

Maxim Kotlyarov

**The Concept of Beneficial Ownership
in the OECD Model Tax Convention 2010:
A Critical Analysis**

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This study addresses the beneficial ownership concept in the OECD Model Convention as an economic and legal instrument of granting tax benefits. Elements of a potential authorised OECD approach on beneficial ownership are introduced in this research.

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Abstract

States conclude tax treaties in order to prevent double taxation and facilitate international trade and investment thereby. Being based on effective methodological principles and properly negotiated, tax treaties become instruments of states' wealth accumulation and provide economic and social stability. Combating tax avoidance in the form of treaty abuse, which leads to significant losses of states' revenues, is another objective of double tax treaties.

This dissertation addresses the *beneficial ownership concept* which is introduced by the OECD Model Convention and included in double tax treaties to combat treaty abuse by certain taxpayers who endeavour to obtain benefits in the form of the reduced withholding tax not being entitled to them.

The central issue developed in this dissertation is the necessity of examining beneficial ownership holistically. This implies both legal and economic examination of the OECD methodological basis which contains in the OECD Model Tax Convention, Commentaries and auxiliary OECD reports and guidelines. The objective of this dissertation is to contribute to development of the concept of "beneficial ownership" as an economic and legal instrument of granting tax benefits to taxpayers who are entitled to them. Elements of a potential authorised OECD approach on beneficial ownership are introduced in this research.

Table of Cases

Case	Full Citation
<i>Azadi Bachao</i>	Union of India v. Azadi Bachao Andolan, (2003) 6 ITLR 233
<i>Bank of Scotland</i>	Ministre de L'Economie, des Finances et de L'Industrie v Societe Bank of Scotland [2006] 9 ITLR 683 (Conseil d'Etat)
<i>De Beers</i>	De Beers Consolidated Mines Ltd v Howe (Surveyor of Taxes) [1906] AC 455, 5 TC 198, 75 LJKB 858, 13 Mans 394, 50 Sol Jo 666, 95 LT 221, 22 TLR 756, [1904-7] All ER Ext 1256
<i>Diebold Courtage SA</i>	Case No. 191191, min. c/SA Diebold Courtage, RJF 12/99 No. 1492
<i>Indofood</i>	Indofood International Finance Ltd v JP Morgan Chase Bank NA London Branch [2006] EWCA Civ 158; [2006] S.T.C. 1195, 8 ITLR 653, [2006] SWTI 582, [2006]
<i>Market Maker</i>	Royal Dutch Case (1994) Hoge Raad, no. 28638, [1994] BNB 1994/217
<i>Prévost</i>	Prévost Car Inc v R [2008] TCC 231, 10 ITLR 736, affirmed 2009 FCA 57, (2009) 11 ITLR 757
<i>Real Madrid F.C.</i>	Real Madrid F.C. v. Oficina Nacional de Inspeccion (18 July 2006), Westlaw Aranzadi JUR/2006/204307
<i>Velcro</i>	Velcro Canada Inc v R [2012] TCC 57, 14 ITLR 613
<i>V SA</i>	Federal Tax Appeal Commission, 28 February 2001, 4 ITTLR 2002
<i>X Holding ApS</i>	X Holdings Aps – Federal Tax Appeals Commission, 3 March 2005, SRK 2003-159

Introduction

Tax avoidance and tax evasion schemes undermine the foundations of wealth of both developed and developing countries. According to the Tax Justice Network in 2006 ‘...the total tax evasion worldwide amounts to more than USD 3.1 trillion... or about 5.1% of the world GDP...’¹ Various aspects of harmful tax practices, aggressive tax planning and tax competition between countries are on the global agenda of international organisations. It is realized that combatting tax avoidance schemes is impossible without addressing economic, social and ethical nature of the problem. Legal instruments, even in the form of perfectly drafted double tax treaties, are not enough. It is also crucial to apply specific approaches when dealing with developed and developing countries and recognize their national interests in a global context. In order to address these interests a holistic legal, socio-economic and ethical approach should be adopted.

Unfortunately, an advanced idea of supporting international trade and foreign investments with the help of tax treaties is often negatively affected by improper use by certain tax payers who endeavour to obtain tax benefits in the form of full or partial tax relief not being entitled to it. Therefore, besides preventing double-taxation, contracting states have to set a goal of combating “double non-taxation” and develop new instruments and methods of preventing tax avoidance. One of such techniques, addressed in this research, is *beneficial ownership concept* which is currently a part of the Organisation of Economic Co-operation and Development (OECD) methodology.

¹ CAVELTI, L. U. Automatic Information Exchange versus the Withholding Tax Regime Globalization and Increasing Sovereignty Conflicts in International Taxation. *World Tax J.* 2013, **05**: 172, 173.

Beneficial ownership is an important concept which has several functions. It qualifies a person to tax treaty benefits and allocates taxing rights between contacting states in respect of passive income (dividends, royalties and interest).¹ It is also considered to be an instrument within specific anti-avoidance rules. However there is a broad discussion concerning the role of beneficial ownership as a tax anti-avoidance technique. As du Tuit underlined:

...the notion of beneficial ownership was incorporated into the OECD Model in 1977 without defining it explicitly and with only limited reference in the Commentaries on the articles of the OECD Model... as to its meaning.²

Collier concluded: ‘Unfortunately, almost the only thing on which there is widespread agreement is that the concept is not particularly well defined and could benefit from greater clarity.’³

The current situation with beneficial ownership concept may be characterised almost as unique. The concept contains in hundreds of tax treaties but there is no mutual understanding what this term means, whether it has economic or only legal essence, should it have international or domestic meaning and, moreover, whether it is an anti-treaty shopping instrument or just a technique of income attributing. Moreover, a point of view exists that the concept may become obsolete or even useless⁴ and that the fundamental problem is in the OECD methodology of allocating taxing rights which focuses on a “person” (resident of a contracting state) and its ownership or any other nexus with the income rather than on this person’s tax liability with respect of particular item of

¹ DU TOIT, C. The Evolution of the Term “Beneficial Ownership” in relation to International Taxation over past 45 Years. *Bull. Intl. Taxn.* 2010, **64**: 500.

² OLIVER, J. D. B. et al. Beneficial Ownership. *Bull. Intl. Taxn.* 2000, **54**: 310.

³ COLLIER, R. Clarity, opacity and beneficial ownership. *BTR.* 2011, **6**: 684.

⁴ GUTMAN, D. The 2011 Discussion Draft on Beneficial Ownership: What Next for the OECD? In: M. Lang et al., eds. *Beneficial Ownership: Recent Trends.* Amsterdam: IBDF, 2013. P. 344.

income.¹ The United Nations Model Tax Convention (the UN MTC) also faces similar challenges. Although some provisions from the UN MTC and some examples of non-OECD countries are examined in this research, **the scope** of this research is limited to the currently applied beneficial ownership concept within the actual OECD approach only.

In the view of above, **the objective** of this research is to contribute to development of the concept of “beneficial ownership” as an economic and legal instrument, which is a part of a greater system of tax-avoidance technique reflected in the OECD documents. In turn, the OECD mission is to contribute to effectiveness of international trade and investment in member states and their wealth increase. Therefore, the key method of this research is to introduce the chain —from a state’s wealth accumulation to particular anti-tax avoidance instrument— and assessing on this basis the role, necessity and essence of the examined concept.

Various aspects of the concept have been widely addressed in the academic literature. Historical aspects of the problem with respect to contemporary challenges and in context of current development of international and European law contain in the articles by Collier, du Toit, Duff, Matteotti, Sutter, Vann. The issues of conceptual nature of beneficial ownership as well as flaws in the OECD approach are thoroughly examined by Avery Jones, Baker, Cavelti, Oliver, Pijl, Reimer, Wheeler. Status of the Commentaries to the OECD MTC, effectiveness of the OECD and UN approach, ethical aspects of the issue were addressed by Avery Jones, Blokker, Boatright, Douma, Engelen, Gooijer, Lennard, van Raad, Ward, De Broe, Jiménez, Kaur, Prebble, Rohatgi, Susarla deeply examined beneficial ownership as a tax anti-avoidance technique and a rule of income attribution for the purposes of granting treaty relief. Fundamental analysis of case law, judicial interpretations of the term “beneficial owner” in national legislation and in double tax treaties is introduced in publications of almost all above named authors as well as in works by Arnold, Booker, Brauner, Bundgaard, Gutman, Hansen, Li, Ouamrane, Sengupta, Shar-

¹ See e.g. WHEELER, J. The Missing Keystone of Income Tax Treaties. *World Tax J.* 2011, 3(2): 247.

ma, Smit. Interaction of legal and economic aspects of the concept as well as general economic nature of tax law was examined by Verdoner, Offermanns, Huibregtse, Posner, van Bladel, Brealy, Jain and others. All the above mentioned academics demonstrated deep holistic and contextual examination of the beneficial ownership concept.

Addressing the topic of this research is particularly urgent in light of the current OECD initiatives aimed at combating harmful tax practices in the form of improper use of tax treaties. For example, in 2013 Base Erosion and Profit Shifting Action Plan (BEPS Action Plan) was introduced. It is stated in it that tax anti-avoidance techniques used by multinational taxpayers are getting more aggressive and may cause negative economic and social consequences in many countries. Therefore, the research is conducted at an important period of global changes in international tax cooperation.

Pursuant to the objective of this dissertation the following issues are examined:

- social and economic rationale of tax cooperation under the OECD MTC and significance of anti-avoidance measures for effective development of member states;

- particular anti-treaty shopping measures introduced by the OECD MTC and recent OECD initiatives on combatting harmful tax practices and improper use of tax treaties;

- legal and economic essence of the beneficial ownership concept in the range of anti-avoidance measures and current situation in developing the concept by the OECD organs;

- application of the beneficial ownership concept in the OECD member states in case law practice.

A holistic approach to the beneficial ownership concept, based on economic and legal essence of the term and contextual comprehension of social and economic challenges in international tax relationship brings opportunity not only to characterise current theoretical and practical contradictions in beneficial ownership concept application, but also to introduce ways of improving the OECD approach. Therefore, methodo-

logical flaws in the general OECD model as well as historical preconditions are examined where necessary.

This dissertation contains three chapters which reflect the purpose of this research. The *first* chapter is devoted to economic and social objectives of tax treaties. Tax treaties are introduced as instruments of states' policy which should contribute to the wealth increase and social stability. Anti-tax avoidance measures in light of general and the OECD approach, their social, economic and ethical significance both for developing and developed countries are examined in this chapter. The significance of this chapter is to give a broad vision and general background for further research of particular concept.

The idea of a holistic approach to the problem is developed in the *second* chapter which introduces beneficial ownership concept in its legal and economic meaning and its place in the range of general and specific anti-avoidance measures.

The *third* chapter contains an empirical study of the beneficial ownership concept. Case law practice in some OECD member states is examined with regards to practical application of the term "beneficial owner". Contemporary OECD initiatives of combating harmful tax practices are also examined in this chapter. Practical suggestions are made, namely some key elements of a proposed authorised OECD approach. The vision of further development of the beneficial ownership concept is also presented in the third chapter. It is a contribution to a potential authorised OECD approach and it maintains the OECD tradition of drafting reports with strong economic component. The necessity of social and ethical dimension to the concept is also underlined in this dissertation. Implementation of the proposed approach will help to synchronize previous OECD experience in developing beneficial ownership concept with current initiatives on combating improper use of tax treaties.

The main sources of information are: OECD Model Tax Convention and Commentaries on the Articles of the OECD MTC; scholars' research introduced in books and journals; OECD reports, discussion drafts and guidelines; cases and comments with regard to beneficial ownership issues.

Chapter 1

Economic and Social Objectives of Tax Treaties

1.1 Introduction

This chapter introduces the holistic contextual approach based on social and economic assessment of the OECD Model Tax Convention and its anti-tax avoidance contents. In order to discuss any particular instrument it is crucial to realize that the system of taxation is one of the elements of states' wealth accumulation. Therefore, a tax treaty based on Model convention is not only a number of legal provisions but also a contribution to the process of wealth creation through stimulating foreign trade and investments. Tax anti-avoidance technique which conventionally contains in double treaties is an essential part of national wealth accumulation.

This chapter consequentially addresses socio-economic objectives under the OECD MTC as well as nature and effect of anti-avoidance measures under the OECD MTC. Therefore, this chapter is aimed to prepare the bases for discussing a particular anti-avoidance instrument — the concept of “beneficial ownership”.

1.2 A Critical Analysis of the Socio-Economic Objectives under the OECD Model Tax Convention, 2010

Like a corporation is aimed to create value, a state endeavours to increase wealth of nation. The system of taxation, as part of public finance, is one

of the key contributors to a national wealth. The process involves many institutional and individual stakeholders and implies intersection of interests of legal, economic, social and ethical nature. As regards the latter, Boatright stressed:

Public finance... is concerned largely with raising and distributing funds for government purposes. These tasks raise ethical dilemmas of personal conduct, as well as broad questions of public policy, when corporate and public financial decisions affect society.¹

From an economic point of view taxation can be presented as a mechanism of resources' allocation and distribution of wealth.² Therefore, the system of taxation should be both fair (legal and ethical issues) and efficient (economic dimension). The situation becomes much more complicated when these principles —equity and efficiency— must be followed on the international level. It requires cooperation between the states and the OECD provides a firm basis for such cooperation. For more than 50 years it has been working on improving standards for more effective tax treaties between the contracting states.

It has long been recognized... that it is desirable to clarify, standardize, and confirm the fiscal situation of taxpayers who are engaged in commercial, industrial, financial, or any other activities in other countries through the application by all countries of common solutions to identical cases of double taxation... This is the main purpose of... the Convention...³

No doubt, the work of the Fiscal Committee expressed in the Report 'Draft Double Taxation Convention on Income and Capital' (1963) and its developed version 'OECD Model Tax Convention on Income and on

¹ BOATRRIGHT, J. R. *Ethics in Finance*. 2nd edition. Oxford: Blackwell Publishing, 2008. P. 5.

² POSNER, R. A. *Economic Analysis of Law*. 7th edition. New York: Aspen Publishers, 2007. P. 511.

³ *OECD Model Tax Convention on Income and on Capital, condensed version 2010; and Key Tax Features of Member Countries 2010*. IBFD, 2010. P. 7.

Capital' 2010, is one of the greatest contributions to tax cooperation on a transnational level.

Another model, which is widely applied by countries, is the United Nations Model Double Taxation Convention between Developed and Developing Countries (the UN MTC) which has been dealing with double-taxation issues since 1921. Comparative analysis of provisions of the UN and OECD models¹ is beyond the scope of this research. Both UN and OECD model endeavour to facilitate international trade and investment by excluding double taxation. It is widely accepted that the models differ in balancing of taxing rights between source and residence countries. Lennard stressed:

...the main differences between the two models are as to the extent of this relinquishment of taxation rights by the source country. Traditionally it has been said that the OECD is more of a “residence country” model (...reducing source country taxing rights and being generally preferable to capital-exporting countries) and the UN Model is a more “source country” oriented model, generally preferable to host countries of investments...²

Lennard also argued that an element of “inter-nation equity” implies that source countries (generally developing countries) grant an attractive investment climate, but have rights to tax profits in order to develop their social infrastructure. It may be assumed that the UN MTC gives more opportunities for source countries for tax manoeuvre or flexibility in such areas as taxation of passive income, permanent establishment and attribution of profits (e.g. application of a “force of attraction rule”), pensions and social security payments and mutual agreement procedures.

31 Articles of the OECD MTC cover a wide range of issues with respect to possible double taxation. Commentary on the Articles of the MTC (the Commentaries) has become a useful methodological and

¹ For detailed comparative analysis of the UN and OECD model tax conventions see e.g.: LENNARD, M. The Purpose and Current Status of the United Nations Tax Work. *Asia-Pacific Tax Bulletin*. 2008, **14**: 23.

² *Ibid*, 25.

practical instrument recognized by the contracting states. However, the non-binding nature of the Commentaries has become a topic of a broad discussion. Blocker stresses that member states may follow the Commentaries and their interpretations, but definitely they are not obliged to do so. He introduced the OECD MTC and the Commentaries as one package and underlined that the non-binding factor did not make the Commentaries irrelevant.¹ Ward agreed and added that there was no such intention to make the Commentaries legally binding. He argued that the Commentaries should be treated as part of the legal context and inform about the intentions of the negotiating states.² Pijl developed the rationale behind non-binding instruments and emphasized that the Commentaries had ‘...certain degree of political bindingness.’³

Both economic and legal quality of the Commentaries will improve if the focus is made on the main purpose of a tax treaty — ability of the contracting states to achieve economic and social objectives through minimizing double taxation and effective anti-avoidance measures. As regards the latter the reality proves that tax avoidance and tax evasion, especially on the multinational enterprises’ (MNE) level is a threat to wealth of many states. The work of Fiscal Committee supports this argument and the “anti-avoidance line” can be traced clearly in its recent reports and documents (especially in the BEPS Action Plan). However, the OECD approach is still fragmentary. Both the OECD MTC and the Commentaries lack a holistic approach to the crucial problem — states’ tax revenues losses and social consequences due to avoidance schemes. It is mentioned briefly only in the introduction to the BEPS Action Plan that governments, individual taxpayers and businesses are harmed because of great scale of minimizing tax burden by MNEs.

¹ BLOKKER, N. Skating on Thin Ice? On the Law of International Organizations and the Legal Nature of the Commentaries on the OECD Model Tax Convention. **In:** S. Douma and F. Engelen, eds. *The Legal Status of the OECD Commentaries*. Amsterdam: IBDF, 2008. P. 21.

² WARD, D. A. Is there an obligation in international law of the OECD Member countries to follow the Commentaries on the Model? **In:** *Ibid*, 92, 93.

³ PIJL, H. Beyond legal bindingness. **In:** *Ibid*, 130.

The importance of the holistic approach to the above mentioned problem is well developed in the research papers and official reports of International Monetary Fund and World Bank which demonstrate macroeconomic approach, namely treating economy as a whole, rather than particular individual markets. From the point of view of specialists of these organisations, international tax aspects are significant ‘...for macroeconomic stability at both the national and international level...’ and their impact ‘...on revenue mobilization —both directly and indirectly... — as well as on investment and capital movements can have important implications...’¹ The authors also raise issues of fair treaties that would take into account interests of developing countries which ‘...inevitably lose if being involved in tax competition, so called ‘races to the bottom.’²

The focus of the OECD MTC and the Commentaries needs to be modified. *Firstly*, avoidance of double taxation is an instrument of developing international investments and increasing wealth of contacting states. Therefore, prevention of double taxation *per se* is not an ultimate objective; it just leads to the main purpose (state’s wealth accumulation). The *second* issue is the necessity of emphasizing and strengthening the anti-avoidance stem of the OECD MTC and the Commentaries based on its economic essence and impact. Ideally, the approach “*to states’ wealth accumulation through corporations’ value creation*” may be developed as a key economic approach in all OECD materials devoted to taxation.

1.3 Tax-Avoidance Measures and their Socio-Economic Effect

The economic nature of tax planning is well summarised by Vernimmen and others, who emphasized the ability of tax planning to create value for

¹ *Issues in International Taxation and the Role of the IMF: Executive Summary*. IMF, 2013. Available from <https://www.imf.org/external/np/pp/eng/2013/062813.pdf> [accessed 2 July 2014].

² See e.g. JAMES, S. *Providing Incentives for Investment: Advice for policymakers in developing countries*. World Bank, 2010. Available from <https://openknowledge.worldbank.org/handle/10986/10511> [accessed 2 July 2014].

investors by reducing taxes and generating savings.¹ Therefore, any impact on corporation dividend policy (e.g. taxation of dividends) changes the company's value and, as a result, influences the wealth of shareholders and, more generally, — stakeholders.

However, the stakeholders' endeavour to higher value leads to higher risks and raises a combination of economic and ethical issues — namely increase of insolvency risk which will be faced by corporation's voluntary and involuntary creditors. As Boatright stressed, in case of default the limited liability of shareholders enables them to “sell” the company to the creditors and “...walk away from a firm and leave its problem in the hands of others.”² Brealy and others also argued that the goal of shareholders' wealth increase should not imply unethical behaviour.³

When the issue of tax avoidance is addressed, it is crucial to realize that reducing of taxes from one side may undermine state's wealth from the other — may lead to corporation's value increase and bring benefits to society. It is a combination of economic, social and ethical aspects which should be taken into account when formulating a state's or international tax policy, especially when classifying particular behaviour as tax avoidance.

The scale of worldwide tax avoidance is getting enormous. Cavelti addressed figures of tax revenues losses:

European governments lose more than USD 1.5 trillion, and with a loss of USD 337 billion the United States is the country with the highest loss through tax evasion followed by Brazil (approx. USD 280 billion), Italy (approx. USD 238 billion), Russia (USD 221 billion) and Germany (USD 214 billion). Moreover... about 18.1% of the earnings worldwide escape taxation. In Europe this ratio is even higher at 20.5%...⁴

¹ VERNIMMEN P. et al. *Corporate Finance: Theory and Practice*. John Wiley & Sons, Ltd. 2005. P. 651.

² BOATRIGHT, J. R. Op. cit., 135.

³ BREALY, R. A., S. C. MYERS and F. ALLEN. *Principles of Corporate Finance*. 11th edition. McGraw-Hill Education, 2014. P. 13.

⁴ CAVELTI, L. U. Op. cit., 173, 174.

Unfortunately, national and international authorities and organisations are not always ready to combat such massive processes either technically or methodologically. One of the reasons is that they always have to follow the refined tax planning strategies of particular taxpayers. More important, however, is that tax authorities' methodological basis is not always strong. There is still no clear difference between such terms as tax "avoidance", "evasion", "mitigation" and "optimization". Baker (2000) addressed this problem from several angles, stressing the point that tax is a cost and it is normal for *homo economicus* to reduce costs. He introduced a line where at one extreme is a tax-disinterested taxpayer (takes no steps to mitigate tax liability) and at the other extreme — a taxpayer with criminal intentions (tax fraud). Baker placed tax avoidance between mitigation and fraud and suggested to identify tax avoidance 'by demarcating the boundaries of tax fraud and mitigation.'¹ He offered to determine sub-categories of avoidance (countered, abusive and ill-advised tax avoidance) instead of using a *purpose-test* (examining the real intention of a taxpayer to enter into a transaction in order to obtain treaty benefits and avoid tax). Baker suggested that everything except falling within these three sub-categories would be tax mitigation and therefore should not be treated by tax authorities as tax avoidance.²

Baker's suggestions, though introduced in 2000, are of high value in light of current international initiatives on combatting harmful tax practices. It is necessary to get mutual international understanding of the term "tax avoidance". As it is illustrated below in this work, in the 2000s tax administrations and courts faced this problem particularly in dealing with the undefined term "beneficial owner" as part of the tax anti-avoidance technique.

Conventionally, several basic groups of tax anti-avoidance measures are distinguished:

¹ BAKER, P. *Tax Avoidance, Tax Evasion & Tax Mitigation*. Available from: http://www.taxbar.com/documents/Tax_Avoidance_Tax_MitigationPhilip_Baker.pdf [accessed 2 July 2014].

² Ibid.

- transfer pricing rules;
- anti-tax-haven measures;
- thin-capitalisation rules;
- anti-treaty shopping provisions;¹
- exchange of information.²

Amore systematic approach to anti-avoidance measures may be introduced, namely division of all range of anti-avoidance measures into unilateral (domestic rules and case law) and bilateral measures (double tax treaties). Measures within domestic law are represented by General Anti-Avoidance Rule(s) (GAARs) and Specific Anti-Avoidance Rules (SAARs)³. In the OECD methodology GAARs are conventionally based on such doctrines as “economic substance”, “abuse of law” and “step transactions”.⁴

As regards SAARs, they are usually clearly established. Four groups of SAARs may be noted:

- transfer pricing regulations;
- thin capitalisation rules;
- controlled foreign companies rules (CFC);
- beneficial ownership concept.

The idea of choosing a jurisdiction for tax purposes (known as *treaty shopping*) was developed in some court decisions at the beginning of the 19th century. E.g. it was stated in *De Beers*:

The test of residence is not where it [a company] is registered, but where it really keeps house and does its real business. The real business is carried on where the central management and control actually abides. ...to be determined not according

¹ *Treaty shopping* ‘usually involves the “flow-through” of income through conduit or base companies in low-taxed treaty jurisdictions’ (Rohatgi, 2005).

² ROHATGI, R. *Basic International Taxation*. Vol. 1. 2nd edition. London: BNA International Inc., 2005. Pp. 5, 6.

³ KAUR, D. and K. SUSARLA. Anti-Tax Avoidance Developments in Selected Asian Jurisdictions. *Asia-Pacific Tax Bulletin*. 2011, **17**: 256, 257.

⁴ *Hybrid mismatch arrangements: Tax policy and compliance issues*, para 32. OECD Publishing, 2012. Available from http://www.oecd.org/tax/exchange-of-tax-information/HYBRIDS_ENG_Final_October2012.pdf [accessed 2 July 2014].

to the construction of this or that regulation or by-law, but upon a scrutiny of the course of business and trading.¹

Indeed it was *De Beers* that gave rise to further research of such practical issues as *residency tests* and *substance-over-form* doctrine in international taxation.

The issue of public benefits from treaty shopping was addressed in the UN Treaty Shopping Report (1988). In *Azadi Bachao* (2003) the Supreme Court of India gave a comprehensive assessment of the controversial role of treaty-shopping for the wealth of developing countries.

Many developed countries tolerate or encourage treaty shopping, even if it is unintended, improper or unjustified, for other non-tax reasons, unless it leads to a significant loss of tax revenues. <...> Overall, *countries need to take... a holistic view. The developing countries allow treaty shopping to encourage capital and technology inflows*, which developed countries are keen to provide them.² (emphasis added)

This case is important, because it proved that even legal and economic criteria are not always sufficient for assessing such things as acceptability of treaty shopping in particular countries. As soon as one faces the ‘...choice between what is morally right and what is morally wrong’³ we are on the field of ethical assessment. Therefore, it should be stressed that tax avoidance in the form of treaty shopping is a complex economic, legal, ethical and social issue.

1.4 **Anti-Avoidance Measures under the OECD Model Tax Convention**

As it was noted in para 1.2 for comprehensive understanding of the OECD approach in international taxation it is crucial not only to examine the

¹ *De Beers*, 455.

² *Azadi Bachao*, 279.

³ MACDONALD, D. B., R. G. PATMAN and B. MASON-PARKER, eds. *The Ethics of Foreign Policy*. Aldershot: Ashgate, 2007. P. 2.

OECD MTC and the Commentaries but also to evaluate the whole work of the OECD Committee of Fiscal Affairs (the Committee). It is mainly introduced in the following OECD documents¹:

— Report on Double Tax Conventions and the Use of Conduit Companies (1986);

— Report on Harmful Tax Competition (1998) with Progress reports (2004, 2006);

— Transfer pricing guidelines for multinational enterprises and tax administrations (1995—2013);

— The attribution of profits to permanent establishments (2010);

— Hybrid mismatch arrangements: Tax policy and compliance issues (2012);

— Action Plan on Base Erosion and Profit Shifting (2012);

— Addressing Base Erosion and Profit Shifting (2013).

The BEPS Action Plan should be distinguished, because it reflects the key directions of further development of the OECD methodology in combating tax avoidance and aggressive tax planning on a global scale. The main objective of this plan is ‘...to provide countries with instruments, domestic and international, aiming at better aligning rights to tax with real economic activity.’² It is recognized that the process of minimization of tax burden by MNEs becomes one of the main challenges for effective development of the world economy. It is stressed in the BEPS Action plan that governments, individuals and business are harmed and particularly in developing countries where significant under-funding of state programmes occurs.³

The BEPS Action plan in essence is an anti-avoidance concept. It is also a road map for the OECD member states’ governments and tax administrations which introduces priorities in combating harmful tax practices. Fifteen actions of the plan refer to such issues as challenges of digi-

¹ Documents are available at <http://www.oecd.org>.

² *Addressing Base Erosion and Profit Shifting*. OECD Publishing, 2013. Available from <http://www.oecd.org/ctp/BEPSActionPlan.pdf> [accessed 2 July 2014].

³ *Ibid.*

tal economy, hybrid mismatch arrangements, CFC rules, treaty abuse and dispute resolution mechanisms. Noteworthy, that at least four actions are devoted to transfer pricing issues. It is a positive trend that OECD puts in priority the development of economic and substantial issues in combating harmful tax practices, namely promoting the concept of value creation and methodology of FAR (functions, assets, risks) analysis. Action 6 is titled “Prevent treaty abuse” and stresses that granting tax benefits in inappropriate circumstances should be limited by developing domestic rules and model treaty provisions.

Current version of OECD MTC and the Commentaries contain provisions aimed to combat tax avoidance and block abuse of tax treaties. Improper use of double taxation conventions is addressed in the Commentaries, namely for article 1 “Persons covered”.¹ It is to be emphasized that prevention of tax avoidance and tax evasion is also a purpose of the Model tax convention, and both general and specific anti-abusive provisions may be included by contracting states in their tax conventions. The Commentaries refer to several issues relating prevention of tax avoidance through treaty abuse. *Firstly*, taxpayers may exploit the differences between regulations and laws of different countries (s. 7 of the Commentaries to article 1).²

Secondly, taxpayers may use artificial legal constructions in order to obtain benefits of domestic tax regimes of both the contacting states. It is emphasized that a conflict between domestic anti-abuse rules and proper implementation of the OECD MTC provisions may arise. Each case of entering into transaction deemed to be abusive should be carefully examined and benefits should not be available when tax avoidance is the main purpose of the transaction. So-called *conduit company*³ is an example of an artificial legal construction. It is pointed out in the Commentaries (s. 20) that conduit companies’ issues are part of a complex problem of

¹ *OECD Model Tax Convention...* Op. cit., 59.

² *Ibid.*

³ The term “conduit company” is generally referred to a company which is not owned (directly and indirectly) by residents of the state of which the company is a resident (s. 13 of the Commentaries).

treaty shopping.¹ Member states are advised to include in double tax treaties detailed limitation-of-benefits provisions in order to prevent persons to obtain benefits of a treaty in case when neither of these persons are residents of the contracting states.

Thirdly, the use of *preferential tax regimes* is called in the Commentaries a substantial element of tax avoidance and treaty abuse. Section 22 of the Commentaries contains two types of possible reaction in case of use of legal arrangements enjoining tax privileges from preferential tax regimes — to exclude them from the scope of the treaty (radical solution) or to insert a safeguarding clause referring to particular types of income (e.g. dividends, interest, capital gains, directors' fees) paid or received by companies-residents of the states with preferential tax regimes.

Fourthly, other possible ways of dealing with abuse of tax treaties contain in the Commentaries (“substance-over-form”, “economic substance” techniques and general anti-abuse rules).² Most of these rules become part of the domestic rules of the contracting states. The crucial issue here is possible conflict between domestic rules and treaty provisions.

All types of contemporary anti-avoidance measures are introduced in the OECD MTC and supplementary materials (the Commentaries, OECD reports and guidelines). It may be concluded that the OECD approach is reflected in the OECD MTC which declares two basic aims— to avoid double taxation and prevent tax avoidance by treaty abuse. OECD official documents, particularly the Commentary, encompass four main types of measures aimed to prevent treaty abuse. It is recognised in the Commentaries that economic approach in dealing with treaty abuse and tax avoidance plays a significant role. However, the OECD approach to tax avoidance cannot be characterised as a holistic methodological, legal and economic doctrine. Elements of this approach may be found separately in the Commentaries and numerous OECD reports.

¹ Section 20 of the Commentaries is the only place where the term “treaty shopping” is addressed.

² *OECD Model Tax Convention...* Op. cit., 70.

1.5 Conclusions

Double tax treaties facilitate the development of international trade, investment and increase of wealth of contracting states. Model tax convention's role, as well as supplementary materials (reports, commentaries and guidelines), is to be a conceptual document which would reflect legal, economic, social and ethical issues of the international tax cooperation (holistic approach). Contemporary OECD MTC and the Commentaries are facing significant challenges. It is stated in the discussions that the non-binding nature of the Commentaries prevents them from being effective and allows using them selectively. However, scholars and practitioners recognize the significant methodological and political role of the OECD MTC and the Commentaries.

These documents reflect objectives (avoidance of double taxation and preventing treaty-abuse), confirm the significance of economic approach, namely substance-over-form doctrine, and introduce conventional (known in numerous domestic laws as GAARs and SAARs) anti-avoidance measures. However, such issues as methodological base of tax-avoidance (even definition of the term "tax-avoidance") and its socio-economic assessment are reflected fragmentarily. The big step forward is introduced in the OECD BEPS Action Plan, but it looks as a preview of what should be done in order to combat tax-avoidance rather than an instrument of developing methodological and doctrinal fundamentals of the OECD approach.

Tax treaties may be introduced as instruments of contracting states' wealth accumulation which has both economic and social dimension. MNEs and other tax payers use international tax planning as instrument of value creation which brings benefits to various groups of stockholders who are parts of the society as well. This implies recognition of legal, economic and ethical assessment of tax-avoidance measures reflected in tax treaties and other international instruments. The concept of beneficial ownership generally introduced in the OECD MTC and the Commentaries, which is among the most significant and controversial measures designed to resist treaty-shopping schemes, is addressed further in this work.

Chapter 2

The Beneficial Ownership Concept in the OECD MTC

2.1 Introduction

Although reflected in the OECD MTC about forty years ago, “beneficial ownership” concept still remains a controversial issue. The situation will not be clarified by introducing one more definition of this term. It is argued in this chapter that a key to the “mystery” of “beneficial ownership” may be in applying holistic legal and economic approach. It is discussed further in this work that the fact of legal ownership (whether of the underlying asset or of the flows of income) or a “bundle of rights that defines what an owner can and cannot do with a thing”¹ may not reflect the fact of actual utilization of the asset or income. Actual use may be hard to confirm, however, there is no point to do this. The fact that a person bears risks from possessing of an asset means that this person requires a compensation for taking the risk. This, in turn, leads to conclusion that this person derives benefits from this asset. Utility, benefits and risks are economic criteria. It is argued in this chapter that economic rationale is a key to effective “beneficial owner” concept.

The concept of beneficial ownership in the OECD MTC is examined in this chapter. It is also reasoned that the term is debated in the OECD discussion drafts and three main issues are highly arguable:

¹ BOATRIGHT, J. R. Op. cit., 179.

- beneficial ownership concept as an anti-avoidance technique or an instrument of income attribution;
 - interaction of international and domestic meaning of the term “beneficial owner”;
 - legal and economic nature of beneficial ownership.
- Particular attention in this chapter is paid to economic rationale of the beneficial ownership concept.

2.2 Examining the Beneficial Ownership Concept

Since the concept of beneficial ownership was introduced in 1977¹ there has not been any mutually agreed definition of it. As Collier pointed out:

...almost the only thing on which there is widespread agreement is that the concept is not particularly well defined and could benefit from greater clarity.²

Oliver used expression “surprisingly little information” implying cases and official comments.³ Li pointed out with regard to beneficial ownership:

The term has been adopted in most bilateral tax treaties, but defined in none. Its meaning is thus left to be interpreted under Art. 3(2) of the OECD Model... Because the term has no specific meaning in the domestic tax law of most countries, the way in which domestic courts should interpret this treaty-originated concept has been the subject of much scholarly debate.⁴

¹ For the reasons of including the “beneficial ownership” concept in the model treaty see: John F. Avery JONES. The Beneficial Ownership Was Never Necessary in the Model. **In:** M. Lang et al., eds. *Beneficial Ownership: Recent Trends*. Amsterdam: IBDF, 2013. P. 333.

² COLLIER, R. Op. cit., 684.

³ OLIVER, J. D. B. Beneficial ownership and the OECD Model. *BTR*. 2001, **1**: 27, 32.

⁴ LI, J. Beneficial ownership in tax treaties: judicial interpretation and the case for clarity. **In:** P. Baker and C. Bobbett, eds. *Tax polymath: a life in international taxation: essays in honour of John F. Avery Jones*. Amsterdam: IBDF, 2010. P. 187.

As it follows from Article 3(2) of the OECD MTC, treaty terms which are not defined are to be given domestic meaning if it does not contradict the context of a treaty.¹ Li stressed, however, that “beneficial ownership” concept is used in the majority of tax treaties under the OECD model, but at the same time it is not defined in domestic law of the majority of the OECD Member states.²

The main articles where the application of the term is implied are Articles 10 “Dividends”, 11 “Interest” and 12 “Royalties” of the OECD MTC.³ The economic rationale behind the provisions of these Articles can be interpreted as a clear signal that use of conduit companies in chains of financial relationship with the sole purpose of getting benefits from the treaty (avoiding withholding tax and getting lower or zero tax rate on dividends, interest or royalties) should not be allowed.

The Commentaries, namely to para 2 of Article 10, explain that the term should be used not in a technical narrow sense, but in light of the OECD MTC purposes – avoiding double taxation and combating tax avoidance.⁴ It is stated in para 12.1–12.2 of the Commentaries to articles 11 and 12 that relief or exemption should not be granted where income is received by an agent, conduit or a nominee, though being a resident of the Contracting state.⁵ The Commentaries stress the following attributes of a conduit company: formal ownership, narrow powers to dispose of the income and mere administrator’s or fiduciary’s duties with regard to the income.

However, debates arose within the OECD when discussion draft ‘Clarification of the meaning of “beneficial owner” in the OECD Model Tax Convention’⁶ was published in 2011. This document was prepared in response to numerous interpretations by tax authorities and courts.

¹ *OECD Model Tax Convention...* Op. cit., 23.

² Li, J. Op. cit., 189.

³ *OECD Model Tax Convention...* Op. cit., 28.

⁴ *Ibid*, 187.

⁵ *Ibid*, 188.

⁶ *Clarification of the meaning of “Beneficial owner” in the OECD Model Tax Convention*. Discussion Draft 29 April 2011 to 15 July 2011. Available from <http://www.oecd.org/tax/treaties/47643872.pdf> [accessed 2 July 2014].

It was confirmed in the Discussion draft that the term “beneficial owner” should not be used in a narrow technical sense, but should be understood in its context and in light of the objectives of the OECD MTC. However, and this is *the first* and the most controversial issue, it is recognized in the draft that domestic law meaning of the term “beneficial owner” may also be relevant. This approach brings difficulties with regard to different interpretations of the term (e.g. in common law and civil law systems). Scholars and practitioners criticized this amendment and argued in favour of international treaty based interpretation of the term.¹ Booker noted that ‘...opening the door to a domestic law characterization of beneficial ownership exacerbates the risk of diverging interpretations and double taxation that the OECD wants to avoid.’²

Secondly, paragraph 12.4 in the Discussion draft defines the term “beneficial owner” as:

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 enjoyment, of the shares on which the dividend is paid. (emphasis added)

It was noted by commentators that economic approach to the term “beneficial owner” was supported and developed in the Discussion draft.³

¹ See e.g. *Tax and Comments on the Revised Proposals concerning the Meaning of ‘beneficial owner’*. Available from <http://www.oecd.org/ctp/treaties/BENOWNTaxand.pdf> [accessed 2 July 2014]; DANON, R. 2011 *OECD Discussion Draft on the Meaning of Beneficial Owner*. Available from <http://www.oecd.org/ctp/treaties/48415237.pdf> [accessed 2 July 2014].

² BOOKER, T. Recent development Regarding Beneficial Ownership in Denmark. *Eur. Taxn.* 2012, 52: 67, 75.

³ *Tax and Comments on the Revised Proposals concerning the Meaning of ‘beneficial owner’*.

The third issue which is discussed in the draft paper is a proposed paragraph 12.6 which addresses the distinction of the meaning of “beneficial owner” for the purposes of the Convention and in the context of other legal instruments (e.g. international anti-money laundering legislation), where the aim is to specify an individual who exercises ultimate control over the company.¹ It is recognized that different meanings of the term “beneficial owner” from other international instruments cannot be applied in the context of Articles 10, 11 and 12 of the OECD MTC. However, it may be a contradiction between the domestic meaning of the term in a particular state and this provision. It refers e.g. to the cases of using the term “ultimate owner” as equivalent to the “beneficial owner” or when the definition may be borrowed from banking or anti-money laundering law.

The concept of beneficial ownership introduced by the OECD has its advantages and drawbacks. *The first* merit of the OECD approach is the clear statement that the term “beneficial ownership” should have an international meaning. *The second* one is the OECD attitude concerning agents, nominees and conduit companies. The mere fact of interposition between beneficiary and the payer of a company which is not treated as an owner of the income is not sufficient to consider this company to be a beneficial owner. The OECD stresses the importance of fact of ownership of income and contains no more commentaries.

The third advantage is recognition by the OECD of the economic approach to beneficial ownership. It may be derived from the discussion paper that the trend is in implementing the criterion of “full right to use and enjoy” the income and lack of legal or contractual obligations to pass this income to a third person. The necessity of the assessment the fact of beneficial ownership on the basis of business circumstances and separation of “use and enjoyment” criterion from the legal ownership also support the argument in favour of economic concept of beneficial ownership

¹ *Clarification of the meaning of “Beneficial owner” in the OECD Model Tax Convention.* Discussion Draft 29 April 2011 to 15 July 2011. Available from <http://www.oecd.org/tax/treaties/47643872.pdf> [accessed 2 July 2014].

in the OECD MTC. Danon pointed out that ownership criteria should be tested on the basis of a substance-over-form approach. He also argued that it is not decisive whether the income recipient owns the underlying asset.¹ Therefore, beneficial ownership is about the level of economic control over the income and ‘...factual ability of a person of a third country to compel an entity interposed in the residence state to transfer to the former the income received from the source state.’²

The key drawback of the current OECD approach is the lack of consistency in recognition the term “beneficial ownership” as having an international treaty, but not domestic, meaning. The fact that such possibility was not excluded in the Discussion draft may mean that there is still no mutual methodological approach to the term “beneficial owner” within the OECD.

It may be stated that the OECD approach contains elements of economic concept of beneficial ownership (acceptance of substance-over-form doctrine). However commentators admit the necessity of its further clarification, particularly with respect to beneficial ownership as an international treaty concept.³

2.3 Economic Rationale of the Beneficial Ownership Concept and a Critical Analysis thereof

One of the issues to be examined is the interaction of legal and economic nature of beneficial ownership concept. Unfortunately, law and economics with respect to beneficial ownership are often presented as incompatible.⁴ It should be admitted that there is no clear and mutual approach, both methodological and practical, to economic meaning of beneficial

¹ DANON, R. 2011 *OECD Discussion Draft on the Meaning of Beneficial Owner*. Available from <http://www.oecd.org/ctp/treaties/48415237.pdf> [accessed 2 July 2014].

² Ibid.

³ LI, J. Op. cit., 209.

⁴ See e.g. JIMÉNEZ, A. M. Beneficial Ownership: Current Trends. *World Tax J.* 2010, 2: 35, 51, 52.

ownership. However, it would be not right to deny the role of economic factor in defining beneficial owner. Moreover, legal and economic approaches contribute to one objective — identification of the beneficial owner by delivering reasonable and motivated assessment.

The following approaches, concerning economic meaning of the beneficial ownership concept, can be emphasized:

1. “Substance-over-form” doctrine.
2. “The responsibility centres” concept.
3. “Remaining economic risk” concept.

“Substance-over-form” doctrine and “economic approach” are often mixed in the academic literature and practice. “Substance-over-form” approach implies that real economic relationships are taken into consideration in the process of identifying beneficial owner. However, it does not mean that economic approach is exhausted at this stage. Substance-over-form approach is mostly a title of general technique based on substantial examination of nature of relationships between investor and financial resources’ recipient. Economic approach is a range, a variety of tools and techniques aiming to contribute to the process of beneficial owner determination.

One of such techniques, named the concept of “responsibility centres”, is described in details by Verdoner et al.¹, who underline the importance of qualitative and quantitative aspects of the term “beneficial ownership”. The concept of “responsibility centres” reflects a contribution of each participant to an economic chain of value creation.

On the first stage, in order to determine the functional profile of all the persons or entities involved, the FAR-analyses (Functions, Assets, Risks) is applied. This approach is widely used in the OECD methodology (e.g. attribution of profits to permanent establishment and transfer-pricing analysis). By applying FAR-analysis functional roles can be identified (production, marketing, research, development, etc.). Each of the

¹ VERDONER, L., R. OFFERMANN and S. HUIBREGSTE. A Cross-Country Perspective on Beneficial Ownership — Part 2. *Eur. Taxn.* 2010, 50(10): 465, 469.

identified units has its own role and responsibility (investment, profit, costs, revenue and expense centre).¹

This method allows to match economic and legal criteria and terms, e.g. “cost centre — nominee”, “cost/revenue centre — broker/agent”, “profit centre — trader/distributor”, “investment centre — owner”. After identifying connections between economic and legal labels it is possible to determine how particular function and responsibility should be compensated.² As a result, application of an economic approach enables to make a distinction between nominee, agent and investor. Agent in case of limited involvement in income flows (dividends, interest, royalties) and investor are qualified as beneficial owners.

Another economic technique which allows interpreting the term “beneficial owner” is based on risk attribution approach and contains several tools or, more precisely, tests. One of them is based on the fact of sharing of risk by a person deemed to be a beneficial owner. Verdoner et al., besides the test of legal ownership, offered the criterion of identifying a person who bears the risk of changes of value of the underlying asset.³

The other modification of the risk-oriented test is introduced by van Bladel and described on the financial institution’s pattern. Van Bladel determined economic ownership as remaining with the legal owner economic risk. Therefore, if no economic ownership of the asset remains, the legal owner of the asset should not be treated as the beneficial owner.⁴

Van Bladel addresses example of Bank of International Settlements (BIS) methodology. As he pointed out, it is not difficult to determine whether the owner of an asset bears any economic risk or not, because each type of asset requires a percentage of capital to cover potential losses

¹ VERDONER, L. et al. Op. cit., p. 470.

² Ibid.

³ VERDONER, L., R. OFFERMANN and S. HUIBREGSTE. A Cross-Country Perspective on Beneficial Ownership – Part 1. *Eur. Taxn.* 2010, **50**(9): 419, 426.

⁴ BLADEL, M. *Commentary on: OECD Model Tax Convention: Revised proposals concerning the meaning of “Beneficial Owner” in articles 10, 11 and 12.* Available from http://www.oecd.org/ctp/treaties/BENOWNMLL_vanBladel.pdf [accessed 2 July 2014].

from this asset possession. As van Bladel argued, even in case of 1.6% risk beneficial ownership can be assumed. He concluded:

To be Beneficial Owner, the owner of an asset needs at least be the legal owner of the asset. ...a *certain degree of economic ownership needs to reside with the legal owner*. The level of economic ownership which has to reside with the legal owner has to be sufficient to reflect the possibility that this legal owner will not be able to fully recover (the value of) his asset.¹ (emphasis added)

2.4 Conclusions

Despite the long drafting history the term “beneficial owner” is still may be broadly construed. It refers to application of international or domestic meaning of the term “beneficial owner”; its function as an anti-avoidance technique and its legal and economic nature.

The objective of the beneficial ownership concept is to prevent improper use of tax treaties by granting benefits to a person which is not a beneficial owner of income (dividends, interest and royalty), but who is merely interposed (conduit company, nominee, fiduciary, administrator, etc.) between the source of income and actual recipient of this income in order to obtain treaty benefits in the form of reduced rate of withholding tax. As it was argued in this chapter test of legal rights is not always helpful. It may clarify the fact that a person has no contractual obligations to pass income or even may use and enjoy it, but it is only the first step in identifying the beneficial owner.

As it follows from the OECD approach, a test of economic beneficial ownership may be applied. However, this approach is not developed and generally implies the use of substance-over-form approach. It is stressed in this research that substance-over-form doctrine, which is aimed to identify the substantive nature of a transaction, does not reflect the whole

¹ BLADEL, M. Op. cit.

economic approach and should not be used interchangeably with it. Moreover, though it may be helpful to understand the economic nature of a transaction, it may not always indicate who beneficial owner is. The opposite approach is introduced in this research. It is suggested not to identify the person who gets the income ultimately, but that who bears risk of possessing income or underlying asset. Risks imply compensation. Compensation means the fact of deriving economic benefits from income or asset even if this person is not a legal owner, or does not actually receive any compensation. Particular types of risks may be determined on the basis of the analysis of functions and responsibilities.

The key to clarification of the beneficial ownership concept is in developing a technique which combines instruments of legal and economic analysis. It is introduced further in this research that courts faced these problems and in most cases applied economic risk-based approach though they had no clear guidance from domestic legislation or international legal instruments.

Chapter 3

An Empirical Study of the Beneficial Ownership Concept as Applied by Certain OECD Member States

3.1 Introduction

For complete understanding of the beneficial ownership concept it is important to examine how national courts of the OECD member states apply it. Examples of Canada, Denmark, England, France, the Netherlands, Spain and Switzerland are examined in this chapter. The criteria of cases' selection were the facts of addressing by the courts the basic elements of the beneficial ownership concept introduced in the previous chapter (beneficial ownership anti-avoidance role; international or domestic meaning; legal or economic substance of the term).

Case law practice and conducted research of the OECD methodology will enable to obtain a holistic vision of the current situation and ways of further development of the beneficial ownership concept. Elements of a proposed official OECD approach with regard to the beneficial ownership concept are introduced in this chapter.

3.2 Application of the Beneficial Ownership Concept in Certain Chosen OECD Member States

Application of the beneficial ownership concept in various states may be assessed through examining positions of tax authorities and courts. Academic publications are also helpful. However, there is no mutual approach to this topic. It refers not only to substantial issues but to its general vision. E.g. Jiménez argued that it is a false impression that beneficial ownership concept is interpreted differently by the courts and tax administrations.¹ Common basic points in the concept definitely exist. Oliver and others pointed out that main debates were about legal or economic nature of the term “beneficial ownership”.² Wheeler argued that case law on beneficial ownership is not helpful. She cites Arnold emphasizing that case law:

...is growing and inconsistent. Some courts consider the term to have a domestic law meaning; others give it an international meaning. Some courts treat it as an anti-avoidance concept; others do not...³

Courts of almost all OECD member states where disputes regarding beneficial ownership arose were apt to examine the issue using the following “common points” within this topic:

- recognizing the beneficial ownership concept as a tax anti-avoidance technique or an instrument of income attribution;
- international and domestic meaning of the term;
- legal and economic essence of beneficial ownership concept.

The leading and the most remarkable case in beneficial ownership is the UK case *Indofood*. It became the first case dealing with interpretation of the term after the new edition of the Commentaries emerged in 2003 and stated that the term should be interpreted in its international broad

¹ JIMÉNEZ, A. M. Op. cit., 35, 49.

² OLIVER, J. D. B. et al. Beneficial Ownership. *Bull. Intl. Taxn.* 2000, **54**: 310, 312.

³ WHEELER, J. The Missing Keystone of Income Tax Treaties. *World Tax J.* 2011, **3(2)**: 247, 258.

fiscal meaning following the purpose of the agreement between contracting states.

The Indonesian company (Indofood) raised a 280 million USD loan.¹ There was a rate of 20% of withholding tax if the interest would have been paid directly to bondholders. The rate of withholding tax under Indonesia–Mauritius tax treaty was only 10%. Indofood established a Mauritian subsidiary which borrowed money from lenders (acted through JP Morgan, which was an agent and trustee) and transferred it to Indofood. The agreement between Indofood and JP Morgan could have been terminated in case of rise of withholding tax rate.

In 2005, the treaty was terminated² which meant that the rate of withholding tax would have increased. JP Morgan suggested to interpose a Dutch subsidiary instead of Mauritian one and thus to preserve favourable tax rate. The question arose of whether the Dutch subsidiary would be a beneficial owner of the interest it received from Indofood. A commercial dispute arose between Indofood and JP Morgan regarding the possibility of interposing the Dutch company as a beneficial owner of the interest. At first instance, it was held that the Dutch company was a beneficial owner of the interest similarly as Mauritian company was.

The Court of Appeal overturned the ruling of the Court of the first instance and held that the term “beneficial owner” should be given international fiscal meaning³ not taken from the domestic law. The second important issue was recognition that the term should be interpreted not technically and literally but economically with the substantive matter of the business relationship. The Court used the construction ‘...enjoy the full privilege to directly benefit from the income’⁴ and opposed it the fact of mere administration of the income (formal ownership). The Court relied on the Commentary to the MTC OECD and emphasized the importance of the object and purpose of the tax treaty (its tax anti-

¹ *Indofood*, paras 1, 9.

² *Ibid*, para 15.

³ *Ibid*, para 37, 42.

⁴ See *Indofood*, para 44; also BOOKER, T. Recent development Regarding Beneficial Ownership in Denmark. *Eur. Taxn.* 2012, 52: 67, 69.

avoidance role) and introduced economic “substance-over-form” approach.¹

The significance of *Indofood* is both in creating the above named substantial properties of the beneficial ownership concept and in influencing further development of case law, tax administrations’ practice and official OECD approach established in the Commentaries in 2010. Some authors, however, recognizing the leading role of *Indofood*, demonstrated some anxiety that tax administrations would use beneficial ownership concept as a ‘broad anti-treaty shopping device which permits HMRC to attack any reduction of UK withholding taxes...’²

Canada, mostly because of *Prévost* case, is the second after the UK country which deserves special attention, because in *Prévost* the conception opposed to *Indofood* was implemented.³ In this case a Dutch company owned by Swedish and English shareholders (Canadian company paid dividends to this Dutch company) was not considered by Canadian tax authorities to be a beneficial owner of dividends and therefore could not obtain benefits from Canada-Netherlands Tax treaty (in the form of reduced withholding tax). Canadian tax authorities argued that Canada-Netherlands treaty could not be applied because the Dutch holding company was not a beneficial owner of the dividends. It was also taken into account by tax authorities that there was an agreement between Swedish and English shareholders concerning the distribution of profits of the Dutch company and also the fact that it has no personnel and assets⁴ with exception to the shares of Canadian joint venture.

Canadian Federal Court of Appeal in construing the term “beneficial owner” applied domestic and legal approach. First of all the Court rejected a broad international meaning of the term and reasoned that according to article 3(2) of the Treaty a domestic interpretation should be applied.⁵ Li underlined:

¹ See *Indofood*, para 46; also VERDONER, L. et al. A Cross-Country Perspective on Beneficial Ownership – Part 2. *Eur. Taxn.* 2010, **50**(10): 465, 468.

² JIMÉNEZ, A. M. Op. cit., 45.

³ *Prévost*, paras 86, 87, 93.

⁴ *Ibid*, paras 25, 102.

⁵ *Ibid*, para 95.

...because beneficial owner is undefined in the Canadian Income Tax Act, Rip, J. held that the ordinary meaning in private law has priority. After considering the meaning of this term under Canadian law, income tax law, the Civil Code of Quebec, and Dutch law, he concluded that “in both common law and civil law, the persons who ultimately receive the income are the owners of the income property.”¹

The judge took into consideration such facts as receiving dividends for the own purpose of the recipient, assuming the risk referred this dividend. It was also assessed that the Dutch company was not a part of any agreement between shareholders. The Court also applied “insolvency test” and stated that the dividends to the Dutch company would be available to any of its creditors in case of insolvency.² The latter aspect should be marked specially. This “insolvency test” was mentioned, however not developed in details, in *Indofood*. Baker summarised this principle:

If the recipient entity went into liquidation, and it was a mere fiduciary, then any dividends, etc., it had received could be claimed by the “real beneficial owner” and would not be available for general creditors in the liquidation...³

Therefore, it was confirmed by the Court that the Dutch company was not a conduit on the basis of legal assessment. Under this assessment, two criteria were applied: ability to dispose of dividends for the own benefit of the Dutch company and rights of the directors of this company to make decisions concerning received dividends.⁴ After *Prévost* commentators came to the conclusion that Canada rejected economic or substance-over-form approach with exception of cases when a tax treaty is used with the only purpose to avoid taxation.⁵

¹ LI, J. Op. cit., 196.

² BOOKER, T. Op. cit., 67, 74.

³ BAKER, P. “Beneficial Ownership”: after *Indofood*. *GITC Review*. 2007, 6(1): 15, 18.

⁴ VERDONER, L., R. OFFERMANN and S. HUIBREGSTE. A Cross-Country Perspective on Beneficial Ownership – Part 1. *Eur. Taxn.* 2010, 50(9): 419, 422.

⁵ *Ibid*, 419.

Commentators also pointed out *Velcro case*, which is the second Canadian case where the company-recipient of royalties was recognised by the court as beneficial owner. This case involved the use of Dutch company (*Velcro Netherlands*) for the purpose of tunnelling royalties from Canadian company to the company registered at the Netherlands Antilles.¹ All the companies were parts of the Velcro group. Velcro Canada paid royalties, which were subject to withholding tax 10 % under Canada-Netherlands treaty², to Velcro Industries. In 1995, Velcro Industries became a resident of the Netherlands Antilles and transferred its rights to another member of the holding — Velcro Holdings, because there was no tax treaty between Canada and the Netherlands Antilles. Ownership of the intellectual property was transferred to Velcro Industries and Velcro Netherlands was obliged only to receive royalties from Velcro Canada and to pay them to Velcro Industries.

It was held by the Court that *Velcro Netherlands* had the possession, use, risk and control of the funds.

It was contractually bound to pay an amount equal to 90 % of the royalties to Velcro Antilles but entitled to deal with actual payments received from Velcro Canada as it saw fit...³

It was observed that the Court in *Velcro* followed the decision in *Prévost*⁴ in recognizing legal approach and rejected the tax administration assessment of *Velcro Netherlands* as an agent, nominee or conduit. Some commentators assessed critically the court's decision, arguing that *Velcro Netherlands* was contractually obliged to tunnel the received royalties.⁵ It is also worth noting that the court used some elements of economic approach⁶ when it assessed risks which *Velcro Netherlands* had assumed.

¹ The Netherlands Antilles was dissolved in 2010.

² *Velcro*, paras 4, 21.

³ *Ibid*, 613.

⁴ *Ibid*, 615, 616.

⁵ GOOIJER, J. Beneficial Owner: Judicial Variety in Interpretation Counteracted by the 2012 OECD Proposals? *Intertax*. 2014, **42**(4): 204, 212.

⁶ *Velcro*, 616.

Generally, Canada reflects a mixed approach to the “beneficial owner” concept. Though the courts introduced domestic and legal approaches, tax administrations examine the substance matter of relationship (economic approach). In treaty abuse cases methods of conduit companies identification of courts and government often coincide.

France has a wide network of treaties (more than one hundred), however the term “beneficial owner” is not defined anywhere. Following the OECD MTC Commentaries domestic meaning of the term can be applied. However, there is no specific definition of beneficial ownership in French legislation. Therefore, some scholars suggested to apply principles of international law as French Supreme Administrative Court did¹ and rules of treaty interpretation reflected in the Vienna Convention. The latter implies interpreting treaties in good faith and in accordance with the ordinary meaning of the words. It is also important that in the process of interpretation preparatory work of negotiating parties and supplementary materials may be used.

Mostly because of *Bank of Scotland* case France is known as the country where broad economic approach to the term “beneficial ownership” is applied. Before *Bank of Scotland* formal legal approach was applied² (e.g. *Diebold Courtage SA*, 1999). The Royal Bank of Scotland (RBS) was not considered by French tax authorities to be a beneficial owner of dividends paid from French subsidiary of a US company. Before that, RBS bought rights (called “usufruct rights”) on preference shares from this US company.³ French tax authorities examined the economic nature of relationship and concluded that in substance the payment for the usufruct rights was a loan to the US company, and this loan was repaid through the dividends. In addition, as Verdoner pointed out, RBS ‘...would be entitled to a tax credit (*avoir fiscal*), following the deduction of the withholding tax. The result was that the amount of the div-

¹ GIBERT, B. and Y. OUAMRANE. Beneficial Ownership – A French Perspective. *Eur. Taxn.* 2008, **48**(1): 2, 5

² *Bank of Scotland*, 712.

³ *Ibid*, 613, 614.

idends plus *avoir fiscal* was higher than the amount paid for the usufruct.¹ It was held that the purpose of the transaction was to obtain treaty benefits (from the UK–France treaty). The court also took into consideration that RBS as shareholder assumed almost no risk² (guarantees under the contract were examined).

Beneficial ownership concept in France may be characterised as an anti-avoidance technique based on broad economic examination of a transaction (French tax law contains anti-avoidance provisions based on beneficial ownership concept). Some commentators pointed out that the French Supreme Court made the concept of beneficial ownership very wide, mostly because it applied a substance-over-form approach.³ Gutman also stressed the “over-extensive” meaning of the term “beneficial owner” which was provided by the Court:

...the main fault in the *Bank of Scotland* judgment consists in an inversion of the logical connection which should exist between beneficial ownership and abuse of law/fraud to the law... *The ...Court distorted the meaning of the concept because its goal was to apply the French general anti-avoidance theory without formally departing from the treaty rule.*⁴ (emphasis added)

Denmark demonstrates a growing interest to beneficial ownership concept. Some academics characterized the amount of cases in beneficial ownership as unprecedented and noted that the reason lies in fundamentally new understanding of the term “beneficial owner” by tax authorities, after the term had been included in domestic law with effect from 1st January 2013.⁵ Previously under the GAAR two principles were established in Denmark, namely the rule of “rightful income recipient” and the “substance-over-form doctrine”.

¹ VERDONER, L., R. OFFERMANN and S. HUIBREGSTE. A Cross-Country Perspective on Beneficial Ownership – Part 1. *Eur. Taxn.* 2010, **50**(9): 419, 423.

² *Bank of Scotland*, 707, 709.

³ GIBERT, B. and Y. OUAMRANE. Op. cit., 8.

⁴ GUTMAN, D. Op. cit., 172.

⁵ HANSEN, H. S., L. E. CHRISTENSEN and A. E. PEDERSEN. Danish “Beneficial Owner” Cases – A Status Report. *Bull. Intl. Taxn.* 2013, **67**: 192, 199.

From the variety of Danish cases¹ (some of them are pending) it may be inferred that tax authorities are facing the new methodology implementation, namely that there is difference between “beneficial owner” and “rightful income recipient”. In all cases the broad international meaning of the term is confirmed (referring to *Indofood*).² In basic principles, Denmark is following the OECD approach concerning conduit companies and applies the concept as an anti-treaty shopping instrument.

Though there was a tradition under Danish law to apply legal ownership concept, the term “beneficial owner”, according to National Tax Tribunal, now ‘...must be interpreted in the interest of a harmonized interpretation of the term. The assessment must then go beyond the legal ownership and also include other assessments, e.g. in relation to financial ownership...’³ The Dutch courts, in fact, applied a variety of methods of assessment, combining legal and economic approaches. For example, the court took into account the lack of any shareholders’ agreement concerning obligations to pay dividends and also applied the above mentioned “insolvency test”.⁴

Other OECD member states also have judicial practice in establishing the concept of beneficial ownership. For example, in the Netherlands it was *Market Maker* case (1994). In this case the Dutch Supreme Court decided in favour of taxpayer and held that ability to dispose freely of dividends constitutes beneficial owner status and it is irrelevant for the purpose of the treaty who is the owner of the shares. In this part the Dutch approach resembles reasoning in Canadian *Prévost*. However, the Dutch court in 1994 (long before 2003 and *Indofood*) reflected a broad international meaning of the term and applied both economic and legal approach assessing risks of the dividends’ recipient (currency and solvency risks where examined).

¹ *National Tax Tribunal*, 3 Mar. 2010, SKM2010.268 LSR; 1 Nov. 2010, SKM2010.729 LSR; 22 Dec.2010, SKM2011.57 LSR; 25 May 2011, SKM2011.485 LSR.

² HANSEN, H. S. et al. Op. cit.

³ BOOKER, T. Op. cit., 71.

⁴ *Ibid.*

In Spain *Real Madrid F.C.* became a leading case on beneficial ownership issues. It is noteworthy that in *Real Madrid F.C.* Spain changed its approach to beneficial ownership concept, as Jiménez noted the approach “suffered mutation”.¹ Jiménez referred to the judgment of the Spanish *Tribunal Económico-Administrativo Central* (TEAC) in 2000 as the first case in beneficial ownership issue and pointed out that TEAC introduced the concept as a rule of establishing nexus between the source of income and the recipient, but not as an anti-avoidance mechanism.²

In *Real Madrid F.C.* the taxpayer, a Spanish football club, purchased rights to use image under a contract with a Hungarian party and claimed benefits under Spain–Hungary treaty. The Hungarian party however transferred the sum to the Dutch company which was recognised by tax authorities as beneficial owner. The Court upheld tax administration and applied broad international meaning of the term “beneficial owner” and economic interpretation. The Court carefully examined OECD approach and pointed out its anti-treaty shopping function.

Switzerland is also a country which develops beneficial ownership concept as an anti-treaty shopping measure. This position as well as general approach with regards to beneficial concept follows from two Swiss cases – *V.SA* (2002) and *X Holding ApS* (2005), where the term “beneficial owner” was given a broad anti-avoidance essence.³ In *V.SA* the term was interpreted by reference to the Vienna Convention and linguistic sources. As a result the court emphasized two criteria of beneficial ownership. *Firstly*, beneficial owner is a person who has income received at his disposal. *Secondly*, beneficial owner is not a conduit company.⁴

¹ JIMÉNEZ, A. M. Op. cit., 38.

² Ibid, 37.

³ VERDONER, L., R. OFFERMANN and S. HUIBREGSTE. A Cross-Country Perspective on Beneficial Ownership – Part 2. *Eur. Taxn.* 2010, 50(10): 465.

⁴ Ibid, 465.

3.3 Developing OECD Approach on Beneficial Ownership

Beneficial ownership concept is currently facing significant challenges. The first one, introduced by Gutman, reflects the general approach to the concept.

...it may well be that in the future most of the controversy on the meaning of beneficial ownership will disappear due to the evolution of tax treaty policy between OECD Member States. Many recently concluded treaties already contain both beneficial ownership provisions and general anti-avoidance rules. If that proves to be a long term trend of tax treaty policy, the beneficial ownership concept will move from useless to obsolete¹.

The second challenge concerns withholding tax regime. Some academics argue that automatic information exchange will provide clearness and certainty while withholding tax regime ‘...privileges the elite and undermines tax morale.’² It is widely considered that withholding tax system helps the wealthiest taxpayers to avoid taxation while automatic information exchange closes such opportunity.

Indirect confirmation that beneficial ownership concept may be modified or even abandoned may be derived from the BEPS Action Plan’s context. The term “beneficial ownership” is not addressed in the Plan. It may be inferred that the use of the concept is implied from provisions devoted to hybrid mismatch arrangements, preventing of treaty abuse or developing a mutual instrument. However, the term contains neither in the Plan nor in the Overview of the actions and timelines.

Although, the abovementioned aspects give certain grounds that the concept may be re-evaluated, it does not mean that the elements of the concept will be rejected. Jain made a remark with regards to beneficial ownership essence:

¹ GUTMAN, D. Op. cit., 344.

² CAVELTI, L. U. Op. cit., 172, 210.

...the term “beneficial owner” does not carry a meaning of its own. It simply reminds courts and tax authorities to adopt a substantive approach.¹

Taking into consideration the above mentioned facts, the following conclusions may be made:

- notwithstanding the prospects of existence of the term “beneficial owner” its substantive application will be further developed;
- the OECD methodology lacks substantive economic approach to beneficial ownership, therefore, gradual methodological improvement should be continued.

Therefore, some elements of substantive approach to the term “beneficial owner” are introduced in this research. These elements may become a part of authorised OECD approach (*the AOA*).

The Committee of Fiscal Affairs of the OECD has developed several effective economic concepts which obtained status of the AOA. E.g. the “*arm’s length principle*” which was introduced in transfer pricing guidelines and later developed in the Report “The attribution of profits to permanent establishments.”² Within the “functionally separate entity approach” a concept of functional and factual analysis was developed which is considered to be a basic premise of the AOA. The general idea of the functional analysis is to identify key functions performed by the entity. Then it is determined what assets are necessary in order to perform these functions and what risks are assumed while performing these functions and possessing the assets.

This approach is discussed here mostly because the OECD methodology applies economic approach based on principle of value creation (e.g. when analysing allocation of taxing rights and identifying value creation chains in order to combat tax evasion) and mechanisms of attribution of income based on functions, assets and risks (FAR). FAR methodology

¹ JAIN, S. *Effectiveness of the Beneficial Ownership Test in Conduit Company Cases*. Amsterdam: IBDF, 2013. P. 201.

² *2010 Report on the Attribution of Profits to Permanent Establishments*. OECD Publishing, 2010. Available from <http://www.oecd.org/ctp/transfer-pricing/45689524.pdf> [accessed 11 July 2014].

may be helpful for further development of economic concept of beneficial ownership. Therefore, the following steps in developing a concept of “beneficial ownership” as part of the OECD AOA (*proposed OECD AOA*) may be introduced.

Firstly, instead of introducing a perfect version of a term “beneficial owner” it is reasonable to implement the elements of the beneficial ownership concept (namely, anti-avoidance role of the concept, international treaty meaning, legal and economic approach in determining the fact of beneficial ownership). It should be emphasized in the proposed AOA that “beneficial ownership” inconsistencies take place as part of a complex methodological problem in the current OECD approach which mixes objective and subjective approach in allocation of taxing rights between contracting states. Therefore, a further holistic decision is in specifying the following issues:

- orientation of the OECD MTC methodology on “income” rather than on “person” when allocating taxing rights between member states (the concept of preventing economic double taxation);
- priority of emergence of tax liability with respect of particular item of income rather than ownership or any other form of nexus with this income.

Corrections of the methodological issues may take a long period of time; however, it does not mean that “beneficial ownership” concept should not be improved within current OECD approach.

Secondly, it is crucial to continue developing the concept of beneficial ownership in light of recent OECD initiatives in combating harmful tax practices. It should be emphasised in the proposed AOA that beneficial ownership methodology which has been worked out by the OECD since 1977 and developed in several landmark documents (report on conduit companies in 1986, amended Commentaries of 2003 and 2010, etc.) will be continued in BEPS Action plan and in other OECD initiatives aimed to combat harmful tax practices, aggressive tax planning and improper use of tax treaties. It may be stressed that the term “beneficial ownership” may not be in use; however its substantial elements are of great practical value. It is particularly urgent in light of Action 15 “Develop a multilateral in-

strument” of the BEPS Action plan. Pursuant to this Action contemporary dynamic situation requires “innovative approach to international tax matters”¹ in rapid and universal amending tax treaties.

Thirdly, it should be stressed in the proposed AOA that there is no contradiction between legal and economic meaning of beneficial ownership. Both approaches bear useful function of establishing the fact of the beneficial ownership for the purpose of granting a tax relief.

Fourthly, the substantial approach rather than formal definition of the term “beneficial ownership” should be confirmed in the proposed AOA. This implies recognition of the substance-over-form approach and use of economic techniques (e.g. “the responsibility centres” and “remaining economic risk”) as part of internationally accepted beneficial ownership test.

Fifthly, elements of FAR-analysis and value creation theory should be at the heart of the OECD AOA. As it was noted above, tax is cost and it is natural for an income recipient to endeavour to reduce this cost and, as a result, to increase value of an asset underlined. Motivation of creating or increasing value of an asset is a sign of a beneficial owner. Another sign is actual acceptance of risk by an income recipient and this risk is connected or, more precisely, derives from underlying asset (e.g. share, loan or intellectual property).

Therefore, the economic logic of the proposed OECD AOA may be introduced as follows:

1. Functions and motives of passive income recipient (*the Recipient*) are to be examined.

2. Examination of functions will clarify whether the Recipient bears any risks² which are derived from the underlying asset. The fact of assum-

¹ *Addressing Base Erosion and Profit Shifting*. OECD Publishing, 2013. Available from <http://www.oecd.org/ctp/BEPSActionPlan.pdf> [accessed 2 July 2014].

² An agent gets remuneration for the services, even if it is only a conduit or nominee. However, the difference between remuneration (even paid at arm’s length), is that compensation implies assuming of real risk. Analyses of real risk assuming will always show where it is compensation for assuming risks and where it is artificial compensation or fee for agency services.

ing such risks may lead to conclusion that the recipient is a beneficial owner.

3. Objectives' (or motives') examination clarifies whether the Recipient has interest in underlying asset value creation. Presence of such interest may lead to conclusion that the Recipient is a beneficial owner.

4. The fact that all risks of devaluation or loss of an underlying asset are insured or merely assumed by third parties demands further investigation. If e.g. the Recipient spends nothing to get the guarantee, it may lead to conclusion that the Recipient is not a beneficial owner.

Sixthly, the proposed AOA should stress the role of legal meaning of beneficial ownership. As case law practice in different countries testifies, the following aspects were addressed in examination of legal meaning of the term and may be used in the proposed AOA:

- the fact of having merely an agent, nominee, administrator or conduit status;

- presence of any kind of agreement between shareholders with regards to the income or any other forms of expressed obligation to pass the income;

- ability to enjoy the full privilege to directly benefit from the income (to dispose of income for the own benefit);

- ability to use dividends freely (also notwithstanding of legal ownership of the underlying asset);

- application of “insolvency test” and assessment of whether funds are available to arm’s length creditors;

- availability of guarantees and insurances from third and related parties, other forms of legal agreements of sharing risks.

Therefore, beneficial ownership concept introduced in the form of an AOA may contribute significantly to the OECD initiatives on combating harmful tax practices and improper use of tax treaties.

3.4 Conclusions

Beneficial ownership as a tax treaty concept is currently facing both methodological difficulties and challenges of practical application. Latest trends in the OECD discussions, academic publications and experts' commentaries bring reasons to consider that the concept will be revised either radically (up to its abandonment) or gradually. The way of gradual methodological and practical improvement is introduced in this research. It is based on previous OECD experience and rich practice of case law in the OECD member states.

The majority of the OECD countries have their own experience of applying the beneficial ownership concept. Though case law practice is not universal in different states, it contains common features. As it is examined in this dissertation, three main topics are mainly addressed by courts and tax administrations:

- “beneficial ownership” as an anti-avoidance rule or income attribution technique;
- international or domestic meaning of the term “beneficial ownership”;
- legal and economic criteria in establishing the fact of beneficial ownership.

It may be concluded, that in the majority of cases the term “beneficial ownership” was given broad international treaty meaning. The concept is also developed by the courts as an anti-avoidance technique rather than an instrument of income attribution. The most problematic issue is selection and combination of legal and economic criteria of beneficial ownership, where the courts have no clear and consistent guidelines. Therefore, it would be reasonable to introduce further development of the beneficial ownership concept in the form of proposal of the authorised OECD approach.

The proposed approach, introduced in this chapter, is based on economic principles developed in other OECD documents, namely — value creation and FAR analysis. Value creation principle is used in order to understand the nature of particular transaction and identify key functions,

performed by participants. Functions imply assuming risks. The presence of risk leads to conclusion that a person or an enterprise has interest in utilising of this asset or income, thus this person may be considered a beneficial owner. This analysis is supplemented by legal examination in order to make sure that this person is not mere a conduit, administrator, agent or nominee, who bears no risk with regards to this asset or income.

It should be recognised in the proposed AOA, that beneficial ownership is an international treaty concept, which is aimed to combat treaty shopping. It is important to reflect that legal and economic approaches do not oppose but complement each other. It also should be clarified that the proposed AOA reflects the spirit of recent OECD initiatives on combating tax avoidance in the form of improper use of tax treaties.

Conclusions

The definition of beneficial owner as a ‘person whose ownership attributes outweigh that of any other person,’¹ introduced by Oliver, will, probably, become the best common and universal theoretical definition which has ever been given to this term. However, in practice of international tax law and particularly relationship under tax treaties the situation with identifying the term “beneficial owner” is much more complicated.

It is emphasized in this dissertation that the concept of beneficial ownership lacks holistic approach. International tax treaties are entered by the states in order to avoid double taxation and combat tax avoidance by improper use of tax treaties, which, in turn, supports foreign trade and investment. Therefore, at a macroeconomic level double tax treaties are means of wealth accumulation and are aimed to achieve economic and social objectives of contracting states. Therefore, it was stressed in this work that examination of any particular issue should be based on holistic view of the problem on macro and micro level.

On the level of taxpayers it is crucial to understand that reducing taxes is an element of value creation and any fact of tax minimization should be examined holistically as well. Tax planning is aimed to contribute to wealth of numerous stakeholders (not only shareholders) and, therefore, may bring benefits to society. All these issues must be taken into account in the process of examination of anti-avoidance measures.

The term “beneficial ownership”, though officially introduced in the OECD MTC in 1977, still does not have clear international treaty meaning and polar discussions periodically arise, — from the growing im-

¹ OLIVER, J. D. B. et al. Beneficial Ownership. *Bull. Intl. Taxn.* 2000, **54**: 320.

portance of the concept to its abolishing. Therefore, it is stated in this dissertation and confirmed by analysis of the OECD reports and case law practice, that it is important to introduce and clarify a concept of beneficial ownership. This concept should be based on principles of wealth accumulation in the states entering in tax treaties and value creation by economic agents who naturally endeavour to utilise the benefits of a tax treaty and minimise their tax burden. Beneficial ownership concept implies broad international meaning, rather than use of domestic terms of contracting states; it aims to combat tax avoidance and it is not only an instrument of income attribution. The most important argument, developed in this dissertation, is that beneficial ownership has both legal and economic nature and it would be erroneously to oppose these two parts.

It is argued in this research that legal approach aims to identify rights with regards to particular asset or income. It is helpful when it becomes clear from the legal nature of documents that mere agent, nominee, conduit company or administrator of income claims status of beneficial owner. However, in practice the situation is seldom so straightforward, and tax administrations has to examine the fact of “enjoyment” of the income, legal ownership of the underlying asset, presence of shareholders’ agreements to transform income etc. Even if economic approach is officially rejected the authorities in fact use it, because they examine the substance of the relationship and find themselves on the economic field dealing with such terms as “enjoyment”, “use” or “utility”.

Economic approach is often construed as substance-over-form doctrine and vice versa. It is stressed in this dissertation that although economic approach always implies understanding of actual business relationship in particular transaction (substance-over-form approach), it also brings other special techniques (e.g. “the responsibility centres” or “remaining economic risk” concepts).

It is argued in this work that concept of beneficial ownership should be introduced in the form of authorised OECD approach and synchronized with current OECD initiatives on tax-avoidance combatting. One of the concerns, pointed out in the dissertation, is that there is a flaw between previous work of the OECD on improper tax treaties’ use and

BEPS Action Plan. The Plan reflects further OECD development in combating treaty abuse; however it does not address beneficial ownership when discussing other special anti-avoidance instruments (transfer-pricing rules, thin-capitalization and CFC rules).

The proposed authorised OECD approach will settle the key elements of the beneficial ownership concept (macro- and microeconomic background; wealth and value creation; social, legal, economic and ethical aspects of tax avoidance and beneficial ownership in particular; risk assuming and economic nature of the concept; interaction with legal approach).

Beneficial ownership concept brings grounds for further discussion. It may be assumed that further discussion is not about rejecting the term “beneficial ownership”, but rather about developing a holistic concept based on legal and economic essence of business relationship. Probably, further research will also introduce separate treatment for dividends, interest, royalty and capital gains with regards to beneficial ownership because these types of income have in fact specific economic nature. Using the expression of respected academics, building “bridges between law and economics” is to be continued.

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States conclude tax treaties in order to prevent double taxation and facilitate international trade and investment thereby. Being based on effective methodological principles and properly negotiated, tax treaties become instruments of states' wealth accumulation and provide economic and social stability. Combating tax avoidance in the form of treaty abuse, which leads to significant losses of states' revenues, is another objective of double tax treaties.

This research addresses the beneficial ownership concept which is introduced by the OECD Model Tax Convention and included in double tax treaties to combat treaty abuse by certain taxpayers who endeavour to obtain benefits in the form of the reduced withholding tax not being entitled to them.

The central issue developed in this publication is the necessity of examining beneficial ownership holistically. This implies both legal and economic examination of the OECD methodological basis which contains in the OECD Model Tax Convention, Commentaries and auxiliary OECD reports and guidelines. The objective of this dissertation is to contribute to development of the concept of "beneficial ownership" as an economic and legal instrument of granting tax benefits to taxpayers who are entitled to them. Elements of a potential authorised OECD approach on beneficial ownership are introduced in this research.

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