred non-voting shares'* in her 100% subsidiary located in France, to Royal Bank of Scotland which was located in the United Kingdom. A condition on the transaction was that the purchase price would be repaid within a period of three years by means of dividend payments by the French subsidiary. Hence, there was no risk for RBS, as the US parent company stood guarantor for its French subsidiary. Therefore, in case the subsidiary was unable to make the dividend payment, the parent company would do so. Additionally, the parent company would provide additional compensation in case RBS

[112] *Velcro,* considerations 50-55.
[113] OECD Discussion Draft, proposed paragraph 12.4.
[114] Conseil d'Etat, Judgment of 29 December 2006, No. 283314 (RBS).

would not receive the redemption of the *avoir fiscal.* By means of this construction, access to the favorable DTC between France and the United Kingdom was gained. And as such, the US parent company could claim refund of the *avoir fiscal*. When the dividend payment went directly to the parent company from the French subsidiary, the refund of the *avoir fiscal* would not be applicable. The French Tax Authorities did not deem RBS as the beneficial owner for the dividends paid by the French subsidiary. It was argued that the compensation paid by RBS on the usufruct was exactly equal to the value of the predetermined dividend payments. Hence, the construction was in fact a loan to RBS by the parent company, with the *avoir fiscal* as benefit for RBS. [115]

The French Court ruled the main purpose of the construction to be that of gaining access to the DTC, with the sole purpose to hide the underlying transaction. The Court redefined the construction to be a loan to RBS, followed by repayment by means of the dividends received. As such, the construction was disregarded and taxation occurred as if the sale of the usufruct did not take place. It seems that the French Court adopted a similar approach as the *fraus legis* doctrine, as it replaced the actual fact pattern with a fictitious fact pattern in order to be able to levy tax. As such, the French approach to the concept of beneficial ownership seems to be more strict than that of the Hoge Raad, which leaves very little room for application of domestic provisions such as the *fraus legis* doctrine.

## 3.2 Conclusion

From the above it comes clear that there are deviations in the interpretation of the concept of beneficial ownership amongst the various courts. The Hoge Raad, for example, considers the treaty provisions as predominant in deciding on beneficial ownership cases. It also sees little room to use the *fraus legis* doctrine in treaty cases. As the substituted fictitious circumstances replace the actual circumstances, a fact pattern is conjured which is unlikely to be followed by a contracting state, through which hazards of double taxation or double non-taxation arise. In the significant international case law, consensus seems to be on a substance-over-form approach to the concept of beneficial ownership. However, differences occur in the extent to which the substance-over-form approach is utilized. The French Court, for example, seems to apply some form of *fraus legis* in redefining the fact pattern. The United Kingdom explicitly discarded the application of domestic definitions in interpreting the concept of beneficial ownership, which is more in line with the Dutch approach, yet puts more emphasis on the

[115] Martin Jiménez 2010, p. 46.

object and purpose of the treaty. The Hoge Raad adheres more to the intentions of the treaty partners, and only deviates from that when the intentions are obviously unclear or contradictory. The Canadian court on the other hand seems to have come back from a substance-over-form approach to a more formal approach with the *Velcro* case, in which even some discretion would suffice to be deemed beneficial owner.

However, since the proposed Commentary now explicitly advocates a substance-over-form approach in the new proposed paragraph 12.4,[116] it seems that an economic view to the concept has become predominant in interpreting the concept of beneficial ownership. Therefore, in order to reach an uniform definition, the views of the Dutch and Canadian legislators would probably have to be geared towards an economic approach in order to reach a uniform definition. However, as there is no binding effect from the OECD MC and its Commentary, there are hurdles to be taken. Should the uniform concept be reached, it would probably contain an equivalent of the *fraus legis* doctrine situations of tax avoidance.

[116] OECD Discussion draft: Clarification of the meaning of Beneficial Ownership in the OECD Model Tax Convention, para. 12.4.

# 4. Conduit companies

This research evaluates the concept of beneficial ownership as an anti abuse provision dealing with tax evasion issues arising from interposing intermediaries, with focus on conduit companies in the Netherlands. As the Netherlands have a widely expanded tax treaty network, it is an inherently popular country for interposing conduit companies. Including an evaluation of the term 'conduit companies' is thus of great importance for this thesis in order to gain an understanding as to what the issues from conduit companies exactly are and how the Dutch domestic law and regulations treat such companies. This Chapter will first analyze the OECD report on Conduit Companies, after which the Dutch legislation and regulations will be evaluated.

## 4.1 OECD Conduit Report

In 1987, ten years after the introduction of the concept of beneficial ownership into the OECD MC, the OECD Council published several reports on tax avoidance and tax evasion.[117] With respect to this thesis, the report on conduit companies is especially of interest.[118] As briefly touched upon before,[119] various methods of international tax planning include the use of interposed companies in tax favorable jurisdictions. As a result, the Conduit Report aims to provide clarifications on the interpretation of the concept of beneficial ownership in relation to the use of conduit companies. As the Direct Conduit strategy and the Stepping Stone strategy have already been explained, this paragraph will focus on the problems and possible solutions which arise from the interposing of conduit companies.

In paragraph 14, the Conduit Report excludes the limitation of tax under the treaty for entities which would not be entitled to the treaty benefits without interposing an conduit company:

*"Thus the limitation* [of tax, MW] *is not available when, economically, it would benefit a person not entitled to it who interposed the conduit company between himself and the payer of income."*[120]

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[117] These reports were originally published in OECD Committee on Fiscal Affairs, *International Tax Avoidance and Evasion, Four Related Studies,* Issues in International Taxation Series, No. 1 (OECD, Paris 1987).
[118] Further referred to as Conduit Report.
[119] See paragraph 1.4 this thesis.
[120] Conduit Report, paragraph 14, letter b.

Furthermore, the Conduit Report considers that not only the agent or nominee should be excluded from the treaty benefits, but also the person or company that has similar characteristics as agents or nominees:

> *"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 interest parties."*[121]

In practice it will most likely proof very difficult for the State of source to establish that the interposed conduit is not the beneficial owner, especially as the OECD considers the fact that the company's main function is to hold assets and/or rights not to be sufficient to regard the entity as a mere fiduciary. As a solution, the OECD suggests that adopting a definition of the concept of beneficial ownership at time of bi-lateral treaty negotiations could provide a solution to the problem. In the Conduit Report, the OECD Council provides various recommendations on improving the way the problems with conduits are dealt with, of which the consideration about specific provisions relating to conduit companies is of particular interest. It provided a general guideline of benchmarks which treaty negotiators can use in creating specific conduit provisions.[122] Aside from adopting anti-abuse provisions in the tax treaties, States have recently started to counteract the information asymmetry by engaging in so called Tax Information Exchange Agreements (TIEA's). By exchanging information about (intended) transactions of companies through conduits, more information is available for the State of Source to establish whether or not a conduit company acts as a mere fiduciary. While this works on paper, the State in which the conduit is resident is unlikely to have all relevant information. Therefore, even exchanging information between States regarding transactions which use a conduit company is possibly not enough to counteract the information asymmetry. It should be noted that domestic legislation of Contracting States could also provide in attributes to ease the process of evaluating a conduit company.[123]

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[121] Conduit Report, paragraph 14, letter b.
[122] OECD Commentary on Article 10 (11 April 1977), para. 22.
[123] For example, the Dutch rules regarding substance (see further: paragraph 4.2 of this thesis).

## 4.2 Dutch domestic approach to conduit companies

### 4.2.1 Introduction

Based on the CITA, a company incorporated under Dutch law, e.g. a limited liability company or *besloten vennootschap* (BV), is deemed to be tax resident in the Netherlands.[124] By passing dividends, interests and royalties through a company incorporated in the Netherlands, access is gained to the Dutch treaty network, as the Dutch entity will be considered resident of the Netherlands for treaty purposes.[125] Most of the DTC's engaged in by the Netherlands contain a provision that limits the power of the other Contracting State to levy tax on the interest and royalty income[126], which opens up tax planning opportunities in situations where the tax rates based on the Dutch treaties are lower than those that would be applicable when the interests and royalties would not pass the Netherlands. In order to combat this unwanted form of treaty shopping, exceptions to this principal deeming provision apply with respect to certain Dutch tax facilities/provisions.[127] In those cases, the residency of a company is determined based on the company's place of effective management at which the company's (key) strategic business decisions are taken.[128] Such determination is made according to the prevailing facts and circumstances and hence, takes a substance-over-form approach. As the beneficial ownership aims to function as an anti abuse provision, the substance-over-form approach is, in my opinion, the correct approach to the concept. A legal approach would not work, as evasion of a legal provision is as simple as creating the appropriate legal documents, leading to a useless provision.

Furthermore, regarding the issuance of advance tax rulings ("ATRs") and advance pricing agreements ("APAs"), the tax authorities require a certain minimal level of substance, based on a resolution issued by the Ministry of Finance. The requirements, as laid down in the aforementioned resolution, should be considered as the bare minimum in order to become

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[124] Based on Article 2, paragraph 4, CITA, a company incorporated according to Dutch law, is deemed to be resident for purposes of the CITA. A similar provision is found in article 1, paragraph 3, Dividend Tax Act.

[125] Article 4 of the OECD Model Tax Treaty defines a resident for treaty purposes as follows: *"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 […]."*. As seen above, the BV is liable to tax in the Netherlands based on Article 2, paragraph 4, CITA.

[126] Articles 10 and 11, paragraphs 1 and 2 of the OECD Model Tax Treaty. Article 12, paragraph 1, provides for an exclusive right to levy tax for the other Contracting State.

[127] For example, the Dutch fiscal unity rules, and situations within an international tax treaty context.

[128] In some tax treaties concluded by the Netherlands, the seat of the company is the decisive criterion based on which it is determined in which jurisdiction the company is tax resident.

eligible for an ATR/APA, and hence cannot necessarily be relied on in a tax treaty context or any other tax provision for which the place of effective management is of importance (e.g. fiscal unity formation). The following section explains the APA/ATR practice in more detail.

### 4.2.2 The Dutch APA/ATR practice and conduit companies

Before 2001, the Netherlands had a ruling practice by means of which tax payers could obtain certainty with respect to the effects of the Dutch tax law on intended transactions. However, in the report of the 'Primarolo Working Group',[129] which investigated harmful tax provisions across the European Union, the Dutch ruling practice was considered harmful tax competition.[130] As there was little to no transparency as to which Rulings were granted, I believe the Primarolo conclusion to be justified. Following the report, the Dutch Ministry of Finance announced to consider legislation regarding deduction of foreign withholding tax on so called financial servicing activities, following the criticism expressed by the 'Primarolo Working group'. This decree aimed to reshape the Dutch ruling practice, to dispose of the issues risen by the Primarolo report. As a result, the Dutch Ruling practice was changed drastically, which resulted in the APA/ATR practice aimed to provide more transparency to external parties. The policy regarding these new types of rulings was recorded in decrees, the first of which was published in 2001.[131] This decree distinguished between two situations: firstly the situation in which a Dutch company has sufficient real economic substance, which is to be tested on a case to case basis, and secondly the situation in which the specific substance requirements of article 8c, CITA, are met, but there is no real risk involved for the company with respect to related transactions.[132] In case of insufficient substance at the Dutch company, not only the requested ruling would be denied, but also information would be exchanged with all treaty partners concerned regarding all - or some - transactions on which the ruling was requested.[133] This provides treaty partners with additional information to combat the information asymmetry, which helps them in determining whether or not to grant treaty benefits with respect to, for example, distributions of dividends, interests and royalties. As such, the treaty partner is able to deny limitation of its withholding tax to the conduit company when the ultimate beneficial owner turns out not to be a Dutch resident.

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[129] The Primarolo Group was instituted following the Behavioral Code against harmful tax competition, adopted by the Ecofin Council on December 1, 1997.
[130] Primarolo report of November 23, 1999, Doc. SN4901/99, V-N 2000/6.6, p. 518.
[131] Ministry of Finance 30 March 2001, IFZ2001/294M, BNB 2001/285.
[132] Ibid.
[133] When there is little to no risk involved by the Dutch company, yet sufficient substance is present, only information relating the transactions that were of limited risk is exchanged.

Furthermore, the decree also used to limit the settlement of the remaining foreign withholding tax with the Dutch taxation on corporate income when the financial servicing entity practically serves as an intermediary. This limitation on settlement of the foreign withholding tax was later codified in the CITA, which provided a legal base for the application of the decree.[134]

In 2004, the Dutch Ministry of Finance has amended the original 2001 decree with respect to companies providing intercompany financing/licensing activities. By issuing the so called "Financial Services Resolution", inter alia, the item of minimum substance in the Netherlands in the context of such Dutch intercompany financing/licensing entities is addressed.[135] The annex to the resolution contains a list of criteria to be used to determine whether an entity will be regarded as having sufficient substance in the Netherlands.[136] Although applicable to the specific context of intercompany financing and/or licensing activities, this list can also be used as an indication for the relevant criteria to determine the substance of a conduit. The indicative criteria mentioned in the Resolution are the following, although it should be noted that the list is not exhaustive and can thus be deviated from:

1. At least 50% of the directors of the entity are resident in the Netherlands.
2. The Dutch resident directors have the required professional knowledge to perform their duties satisfactorily. The duties of the (aggregate) directors include at least the decision making on any transactions to be entered into by the entity and a proper fulfillment of such transactions. The entity should have qualified personnel (directly employed by the entity or hired from third parties) to fulfill and administer the transactions entered into by the entity.
3. Important decision of the board of directors must be taken in the Netherlands.
4. The bank account(s) of the entity must be maintained in the Netherlands.
5. Bookkeeping of the entity must be done in the Netherlands.
6. The entity correctly fulfils its duties with respect to filing tax returns

[134] Article 8c, CITA.
[135] Ministry of Finance 11 August 2004, IFZ2004/126 , BNB 2004/376.
[136] Ibid, annex.

(corporation tax, VAT, wage tax, whichever are applicable).

7. The principal place of business of the entity is in the Netherlands. The entity should not be regarded as resident in another country.
8. The entity has sufficient equity (taking into account assets used and risks assumed) to fulfill its activities.

As I support the use of substance-over-form attributes in determining residency of a conduit company, the above criteria should in my opinion be sufficient to establish the substance of a company. As it shows, the conditions require the company to have all effective business decisions to be made in the Netherlands, by Dutch residents. In my opinion, by looking at the employed personnel, the place where the bank account is held, where the books are kept and the equity present in the entity sufficient attributes are in place to ensure that the company has all relevant business aspects located in the Netherlands. Furthermore, these requirements make it impossible for a letterbox company to qualify for the substance requirements. In a recent response to the resolution of Members of Parliament Braakhuis en Groot regarding the Dutch substance requirements,[137] the State Secretary of Finance stated that in his opinion the substance requirements in itself have no autonomous legal relevance and is as such not a qualified autonomous criterion to counteract treaty abuse.[138] I adhere to this view, as using the substance requirement as a autonomous anti abuse provision would be conflicting with the Dutch company law and the CITA.[139] From literature and case law it shows the place of effective management in particular is of great importance for meeting the substance requirement.[140] The place of effective management can only be determined on a case by case basis, based on the facts and circumstances of the case.[141] This provides for practical issues in determining the attributes on which the place of effective management can be tested. However, some guidance can be derived from case law as to what are the important items and/or considerations. The place of effective management is, in principle, equal to the place where the board of an entity exercises its management activities. Consequently it is assumed that the board is also responsible for the management of the entity. However, it is possible that

[137] Kamerstukken II 2011/12, 33003 nr. 62.
[138] Ministry of Finance 25 June 2012, IFZ/2012/85U.
[139] For example, the fiction of article 2, paragraph 4 CITA and Book 2 of the Dutch Civil Code, which regulates the incorporation of entities.
[140] Brood 1989, para. V.1.2.4.11; Van Raad 2011, para. IBR.3.2.4.B.d; De Graaf, Kavelaars and Stevens 2011, para. 1.4.3.
[141] Article 4, General Law on State Taxes (in Dutch: *Algemene Wet inzake Rijksbelastingen*).

the management of an entity lies with a third party. In that case, it is possible to deem the place from which that party exercises its management activities as place of business of the entity.[142] The State Secretary of Finance also adopts the definition of the Hoge Raad for the purpose of determining the place of effective management of an entity,[143] so that this definition effectively is agreed upon by the concerned parties in the Netherlands. This definition is further refined in several cases by the Hoge Raad,[144] resulting in the following definition:

> *"In the evaluation of the circumstances regarding the place of business of an entity, it has to be assumed that, in principle, the effective management of that entity lies with its board, and that the place of business is equal to the place at which the board executes its managing activities. When exercising the managing task the board can be supported by third persons, provided an adequate reward is paid for this assistance. However, when it is likely that the effective management is exercised by someone other than the board, there may be cause to assume the place at which that other person exercises the management activities. The burden of proof that the effective management is exercised by someone other than the board, lies with the inspector. Should the facts and circumstances cited by the inspector provide a convincing and sufficiently objectified suspicion that the effective management is exercised by someone other than the board, the burden of proof on that matter shifts to the company to refute this presumptive evidence."* [145]

Furthermore, case law also provides circumstances which can serve as an indication/tool to determine the place of effective management in respect to a Dutch holding/financing company.[146] Considering the importance of the management activities, the authority of the board members to execute agreements on behalf and in the name of the Dutch company, which authority is normally and regularly exercised in the Netherlands, could show management relations. Furthermore, the circumstance whether or not board decisions are

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[142] E.g. Hoge Raad 23 September 1992, nr. 27.293, BNB 1993/193, para. 3.3.3; Hoge Raad 3 February 2012, nr. 10/05383, BNB 2012/126; Hoge Raad 29 May 2009, nr. 43 632, BNB 2009/184 and Hoge Raad 12 May2006, nr. 39 223, 39 224, 39 225, V-N 2006/25.9.

[143] Decree of 6 March 2001, nr. CPP2000/3020, NTFR 2001/436.

[144] Hoge Raad 17 December 2004, nr. 39.719, NTFR 2004/1867 and Hoge Raad 17 December 2004, nr. 39.720, NTFR 2004/1859.

[145] Derived from the note accompanying those cases, published in FED 2005/44.

[146] Derived from Vakgroep Belastingrecht RU Groningen 1999, Chapter 1, para. 2.2; and Burgers 2005, para. 4.2.4.3.

made during physical meetings in the Netherlands, which take place on a frequent basis consistent with the Dutch companies policies and activities, is also valuable in determining effective management.[147] Additionally, administrative aspects could provide insight. When the bank accounts and administration are kept in the Netherlands and the entity has both a registered address and business address in the Netherlands (and also uses those addresses on its corporate documentation), it is probable that the Dutch entity has sufficient substance.

## 4.3 Conclusion

The Committee on Fiscal Affairs expanded the concept of beneficial ownership as originally included in the 1977 OECD MC, by elaborating the group of persons that do not qualify as beneficial owner. From the report, it is obvious that the Committee adheres to a substance-over-form approach where all facts and circumstances should be used in the process of determining whether or not an entity qualifies as beneficial owner. However, irrespective of the elaborations done, the Conduit Report did not formulate a positive definition of the concept of beneficial owner, but let it to the contracting parties to determine their interpretation of the concept. However, it did come clear that a conduit company merely acting as an intermediary, does not qualify as beneficial owner. Therefore, conduit companies are now to be tested on their substance.

Due to the lack of a positive definition, domestic law is of great relevance in interpreting and testing the concept of beneficial ownership relating to conduit companies. The Dutch tax system mainly adheres to whether or not a conduit company has sufficient substance in the Netherlands to be deemed resident for treaty purposes. In my opinion, the alternative legal approach to conduit conduits for determining residency for treaty purposes does not match with the anti abuse nature of the beneficial ownership concept. When a legal approach would be used, residency could be obtained by incorporating a company in such a way it matches the domestic and treaty provisions.[148] When an entity lacks this substance, received and paid interests and/or royalties are disregarded from the Dutch tax base. Substance is to be tested against the factual circumstances, including the seat of management, the board meetings, the place where the administration is kept and whether or not a company has – and uses – a corporate address. The Dutch ruling practice requires that applicants for rulings meet strict requirements, especially so after the Primarola report. Therefore, the testing of substance of companies in the Netherlands is of great relevance, as gaining prior certainty to intended

[147] It is also of relevance whether or not records of these meetings exist.
[148] For this purpose, incorporating by laws of - and choosing residency in - the intended conduit country would suffice, as the company then is fully liable to tax in that country.

transactions is of great benefit to multinational organizations. When a company is deemed to have insufficient substance, it could pose a tax risk for the organization as the information relating (all) intended transactions is shared with other Contracting States. As the attributes of substance requirements are derived from case law, discrepancies are likely to occur between different States. Since nor the OECD, nor the Conduit report provides a framework to test when exactly one serves merely as a fiduciary, the rules concerning conduit companies are unclear at best. As the legal circumstances of a conduit are well documented – and as such can be assessed – the most difficulty with the interpretation of the concept of beneficial ownership regarding interposed conduits arises from the substance requirements mentioned in the Discussion Draft, the Conduit Report and the Dutch ATR/APA ruling decrees. Therefore, providing more clarity on the substance requirements is necessary. When the concept is adequately defined either in the OECD Commentary, or by other means[149], international trade benefits from it as the risks relating various definitions is thus eliminated. The attempt made at defining the term beneficial owner – and the substance requirement – in the Discussion Draft is laudable, though in my opinion does not meet the required level to function in providing a definition of the substance requirements for treaty negotiations. Currently, these interpretations are still based on domestic legislation which results in prolonged uncertainty with respect to the application of beneficial ownership. In order to be able to properly determine the nature of a conduit company, the difficulties in defining the nature of business of that conduit should be removed to the furthest extend possible. In my view, a solution would be to disregard domestic laws in the definition and adhere to a global definition. However, considering the questionable role the OECD MC and the Commentary play in interpreting the treaties,[150] this would prove to be a long and difficult process to achieve.

[149] In this respect, be referred to my recommendations in para. 6.2 of this thesis, which provide several options.
[150] See Chapter 2 of this thesis.

# 5. A practical analysis of the application of the beneficial ownership requirement

In order to put the previous – rather abstract – findings of the concept of beneficial ownership in perspective, this chapter will analyze the current standing of the concept with respect to a fictitious (and hypothetical) case, in which all relevant differences should come clear. With this respect I appreciate that paper is patient and that various other cases could be conjured in which the outcome might be different. As such an overview of the impact of the intended paragraphs is gained, as well as an understanding of the differences that would occur when the case would be treated with respect to domestic law, or based on the OECD MC.[151]

The case to which the effects of the beneficial ownership requirement are tested is the following:

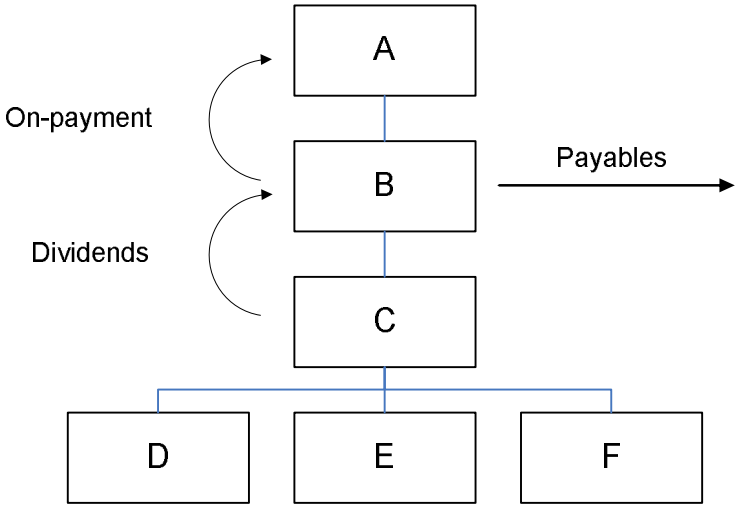


**Figure 2 – Exemplary Case**

In this situation, B functions as an interposed company in a state with a favorable tax treaty with State C, the State of Source. There is a favorable withholding tax rate on dividends between States A and B (either based on the treaty, or possibly based on application of the Parent-Subsidiary Directive, which exempts dividend distributions in EU Member States from taxation). Company B functions as a financing company in the group and as such has payables to external parties.[152] Assume the dividends are its only source of income, and any

[151] As this thesis uses the Dutch tax system as reference, the evaluation of domestic law will exclusively see to Dutch law.

[152] The company could have any other function in a concern. However, as financing companies are more likely to have cash flows run through them, I utilize a financing company for my example.

excess dividends are immediately paid onwards to the parent company in State A, with the exception of an at arm's length remuneration for the financing services, a so-called spread.[153]

In the following paragraphs, I will analyze the effects of the beneficial ownership requirement on the case under: (a) the current OECD MC and the Commentary, (b) the Commentary based on the proposed changes of the Discussion Draft, (c) the Commentary based on my changes to the Discussion Draft and (d) the Dutch domestic rules and legislation.

## 5.1 The effects under the current OECD MC and Commentary

The current Commentary features three paragraphs on the subject of beneficial ownership, paragraphs 12, 12.1 and 12.2. As seen before, these paragraphs explain how the concept should be interpreted, though not in a very elaborate way. Application these paragraphs leads to the test of whether or not the interposed company has sufficient power with respect to the income derived.[154] As the financial center, the company is responsible for the cash flows of the organization. Therefore, it has some discretion as to how the funds are distributed. However, as company B is an intermediate company in the chain, the ultimate power to decide what happens with the cash flows lies with company A, as its major shareholder. Regardless, it seems likely that the interposing of company B followed from business motives, as interposing a financial center in a tax favorable jurisdiction is normal practice to limit unnecessary taxation on intercompany cash flows. As such, granting the treaty benefits to company B would not be contradictory to the object and purpose of the Convention. Therefore, under the current Commentary, the facts and circumstances of our case should pass the beneficial ownership requirement, as a result of which company B is eligible for the limitation of taxation under the treaty between States B and C.

## 5.2 The effects under the proposed OECD Commentary

As our case sees to a legitimate company, the outcome under the proposed text should be the same under the proposals. However, there are various alterations to the Commentary that could warrant another treatment for our case. As stated in the introduction to this chapter, company B functions as a financial center. As such, it has engaged in contracts and agreements under which the company is obligated to make payments. While the function of company B is still the same as before – one can safely assume that the company is more than

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[153] A 'spread' is a percentage of the income received and paid-on income, which serves as 'payment' for the services of the entity – in this case, company B.

[154] Commentary on article 10, paragraph 12.1 states: *"[…] 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."*

a letterbox company – it is has legal obligations to pay the money it receives from the dividend distributions. Furthermore, it is required to pass on any excess cash to the parent company A. With finance companies, this is not uncommon practice and is thus likely to be business motivated. However, as these obligations could be considered legal (or factual) obligations, and company B effectually has no say in the income it receives, the treaty benefits could now very well be denied for company B, even though it is in no way an interposed conduit acting as a mere fiduciary. This overkill was criticized by (almost) all public parties that commented on the Discussion Draft as well and it should in my opinion be made absolutely clear how this provision is intended to take effect.

## 5.3 The effects under the amended proposed OECD Commentary

In order to prevent the effect that is described in the above paragraph, I have amended the proposals to avoid this potential overkill.[155] Under these amendments it is sufficient to retain some power to exercise control over de dividend received in order to qualify as beneficial owner. As such, in our example, company B controls the cash it pays on basis of its legal obligations. By means of the at arm's length remuneration retained by company B for its intergroup financing services and the discretion company B has with respect to the payments it has to do to external parties, the following on-payment of the income received is cleansed of tax avoidance motives as the payment is no longer fully and immediately passed on.[156] In our example, first the payments to the external parties are done, and any excess is then transferred to the parent company. As such, through the amended proposal, company B would qualify as beneficial owner and be granted the treaty benefits.

Should company B in our example however not be required to make third party payments, but solely be required to pass on the received dividends to the parent company A, company B would fall under the provision of paragraph 12.4, as it does not have any legal, factual or economical power to exercise control over the income received. The fact that company B retains an 'at arm's length' spread for the services provided does not prevent denial of the treaty benefits, as it is obligated to pass on the full payment it receives in the same legal form. As such, the amended proposal better functions as a beneficial ownership requirement than the proposed paragraph. Overkill is eliminated and actual tax avoidance structures are identified and dealt with accordingly.

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[155] For the full text of my amendments, be referred to Annex II.

[156] Since the remuneration and the external payments are subtracted from the original amount of income received.

## 5.4 The effects under Dutch legislation and definitions

Since only residents of Contracting States are entitled to the treaty benefits, when it is assumed that company B is incorporated in the Netherlands, it must be tested whether or not company B qualifies as a resident for treaty purposes. In the Netherlands, this means that substance requirements must be passed.[157] The main attribute in determining the substance of a company is the place of effective management. Albeit applicable for the ATR/APA practice, the criteria mentioned in the Financial Services Resolution should therefore provide a solid starting point for determining treaty residency as well.

Testing against these criteria, it proves vital that all relevant board meetings and decisions are held and made in the Netherlands. The company also is required to have sufficient equity, hold a Dutch bank account and all books must be kept in the Netherlands. As company B serves as a financial center for the group, it is given that the substance requirements are met for this company, which establishes company B to be resident for treaty purposes.

Now that company B is established to be resident of the Netherlands for treaty purposes, it should be determined whether or not it qualifies as beneficial owner with respect to the received dividend distributions from company C.

As seen above, the Dutch domestic law contains no positive definition of the concept of beneficial ownership. In our case, from the negative formulations in the CITA, DTA and ITA can be derived that company B qualifies as beneficial owner when the parent company A, to which the income is paid on, is entitled in to the same benefits, when the distribution was paid directly to company A by company C.

> *Article 25, section 2 CITA*
>
> a recipient of dividends is deemed not to be beneficial owner when that recipient, in relation to the enjoyed income, performed a consideration as part of a complex of transactions in which it is plausible that:
>
> *a.* the yield totally or partially direct or indirect benefitted a natural person or entity which is in lesser amount entitled to the limitation, refund or settlement of the taxation on dividends than the one who performed the consideration; and
> *b.* said natural person or entity directly or indirectly holds or acquires a

[157] Article 4, General Law on State Taxes.

> position in shares, profit coupons or loans as meant in article 10, section 1, sub d CITA, which is comparable to his position in similar shares, profit coupons or loans prior to the moment on which the complex of transactions has commenced.[158]

In our example, the excess income is passed on to parent A, not entitled to the same benefits as company B under the treaty between State B and C. As such, following the provision of Article 25 CITA, the requirement of (a) is met. Furthermore, the parent company A retains all interest in company B, meeting requirement (b) as well. Thus, it is likely that company B could be denied the status of beneficial ownership. In the Netherlands, however, case law limits the application of domestic law in treaty situations. Therefore, the relevance of the domestic definition of the concept is questionable. As the jurisprudence of the Hoge Raad states,[159] domestic legislation and anti-avoidance provisions can be applied when the intentions of the contracting parties are at doubt. In the situation where there is no consensus between Contracting States, on how the concept of beneficial ownership should be interpreted, the definition of the Hoge Raad[160] can be applied. Testing these attributes, it is unlikely that company B qualifies as beneficial owner. When the relevant payments are made to the external parties, company B is required to pass on any excess cash to the parent company A. As such, there is no ability to freely avail and dispose of the dividend coupons, nor can the amounts distributed be freely used. However, under the APA/ATR practice, it is possible for company B to obtain certainty with respect to the application of Dutch taxation. As company B is likely to meet the substance requirements, it could well be granted a ruling that grants the company the status of beneficial owner for treaty purposes. When such a ruling is obtained, there is no dispute regarding the status and as such, the Hoge Raad's attributes will not have to be tested against, as the case will not be brought to court.

[158] Similar provisions are included in the Income Tax Act (article 9.2) and the DTA (article 4).
[159] See Section 3.1 of this thesis for an in depth analysis.
[160] Hoge Raad 6 April 1994, nr. 28 638, BNB 1994/217c*, the definition is provided in Chapter 3 of this thesis.

## 5.5 Conclusion

It shows that the result in our case is that the status of beneficial ownership should be granted under the current concept of beneficial ownership. As in our case, company B serves a legitimate business function – that of a finance center – in the international group, this is the proper outcome of the case, as there is no tax avoidance intended by interposing the structure. However, the current text of the proposed changes potentially lead to a different outcome, in which the treaty benefits would be denied for the conduit company, based on the obligations it has to make payments to the external party from his function as a finance center of the group. The amendments I made to the proposals fix this potential overkill, resulting in a situation that excludes the overkill, yet still limits treaty benefits to structures that are implemented with the sole purpose of avoiding taxation by means of interposing a conduit company. The Dutch tax law itself does not provide statutory anti-abuse provisions with respect to beneficial ownership. As such, based on case law the beneficial ownership status could possibly be denied in our situation, as the attributes that the Hoge Raad has formulated are not fulfilled. However, due to the ATR/APA practice of the Netherlands, company B should nonetheless be regarded as beneficial owner since the substance requirements are met.

# 6. Recommendations and Conclusion

## 6.1 Recommendations

The incentive for my research comes from the ongoing debate on the concept of beneficial ownership. Even though the legal position of the Commentary and the OECD MC is not uncontested, they still play a very important part in the interpretation of treaty provisions across the globe. As it stands, the current concept of beneficial ownership leads to considerable risks of on double taxation, or double non taxation, depending on the interpretation that is adopted by Contracting States. With its Discussion draft, the OECD Council aims to clarify the concept, and give guidelines on the interpretation of the requirement, aiming to take away the uncertainty around the concept of beneficial ownership. It can be concluded that the proposals in the Discussion draft certainly proved to be a step in the right direction. However, I have found that the use of broad language and vague terms could potentially give tax authorities the opportunity to apply the beneficial ownership test at will.[161] Combined with the potential overkill (which would deny entities, that exist for perfectly legit business purposes, the benefits of the treaty), included in the broad wording of the proposal, the current text is likely to create uncertainty instead of counteracting it. As such, I have tried to formulate improvements to the Discussion draft, which in my opinion should fix the issues brought up by the various public parties that commented on the Discussion draft.[162] These improvements mainly see to removing the overkill in paragraph 12.4 by adopting a more narrow formulation of the attributes included in the Discussion draft, which lead to a more defined beneficial ownership test. Furthermore, by removing the part that allowed States to utilize their domestic law in the interpretation process of a treaty provision, the risk of multiple anti-avoidance provisions to be applied to the same fact pattern is negated. As I have advocated in my amended text of the proposals, domestic anti-abuse provisions should not play part in establishing beneficial ownership to prevent a wild growth of interpretations of the concept. With this in mind, I realize that adopting an explicit test in (for example) the OECD Commentary requires States to give up certain sovereignty with respect to their domestic tax law, an uniform definition of the concept of beneficial ownership in a Model of a coordinating authority – which is already endorsed as the benchmark to which tax treaties are negotiated – should prove to be of much value in achieving the OECD

[161] See Section 2.1.1.2 of this thesis.
[162] See Chapter 2 and Annex III of this thesis.

Councils aim to enhance and facilitate international trade. Although the road to a uniform concept of beneficial ownership is a long one, in my view it is the most beneficial way for all parties concerned. In this respect, I have considered the following – mutually exclusive – options to achieve a uniform concept:

I. Bring the OECD Commentary under articles 31 and 32 of the Vienna Convention. Such could be achieved by means of including the OECD Commentary in the list of supplementary interpretations of article 32 which makes it an official interpretation of the OECD MC and therefore, of treaties that are based on the OECD MC. However, this option still has the problem that Contracting States may explicitly exclude the Commentary in their treaty.

II. Extract the concept of beneficial ownership from the recommendation the OECD makes to update the Commentary and implement and update the concept through a decision that is to be taken unanimously by the OECD Member States. The concept that is thus achieved has legal binding force on all OECD Member States under the Convention on the OECD[163] and – as the concept has to be agreed upon unanimously – the interests of all parties concerned are taken into account. However, in order to reach that unanimous decision, a long and repeating process of negotiation is required both when the concept is first to be formulated and afterwards updated.

III. Remove the concept entirely from the OECD MC and publish it in an equivalent of a European Directive, under which domestic legislators are required to implement a concept that is equivalent to the Directive.[164] Through this, the domestic law of all Member States contains an equivalent concept of beneficial ownership, which counteracts the various interpretations and there would be no definition in the OECD MC.

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[163] Article 5(a), Convention on the OECD.

[164] As not all OECD Member States are member of the European Union as well, simply a Directive does not suffice to achieve the goal of an uniform concept. Therefore, an equivalent should be found with which the OECD Member States all agree.

It is obvious that all above options have the same downside that Member States are required to give up sovereignty on the field of anti-abuse provisions. Furthermore, they would no longer have treaty freedom with respect to the concept of beneficial ownership. However, as all solutions require the Member States to either unanimously agree, or to adjust their domestic law to match the definition offered in a Directive, the problem of deviating interpretations and definitions should be solved through either of the options.

## 6.2 Conclusion

In this thesis I aimed to answer to several questions, which are all combined to form the research question of this thesis. The first question sees to the impact of the proposed changes to the Commentary on the concept of beneficial ownership. With respect to this question, it can be concluded that the proposed changes potentially affect the concept rather drastically, by denying treaty benefits to legit business structures. Furthermore, with the proposed text, an opening is created for the application of additional anti-abuse provisions to the same fact pattern. This brings me to the answer to the second part of my research question, which sees to whether or not the proposed changes meet the aim of the OECD to clarify the concept of beneficial ownership. As came clear, the proposed changes are certainly a step in the right direction. However, through the broad use of language in the proposed paragraphs, uncertainty is also created. Therefore, in my view, it can be concluded that the current wording of the proposals do not meet the intentions the OECD had with publishing the proposed changes. As I have demonstrated from my amendments to the proposal, improvement lies in the use of more narrow language, which removes potential overkill included in the current text of the Discussion Draft. Through my amendments, the aim of the concept of beneficial ownership as an anti-avoidance provision is still secured, yet legit business situations do not face the hazard of being denied the treaty benefits based on a broad beneficial ownership test. Furthermore, I have amended the text to make absolutely clear that the beneficial ownership test is exclusively applicable to tax-avoidance under the provisions 10, 11 and 12 of the OECD MC. Herewith, the hazard of having multiple applicable and overlapping anti-avoidance provisions to the same fact pattern is negated.

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# ANNEX I – Text of the Discussion Draft

Text of the paragraphs of the Commentary on Article 10, following from the Discussion draft by the OECD.

12. The requirement of beneficial owner was introduced in paragraph 1 of Article 10 to clarify the meaning of the words "paid … to a resident" as they are sued 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~~***paid direct to*** a resident of a State with which the Stae of source had concluded a convention. [*the rest of the paragraph has been moved to new paragraph 12.1]*

***12.1 Since the term "beneficial owner" was added to address potential difficulties arising from the use of the words "paid to … a resident" in paragraph 1, it was intended to be interpreted in this context and 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" is ***therefore*** not used in a narrow technical sense ***(such as the meaning that it has under the trust law of many common law countries),*** rather, it 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. ***This does not mean, however, that the domestic law meaning of "beneficial owner" is automatically irrelevant for the interpretation of that term in the context of the Article: that domestic law meaning is applicable to the extent that it is consistent with the general guidance included in this Commentary.***

12.1*2* Where an item of income is ~~received by~~***paid to*** 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~~ ***direct*** recipient of the income as a resident of the other Contracting State. The ~~immediate~~ ***direct*** recipient of the income in this situation qualifies as a resident but no potential double taxation arsis 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. [*the rest of the paragraph has been moved to new paragraph 12.3]*

***12.3*** 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 of nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned. 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.

***12.4 In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the recipient of the dividend is not the "beneficial owner" because that recipient does not have the full right to use and enjoy the dividend that it receives and this dividend is not its own; the powers of that recipient over that dividend are indeed constrained in that the recipient is obliged (because of a contractual, fiduciary or other duty) to pass the payment received to another person. The recipient of a dividend is the "beneficial owner" of that dividend where he has the full right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass the payment received to another person. 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 full right to use and enjoy the dividend; also, the use and enjoyment of a dividend must be distinguished from the legal ownership, as well as the use and enjoyment, of the shares on which the dividend is paid.***

***12.5 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 provided for by paragraph 2 must automatically be granted. This limitation of tax should not be granted in cases of abuse of this provision (see also paragraphs 17 and 22 below). As explained in the section on "Improper use of the Convention" in the Commentary on Article 1, there are many ways of addressing conduit company and, more generally, treaty shopping situations. These include specific treaty anti-abuse provisions, 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 the dividend to someone else), 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.***

***12.6 The above explanations concerning the meaning of "beneficial owner" make it clear that the meaning given to this term in the context of the Article must be distinguished from the different meaning that has been given to that term in the context of other instruments that concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of "beneficial owner" cannot be applied in the context of the Article. Indeed, that meaning, which refers to natural persons (i.e. individuals), cannot be reconciled with the express wording of subparagraph 2 a), which refers to the situation where a company is the beneficial owner of a dividend. Since, in the context of Article 10, the term beneficial owner is intended to address difficulties arising from the use of the word "paid" in relation to dividends, it would be inappropriate to consider a meaning developed in order to refer to the individuals who exercise "ultimate effective control over a legal person or arrangement".***

12.7 Subject to other conditions imposed by the Article, the limitation of tax in the State of source remains available when an intermediary, such as an agent or nominee located in a Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State (the text of the Model was amended in 1995 to clarify this point, which has been the consistent position of all Member countries). States which wish to make this more explicit are free to do so during bilateral negotiations.

# ANNEX II – Improvements to the proposal

As a base the text of the Commentary as proposed in the Discussion draft is taken. My changes are marked in the text. Additions are in ***bold italic*** whilst deletions appear in ~~strikethrough.~~

12. The requirement of beneficial owner was introduced in paragraph 1 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 paid direct to a resident of a State with which the State of source had concluded a convention.

12.1 Since the term "beneficial owner" was added to address potential difficulties arising from the use of the words "paid to … a resident" in paragraph 1, it was intended to be interpreted in this context and 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" is therefore not used in a narrow technical sense (such as the meaning that it has under the trust law of many common law countries), rather, it 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. ~~This does not mean, however, that the domestic law meaning of "beneficial owner" is automatically irrelevant for the interpretation of that term in the context of the Article: that domestic law meaning is applicable to the extent that it is consistent with the general guidance included in this Commentary.~~

***12.1A To achieve an internationally recognized concept, Contracting States are to interpret the concept against the intentions of the OECD (laid out in paragraph 12.3 and 12.4) as shows from this Commentary, irrespective of their domestic law.***

12.2 Where an item of income is paid ***directly*** to 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 direct recipient of the income as a resident of the other Contracting State. The direct recipient of the income in this situation qualifies as a resident but no potential double taxation arsis 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.

12.3 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 of nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned. 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.

12.4 ***In*** ~~these various examples~~ ***the examples given in paragraph 12.3*** (agent, nominee, conduit company acting as a fiduciary or administrator), the recipient of the dividend is not the "beneficial owner" because that recipient does not have ~~the full~~ ***any legal, factual or economical power to*** ~~right to use and enjoy~~ ***exercise control over*** the dividend that it receives and this dividend is not its own; the powers of that recipient over that dividend are indeed constrained in that the recipient is obliged (because of a contractual, fiduciary or other duty) to pass the ***full*** payment received to another person ***in the same legal form***. ***The examples***

***given in paragraph 12.3 are not to be interpreted in any restrictive manner and this paragraph is applicable to any entity that meets the attributes listed.***

***12.4A*** The recipient of a dividend is the "beneficial owner" of that dividend where he has ~~the full right to use and enjoy~~ ***any legal, factual or economical power to exercise control over*** the dividend unconstrained by a contractual or legal obligation to ***immediately*** pass the ***full*** payment received to another person ***in the same legal form***. 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 ***any*** right to use and enjoy the dividend; also, the use and enjoyment of a dividend must be distinguished from the legal ownership, as well as the use and enjoyment, of the shares on which the dividend is paid.

12.5 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 provided for by paragraph 2 must automatically be granted. This limitation of tax should not be granted in cases of abuse of this provision (see also paragraphs 17 and 22 below). As explained in the section on "Improper use of the Convention" in the Commentary on Article 1, there are many ways of addressing conduit company and, more generally, treaty shopping situations. These include specific treaty anti-abuse provisions, general anti-abuse rules and substance-over-form or economic substance approaches. Whilst the concept of "beneficial owner" ***exclusively*** deals with ~~some~~ forms of tax avoidance ***under articles 10, 11 and 12 of the Convention***~~(i.e. those involving the interposition of a recipient who is obliged to pass the dividend to someone else)~~, 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.

12.6 The above explanations concerning the meaning of "beneficial owner" make it clear that the meaning given to this term in the context of the Article must be distinguished from the different meaning that has been given to that term in the context of other instruments that concern the determination of the persons

(typically the individuals) that exercise ultimate control over entities or assets. That different meaning of "beneficial owner" cannot be applied in the context of the Article. Indeed, that meaning, which refers to natural persons (i.e. individuals), cannot be reconciled with the express wording of subparagraph 2 a), which refers to the situation where a company is the beneficial owner of a dividend. Since, in the context of Article 10, the term beneficial owner is intended to address difficulties arising from the use of the word "paid" in relation to dividends, it would be inappropriate to consider a meaning developed in order to refer to the individuals who exercise "ultimate effective control over a legal person or arrangement".

12.7 Subject to other conditions imposed by the Article, the limitation of tax in the State of source remains available when an intermediary ***on which paragraph 12.3 and 12.4 could be applicable***, ~~such as an agent or nominee~~ located in a Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State (the text of the Model was amended in 1995 to clarify this point, which has been the consistent position of all Member countries). States which wish to make this more explicit are free to do so during bilateral negotiations.

# ANNEX III – An overview of the comments on the Discussion Draft

| Comment on the Discussion Draft by | Proposed paragraph | | |
|---|---|---|---|
| | **12.1** | **12.4** | **12.5** |
| **E&Y** | The clarification of the meaning and interpretation of the term beneficial owner is considered a necessity, therefore the exclusion of ultimate owner for beneficial ownership purposes is a welcome one. | It is unclear if the Proposed Changes should be interpreted as clarifying or as a change to the meaning and interpretation. The text leaves room to interpret it as the latter, which results in only full use and enjoyment leading the qualification as beneficial owner. Thus, any legal (or other) obligation to pay (part of) the amount received to another person would then seem to disqualify a person as beneficial owner.<br><br>They feel there is a serious risk that tax authorities could interpret the text of the changes in that way, which would lead to significant overkill. This result has far too wide implications and therefore it should be made clear beyond a doubt that this interpretation is not the one intended. | |
| **Deloitte** | | The proposed paragraph creates uncertainty and leads to two possible interpretations.<br><br>1: The wording of the opening phrase fixes the boundary of the scope of the paragraph and leads to two interpretations. This leads to the description of the features of beneficial ownership to be merely an illustration of the nature of the relationship between a conduit and the beneficial owner of the income. This limits the test to agents, nominees and conduits acting as a fiduciary or administrator.<br><br>2: The opening phrase serves as an example within a broader class. Then, the second sentence is a statement of the general principle capable of application to any factual scenario.<br><br>Hence, clarification is required. | |

| Comment on the Discussion Draft by | Proposed paragraph | 12.1 | 12.4 | 12.5 |
|---|---|---|---|---|
| | **Taxand** | A domestic law approach creates differences in interpretation per country and as such will not eliminate all discussions.<br><br>Allowing application of domestic law by the interpretation could be considered to enable the taxpayer to choose between the guidance and domestic law, adding more confusion | The current wording is too broad, could create uncertainty. Legal documents should be the prevailing factor. Economic approach should only be relevant for agents, nominees and mere conduits.<br><br>Reference to the Conduit report should be made.<br><br>The current wording may impact normal holding/finance companies which use part of the received income to pay on (debt) obligations.<br><br>'unconstrained by a contractual or legal obligation' should be clarified to ensure consistent and equitable application of the concept of beneficial ownership.<br><br>Examples should be included on how to deal with the impact of complex financing vehicles in a beneficial ownership discussion | Multiple layers of anti-abuse provisions may render a treaty inoperable.<br><br>It should be clarified whether beneficial ownership works as an anti-abuse clause or an attribution of income |
| | **Prof.dr. R. Danon** | The used language is difficult to reconcile with the objective of the proposed amendments to the Commentaries, which are designed to avoid, "risks of double taxation and non-taxation arising from these different interpretations".<br><br>Opening the door to a domestic law characterization exacerbates the risk of diverging interpretations and double taxation.<br><br>Also, defining the application of the concept of beneficial ownership requires a uniform definition of beneficial ownership that leaves no ambiguity whatsoever to the autonomous nature of the term.<br><br>Does not recommend including the proposed language because of the above in the Commentaries. | | The cumulative application of both the beneficial ownership requirement and the guiding principle to the same fact pattern would undermine a literal reading of the OECD Model. Therefore, it is essential to distinguish between the scope of the beneficial ownership requirement and the guiding principle.<br><br>Elements of the fact pattern relating to the manner in which the income arising in the source state is transferred to the residence state should exclusively be tested in light of the beneficial ownership requirement. The guiding principle could then be used to test other elements of the fact pattern. |

| Comment on the Discussion Draft by | Proposed paragraph | | |
|---|---|---|---|
| | **12.1** | **12.4** | **12.5** |
| **IBFD** | The use of the undefined term beneficial owner to define the undefined term 'paid to' invites confusion. | There should be more illustrations on the use and enjoyment of income, as it does not cohere with a common view that sees the concept of beneficial ownership as an anti-abuse provision.<br><br>The description 'full right to use and enjoy' poses massive problems for trustees, as a trustee cannot have full rights over the income.<br><br>The proposed Commentaries could be read that a person subject to *any* obligation could prevent that person from being the beneficial owner. The discussion paper should contain differentiation between obligations that should – and should not fall under the provision.<br><br>The brevity of the proposed commentaries should be avoided in light of the plethora of mixed case law on the matter | |
| **Kim & Chang** | | Paragraph 12.4 should be amended to clarify the meaning of 'full right to use and enjoy'. Such language is ambiguous and could create added uncertainty. Therefore, a more elaborate explanation is required and it should be made unequivocally clear whether or not the terms 'use' and 'enjoy' are legal and economic concepts. Furthermore, concrete examples on this matter could proof beneficial.<br><br>Also, it should be more clearly stated that only agents, nominees and conduit companies (as discussed in the Conduit Report) do not qualify as beneficial owner. Furthermore, the contractual and legal obligations requirement should be clarified in that it does not see to payments required under contracts entered into from business motives. | The paragraph should be amended to more clearly state that beneficial ownership should only be used as a tax avoidance tool in limited circumstances, and that tax avoidance should in principle be addressed in a Limitation of Benefit article in the negotiated tax treaty between two states. |

| Comment on the Discussion Draft by | Proposed paragraph | | |
|---|---|---|---|
| | **12.1** | **12.4** | **12.5** |
| **City of London Law Society** | | The broad wording could create uncertainty and possibly result in the denial of treaty benefits where there is no abuse.<br><br>Treaty Shopping should not be dealt with through the concept of beneficial ownership, but rather through specific Treaty anti-abuse provisions.<br><br>There is no consensus that the 'full right' definition used is the correct test, nor is the substance approach accepted by all jurisdictions and that approach will lead to uncertainty.<br><br>There is risk of overkill by the wording, as many commercial arrangements will be adversely affected, when there is no Treaty shopping involved. As such, in some cases there could be risk of double taxation. | |
| **Jones, Vann & Wheeler** | The proposed clarification provides room to deny the treaty benefits even in case the state of source levies tax. The clarification should make distinction between the situation where tax is levied and the situation where tax is not levied. The current wording is inappropriately broad. | The wording of 'full right to use and enjoy the income unconstrained by a contractual or legal obligation' appears to look for full ownership of the income, whereas the beneficial ownership of income is primarily an issue in situations where a person has very limited rights over the income. As such, essential factors that distinguish a person who does not have beneficial ownership from a person who has limited rights but passes the threshold are not addressed.<br><br>Furthermore, it seems that paragraph 12.4 excludes trusts as beneficial owners, where paragraph 12.1 explicitly states that they could qualify as beneficial owner. | |
| **PricewaterhouseCoopers** | | The commentary should be more clear about on-payments and payment equivalents, so that overkill on those payments is avoided.<br><br>This should also be expressly stated in the Commentary, with clear examples to illustrate. | |