Recherches juridiques lausannoises
Faculté de droit, des sciences criminelles
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Le droit public en mouvement

Mélanges en l'honneur du Professeur Etienne Poltier

Édités par Véronique Boillet / Anne-Christine Favre /
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The beneficial ownership requirement under art. 10 (dividends), 11 (interest) and 12 (royalties) of the OECD Model Tax Convention: the case of conduit companies

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Introduction

The problem of improper use of double taxation conventions (DTAs) involving conduit companies has been identified by the work of the OECD and the UN at a rather early stage of tax treaty policy. In Switzerland, this problem has traditionally captured serious attention, in particular with respect to outbound dividends distributed by Swiss companies to non-residents[1] which, absent limitations imposed by DTAs, may be subject to a 35 % withholding tax. In fact, Switzerland's policy in this area dates back from 1962 when an Anti-Abuse Decree was adopted to protect the country's partners from treaty shopping situations. In essence, the decree states that a tax treaty relief is claimed abusively where, in effect, such relief accrues to persons not entitled to the benefits of the applicable DTA[2]. Interestingly, the Swiss Supreme Court upheld the constitutionality of this Decree for two main reasons. First, the Decree was regarded as being directly rooted in DTAs concluded by Switzerland. Secondly, and from a substantive standpoint, the Federal Tribunal considered that the prevention of treaty shopping was an inherent expectation of Switzerland's treaty partners in line with the object and purpose of DTAs[3]. The principles introduced by the Decree were indeed accepted at the time by all treaty partners of Switzerland[4] and may be regarded as illustrating an inherent prohibition of abuse flowing from a proper interpretation of DTAs[5]. In fact, the reasoning followed by this judgment was upheld more than 35 years later when in the famous *A Holding ApS*

[1] Art. 4 of the Swiss Federal Withholding Tax Law of 13 October 1965 (RS 642.21).
[2] Art. 2 1962 Anti-Abuse Decree.
[3] Federal Tribunal decision of 22 November 1968, in: ATF/ 94 I 659.
[4] GANI, Limitation des bénéfices, p. 42-43.
[5] See 2011 UN Commentary, para. 53 ad art. 1.

case[6], the Federal Tribunal confirmed formally in 2005 that DTAs were subject to an inherent anti-abuse rule rooted in their proper interpretation in good faith pursuant to the customary rules embodied in the Vienna Convention on the Law of Treaties (VCLT)[7].

From a policy perspective, tax treaty abuse is considered as inappropriate for two main reasons. First, tax treaty benefits negotiated between the contracting states are extended to persons resident in a third country in a way unintended by these jurisdictions.[8] A bilateral international agreement thus becomes *de facto* a treaty with the world.[9] As a result, the principle of reciprocity is breached and the balance of the DTA disturbed Second, the state of residence of the ultimate income beneficiary has little incentive to enter into a tax treaty with the source country, because its residents can indirectly receive tax treaty benefits from the source state without the need for the country of residence to provide reciprocal benefits.[10]

In 1977, a dedicated section relating to the improper use of DTAs was finally included in the OECD Commentary to art. 1 OECD MC. In the 1977 OECD MC itself, a beneficial ownership limitation was included in the dividends,[11] interest[12] and royalties[13] articles. Technically, this limitation operates as a condition in order to limit the taxing right of the state of source to the relevant treaty rate on these items. For example, art. 10(2) OECD MC (dividends) provides that: *"dividends paid by a company which is a resident of a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed"*.[14] In Switzerland, like in other jurisdictions, the beneficial ownership gradually became a key response to treaty shopping situations involving interposed conduit companies[15]. This being said, the systematic insertion of beneficial ownership in the dividends, interest and royalties articles of the OECD MC makes it unclear as to whether this requirement is a mere condition to access tax treaty benefits or a specific anti-anti avoidance rule.

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6 A Holding ApS v Federal Tax Administration, 8 ITLR 536.
7 Art. 26 and 31 VCLT.
8 OECD, Conduit Report, N 7.
9 DOERNBERG/VAN RAAD, p. 172.
10 OECD, Conduit Report, N 7.
11 Art. 10(2) OECD MC.
12 Art. 11(2) OECD MC.
13 Art. 12 OECD MC.
14 See also art. 11(2) (interest) OECD MC: "However, interest arising in a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10 per cent of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation".
15 See below I/E/3.

Further, over the years, what, in essence, constitutes a conduit company remained controversial, particularly for multinational groups organizing their operations through a holding, licensing or a financial company. Recently, the topic also captured attention within the internal market with two landmark decisions rendered by the Court of Justice of the European Union (CJEU).[16] In her Opinion on these cases, Advocate General Kokott perfectly summarizes the tension with which any multinational group is faced when arranging its flows of income: *"The key question that arises here is how far a multinational group can go when configuring corporate structures to reduce final liability for withholding tax [...] within the Group"*.[17] This observation is of course completely relevant in tax treaty policy.

The 1977 commentaries were ambiguous on this point. On the one hand, the commentaries to these articles simply stated that: *"the limitation of tax in the State of source is not available when an intermediary, such as an agent or nominee, is interposed between the beneficiary and the payer, unless the beneficial owner is a resident of the other Contracting State"*.[18] On the other hand, the 1977 commentaries established a clear link between beneficial ownership and the improper use of DTAs providing that: *"Some of these situations are dealt with in the Convention, e.g. by the introduction of the concept of 'beneficial owner' (in Articles 10, 11 and 12)"*.[19] While the 1977 commentaries were thus rather concise, they nevertheless paved the way for future work. It is fair to say that the main milestones of this work were the 1986 Conduit Report, the 1992, 2003 and, in relation to the beneficial ownership limitation specifically, the 2014 update of the commentaries.

Over the years, however, what, in essence, constitutes a conduit company remained controversial, particularly for multinational groups organizing their operations through a holding, licensing or a financial company. Recently, the topic also captured attention within the internal market with two landmark decisions rendered by the Court of Justice of the European Union (CJEU).[20] These cases involved the denial of the benefits provided by the Parent-Subsidiary and Interest and Royalty Directives to various conduit structures (hereafter: the PSD and IRD cases). In her Opinion on these cases, Advocate General Kokott perfectly summarizes the tension with which any multinational group is faced when arranging its flows of income: *"The key question that arises here is how far a multinational group can go when configuring corporate structures to reduce final*

[16] CJEU, 26 February 2019, Case C-116/16 (Joined cases; CJEU, 26 February 2019, Case C-115/16 (joined cases).

[17] Case C–117/16, *Skatteministeriet v Y Denmark Aps* [2019], Opinion of AG Kokott, para 3.

[18] 1977 OECD Commentary para. 12 ad art. 10; para. 8 ad art. 11; para. 4 ad art. 12.

[19] 1977 OECD Commentary, para. 10 ad art. 1.

[20] CJEU, 26 February 2019, Case C-116/16 (Joined cases; CJEU, 26 February 2019, Case C-115/16 (joined cases).

liability for withholding tax [...] within the Group".[21] This observation is also completely relevant in a tax treaty context.

Further to the adoption of the 1986 Conduit Report and 2003 update of the commentaries, it is fair to say that the beneficial ownership limitation gradually became the primary response to treaty abuse involving conduit structures. During this period, there was in particular a significant increase in relevant court decisions around the globe. The decisions often made reference to the 1986 Conduit Report and/or the 2003 commentaries with several courts accepting their application to DTAs concluded before these OECD materials. Some prominent scholars have shown that beneficial ownership was historically not intended to address the conduit company problem but, rather, to deal with technical difficulties stemming from the interposition of agents and nominees in the state of residence. However, when it comes to the interpretation of beneficial ownership under the rules of the VCLT, a restriction of the beneficial ownership limitation to agents and nominees seems to be difficult to derive from the ordinary meaning of this term – also understood in its context, object and purpose[22] – which is rather open-ended. Moreover, since the 1986 Conduit Report the OECD clearly went in the opposite direction stating that: *"a conduit company can normally not be regarded as the beneficial owner if, though the formal owner of certain assets, it has very narrow powers which render it a mere fiduciary or an administrator acting on account of the interested parties (most likely the shareholders of the conduit company)"*.[23] It is remarkable that this passage, which was formally included in the OECD Commentary in 2003[24] remained consistently unchanged up to its most recent update in 2017.[25] In particular, the changes introduced in the commentaries in 2014, arguably designed to convey a more legal interpretation of beneficial ownership, did not affect the commentaries on this point.[26]

This being said, the application of the beneficial ownership limitation continues to raise difficulties in treaty practice for a number of reasons, in particular the two following ones. First, beneficial ownership is not capable of addressing all components of the conduit problem. Secondly, beneficial ownership only applies to dividends, interest and royalties and even if it were to be included in other distributive rules such as capital gains[27] it would it be conceptually inappropriate to deal with the form of tax treaty not involving the channelling of item of income to non-residents. Thirdly, as several court decisions around the globe have shown, and indirectly the latest judgments of the CJEU

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21 Case C–117/16 *Skatteministeriet v Y Denmark Aps* [2019], Opinion of AG Kokott, para 3.
22 Art. 31(1) VCLT.
23 OECD, Conduit Report, N 14.
24 2003 OECD Commentary, para. 12.1 ad art. 10.
25 2017 OECD Commentary, para. 12.3 ad art. 10.
26 2014 OECD Commentary, para. 12.3 ad art. 10.
27 Art. 13 OECD MC.

in the PSD and IRD cases, the interaction of beneficial ownership with general anti-avoidance rules remains extremely controversial. In particular, what happens if an entity established in the state of residence fails the pass the beneficial ownership test but, on the facts and circumstances of the case, it appears that there is no intention to abuse the DTA at stake? Here, of course the order of application of beneficial ownership matters. If beneficial ownership is considered as a mere condition to access tax treaty benefits and is applied first then tax treaty benefits should be denied even if there is no abuse. The question of course is then whether this makes sense from a policy point of view. Moreover, as we shall see, courts are not always consistent on this matter. Finally, and along the same lines, what if a conduit entity established in the state of residence is not the beneficial owner but that the latter is a person established in a third state with which the state of source has concluded a DTA, are the benefits provided by this agreement alternatively automatically available? In these instances, the OECD commentaries provide that the *"limitation of tax in the state of source remains available when an intermediary [...] is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other contracting state"*.[28] While the text of the OECD MC was even amended in 1995 and 2014 to make this point clearer, some courts, at least from a procedural standpoint, do not understand the commentaries to mean that alternative tax treaty benefits would be automatically available.

In our opinion, the foregoing difficulties – at least several of them – are likely to be exacerbated with the introduction of a Principal Purposes Test (PPT)[29] and a new preamble in the 2017 OECD MC further to the OECD/G20 Base Erosion and Profit Shifting Initiative (BEPS). It is indeed remarkable that the beneficial ownership limitation was kept into the OECD MC and the commentaries stemming from the 1986 Conduit Report remained unchanged[30] while, at the same time, the PPT is clearly intended to deal with the conduit problem in a holistic fashion.[31] The articulation between the two tests and, more importantly in practice, whether they may lead to a different outcome thus becomes relevant. The question of the relation between beneficial ownership and the new preamble to the MC also arises. This preamble provides indeed that DTAs should not create opportunities for non-taxation or reduced taxation *"including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third countries"*.[32] Interestingly, as we shall see, the 2017 commentaries mainly consider the effect of this preamble on the interpretation of the PPT. By contrast, little or no consideration has been paid to the possible impact of this preamble

[28] 2017 OECD Commentary, para. 12.7 ad art. 10.
[29] Art. 29(9) 2017 OECD MC.
[30] 2017 OECD Commentary, para. 12.3 ad art. 10.
[31] 2017 OECD Commentary, para. 187 ad art. 29.
[32] Preamble to the 2017 OECD MC.

on other tax treaty terms and provisions, in particular the beneficial ownership limitation. It is therefore an opened question whether the new preamble could affect – namely expand – the meaning of beneficial ownership and, as a result, complicate further the delineation between the application of this limitation and the PPT in conduit cases.

In light of the foregoing latest developments, the author finds it appropriate to return to the issue of beneficial ownership in the present volume dedicated to Professor Etienne POLTIER with whom we had in particular the pleasure of debating, over the years, the problem of application of tax treaty shopping in light in particular of Switzerland's case law.

The aim of the present contribution is to assess whether the beneficial ownership limitation is still necessary in post-BEPS tax treaty policy. For this purpose, our discussion will be articulated into two main sections, the analysis of the beneficial ownership limitation before (2) and after (3) BEPS.

I. Beneficial ownership as a response to conduit companies cases in pre-BEPS treaty policy

A. Conduit companies cases and improper use of DTAs

The 1977 OECD Commentary to art. 1 MC states first of all that: *"[...], the extension of the network of double taxation conventions still reinforces the impact of such manoeuvres by making it possible, using artificial legal constructions, to benefit both from the tax advantages available under domestic laws and the tax relief provided for in double taxation conventions"*.[33] Paragraph 9 of this commentary then goes on to provide that: *"This would be the case, for example, if a person (whether or not a resident of a Contracting State), acts through a legal entity created in a State essentially to obtain treaty benefits that would not be available directly"*.[34] The combined reading of these two passages of the commentaries confirms that a conduit company may in essence be described as an *"artificial legal construction"*.[35] Therefore, the notion of *"legal entity"* in paragraph 9 of the commentaries should not be read beyond artificial legal constructions. It is remarkable that the OECD Commentary remained unchanged on this point until its

[33] 1977 OECD Commentary, para. 8 ad Art. 1.

[34] 1977 OECD Commentary, para. 9 ad Art. 1. In the same vein, in 1987 United Nations Ad Hoc Group of Experts, N 8 also favoured the same definition: *"The term 'abuse of tax treaties' may be defined loosely as the use of-tax treaties by persons the treaties were not designed to benefit, in order to derive benefits the treaties were not designed to give them"*.

[35] DE BROE, Prevention of Abuse, p. 321.

2017 update which no longer makes reference to the notion of artificial legal construction. The possible impact of this change under post-BEPS tax treaty policy will be addressed in the second part of this contribution.

In 1986, the OECD Conduit Report built on the 1977 commentaries and further illustrated the notion of conduit company by drawing a distinction between so-called *"direct conduit"* and *"stepping-stone"* structure.[36] A direct conduit situation occurs where, in essence, the income received by an entity interposed in the state of residence is immediately and (almost) entirely distributed in the form of dividends[37] to persons not entitled to (identical) tax treaty benefits.[38] By contrast, stepping stone structures refer to cases in which the entity interposed in the state of residence is under the obligation to pass on the treaty favoured income it receives to a non-resident through deductible expenses[39] (management fees, interest, royalties, etc.) eroding its taxable basis and usually giving rise to no withholding tax.[40] A classic example of stepping stone strategies is a back-to-back arrangement involving two mirror loans and corresponding interest payments.[41]

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36 OECD, Conduit Report, p. 2 N 2. For a detailed discussion of these notions, see in particular VAN WEEGHEL, Improper Use of Tax Treaties, p. 119 et seq.; DE BROE, Prevention of Abuse, p. 5 et seq.

37 These dividends would typically not be subject to a domestic withholding tax in the state of residence of the intermediary entity.

38 See OECD, Conduit Report, N 4, pp. 2-3: *"A company resident of State A receives dividends, interest or royalties from State B. Under the tax treaty between States A and B, the company claims that it is fully or partially exempted from the withholding taxes of State B. The company is wholly owned by a resident of a third State not entitled to the benefit of the treaty between States A and B. It has been created with a view to taking advantage of this treaty's benefits and for this purpose the assets and rights giving rise to the dividends, interest or royalties were transferred to it. The income is tax-exempt in State A, e.g. in the case of dividends, by virtue of a parent-subsidiary regime provided for under the domestic laws of State A, or in the convention between States A and B".* See thereupon DE BROE, Prevention of Abuse, p. 14 et seq.

39 OECD, Conduit Report, N 6, p. 3: *"The situation is the same [...]. However, the company resident of State A is fully subject to tax in that country. It pays high interest, commissions, service fees and similar expenses to a second related 'conduit company' set up in State D. These payments are deductible in State A and tax-exempt in State D where the company enjoys a special tax regime".*

40 OECD, Conduit Report, N 5; DANON, Bénéficiaire effectif, p. 38 et seq.

41 OECD, Conduit Report, N 4. See also OECD, Conduit Report, N 5d, example 4: *"A tax haven company plans to invest funds as a loan in a high tax State A. The funds are channelled through a company set up for this purpose in a high tax State B. This company receives interest from State A at a rate of, say, 12 per cent and pays interest to the tax haven company at a rate of 11.5 per cent. State A levies a withholding tax on interest which is reduced to nil under the convention between States A and B. State B does not levy withholding tax on interest under domestic law. In such a case the tax haven company benefits from a treaty between the high tax States A and B though it is subject to tax in the latter State only to an insignificant degree (i.e. paying a normal tax only on the marginal 0.5 per cent of the interest)".*

In our opinion, the notion of *"artificial legal construction"* under the 1977 OECD Commentaries is materially very similar to the concept of *"wholly artificial arrangement"* developed by the CJEU in the framework of abuse rights within the internal market. Therefore, the PSD[42] and IRD cases[43] decided by the CJEU to which we shall revert on several occasions, may also in our view provide useful guidance as regards the characterization of an artificial conduit company for tax treaty purposes. The CJEU held, very much in line with the 1986 OECD Conduit Report, that an indicator of the existence of a direct conduit arrangement was the fact that the interposed entity receives dividends which *"very soon after their receipt"* are passed on to its shareholders.[44] A similar conclusion was drawn by the CJEU in relation to a stepping structure involving a classical back-to-back loan: *"The fact that a company acts as a conduit company may be established where its sole activity is the receipt of interest and its transmission to the beneficial owner or to other conduit companies"*.[45] More generally, for both direct conduit and stepping stone structures other indicators include the *"absence of actual economic activity"* which must *"in the light of the specific features of the economic activity in question, be inferred from an analysis of all the relevant factors relating, in particular, to the management of the company, to its balance sheet, to the structure of its costs and to expenditure actually incurred, to the staff that it employs and to the premises and equipment that it has."*[46] In these instances, the intermediary company of a group is no longer a regular holding company which, as the CJEU has held in the *Deister* case, cannot *per se* be regarded as an artificial arrangement.[47]

This being said, there is often some confusion as what to are really the decisive elements to be taken into consideration for the purposes of assessing whether an intermediary company is to be regarded as an artificial conduit in the context of dividends, interest and royalties. To some extent, the CJEU maintains this confusion in the foregoing guidance. This is because some criteria mentioned by the Court could be interpreted as pointing to the degree of nexus that an intermediary entity has with a state (for example the references to the availability of premises and equipment[48]) while others by contrast refer to the manner in which the entity derives its income and passes it on to related entities in

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42 CJEU, 26 February 2019, Case C-116/16 (Joined cases).
43 CJEU, 26 February 2019, Case C-115/16 (joined cases).
44 CJEU, 26 February 2019, Case C-116/16 (Joined cases), para. 101.
45 CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 131.
46 CJEU, 26 February 2019, Case C-116/16 (Joined cases), para. 104; CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 131.
47 CJEU, 20 December 2017, Cases C-504/16 and C-613/16 (Joined cases), para 73: *"The fact that the economic activity of a non-resident parent company consists in the management of its subsidiaries' assets or that the income of that company results only from such management cannot per se indicate the existence of a wholly artificial arrangement which does not reflect economic reality"*.
48 CJEU, 26 February 2019, Case C-116/16 (Joined cases), para. 104.

the group (for example the reference to the fact that the dividends are passed on very soon after their receipt[49] and indications of an artificial arrangement may also be constituted by the various contracts existing between the companies involved in the financial transactions at issue, giving rise to intragroup flows of funds).[50] In our opinion, in order to determine whether an intermediary entity is to be regarded as an artificial conduit company in relation to dividends, interest and royalties, the key question to address is not its nexus with a given state but rather to what extent it receives the relevant item of income in an artificial fashion.[51] Therefore, a large financial company having a significant presence in a state (personnel, premises etc.) may, depending on the facts and circumstances, still act as a conduit with respect to some income streams which it artificially receives and transfers (for example on the basis of an artificial back-to-back loan). Conversely, a holding company having a very limited organizational structure is not necessary a conduit company to the extent the facts reveal that, for instance, the redistribution to its shareholders of the dividends it receives from its subsidiaries is not part of an artificial arrangement but rather the genuine expression of its corporate existence and a dividend policy consistent with its interests.

Usually, a conduit company is incorporated by residents of a third country not having concluded any DTA with the state of source (or a DTA providing for equivalent benefits). However, treaty abuse may also involve residents of a contracting state. The 1977 OECD Commentary indeed makes it very clear that treaty shopping occurs where a person *"whether or not a resident of a Contracting State"*, acts through a legal entity created in a State essentially to obtain treaty benefits that would not be available directly.[52] In fact, treaty shopping involving residents of a contracting state may in certain instances be regarded as a more severe form of abuse. This is the case in so-called *"round-tripping"* structures in which income arising in one contracting state is artificially shifted to an

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49 CJEU, 26 February 2019, Case C-116/16 (Joined cases), para. 101.

50 CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 132.

51 In a similar vein, from an EU law perspective, DE BROE/GOMMERS, beneficial ownership cases, sec. 4.1. rightly note that: *"as the objectives of the PSD or IRD are not the same as those underlying the TFEU freedom of establishment for which economic substance in the State of secondary establishment is required, the fact that the interposed company carries on a considerable economic activity and has commercial substance does by no means shield it off from a claim that it abuses the IRD if e.g. a back-to-back loan is routed through that company. The same goes a fortiori where a company is interposed on a large scale in such financial conduit arrangements and uses staff, premises and equipment for that activity"*.

52 1977 OECD Commentary, para. 9 ad Art. 1. In Starr International Co Inc v United States of America; United States of America v Starr International Co Inc, 20 ITLR 94, 116, the US Court, specifically referring to this passage of the 1977 OECD Commentary, confirmed for example *"treaty shopping does frequently involve the participation of a third-country resident, but it needs not. Rather, its essential characteristic is treaty abuse—manipulating on-paper residency for the purpose of obtaining treaty benefits"*.

entity interposed in the other contracting state and then transferred back to resident investors of the first contracting state. In these instances, the state granting treaty benefits is in a worse position: the revenue losses borne by this state are not even compensated by a genuine increase in foreign direct investment.[53]

B. Delineation between conduit companies cases and other forms of treaty abuse

Strictly speaking, the problem of improper use of DTAs caused by the interposition of a conduit company in the state of residence should be distinguished from tax treaty shopping associated to an abusive restructuring. Here, a restructuring takes place in order to cause the application of the relevant tax treaty or of a more favourable treaty provision (rule shopping).[54] The problem does thus not lie in the way in which income is transferred to a non-resident through a conduit company. Rather, at issue are the circumstances surrounding the restructuring (typically the timing and/or sequence of events) that may appear awkward and hence abusive.

A first example are cases in which a resident of a third country transfers its shareholding in a company in the state of source (State S) to an entity in the state of residence (State R) with a view to claim the benefits of the S-R treaty (i.e. a more favourable residual rate) on subsequent dividend distribution. The existence of a potential abuse typically arises if a dividend consisting in the retained earnings generated before the transfer is distributed shortly after the latter (or even more so in the case of a liquidating distribution). In Switzerland, for example, this fact pattern is tackled by the so-called "old reserves theory", which in a treaty context essentially leads to the application of the (treaty

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53 While some jurisdictions have approached treaty shopping rather liberally when it involves foreign investors (Union of India and another v Azadi Bachao Andolan and another 6 ITLR 233) there is by contrast a consensus that treaty shopping aiming at achieving *"round-tripping"* represents the most blatant form of treaty abuse. In Vodafone International Holdings BV v Union of India and another, para. 68, 14 ITLR 431, 451, the Indian Supreme Court considered for example that: *"if a structure [...] for circular trading or round tripping then such transactions, though having a legal form, should be discarded by applying the test of fiscal nullity"*. See also *Re Verdannet*, 20 ITLR 832, 872 in which the reporting Judge rightly noted *"the primary function of these treaties, beyond this immediate purpose, is to facilitate international economic exchanges [...]. It is, therefore, part of their very logic that they be read as not intending to apply to taxpayers who artificially create the conditions of foreignness allowing them to claim, according to a literal interpretation, the benefit of their clauses"*.

54 On this distinction see in particular DANON, distinction entre évasion fiscale, "treaty" et "rule shopping", particularly p. 133 et seq. and 145 et seq.

residual) withholding tax rate on the reserves generated before the share transfer.[55] A variation of this example is the case in which a taxpayer (for instance an individual) entitled to the 15 % portfolio rate of article 10(2)(b) of the S-R treaty contributes his shareholding to a company resident of State R in order to obtain the 5 % (or even 0 %) rate of article 10(2)(a) of the same treaty on subsequent dividend (liquidating) distributions. This second variation is described as a "rule shopping" because the question is whether the benefit of a more favourable distributive should be regarded as abusive.[56] From the perspective of the DTA's operation, the problem lies here in the fact that in the foregoing examples, treaty benefits may not be denied on the basis of wording of art. 10 OECD MC. Under this distributive rule, the situation prevailing at the time of payment of the dividends is indeed solely decisive.[57] Hence, a so-called "compartmentalization" approach consisting in granting treaty benefits only with respect to earnings generated after the cross-border or domestic restructuring is not possible.

Of course, in real life cases involving treaty shopping associated to dividends, interest and royalties the existence of a conduit structure may well be combined with an abusive restructuring. In the first example mentioned above assume for instance that, after the share transfer, a liquidating distribution is made to a conduit company in the state of residence which, in turn, immediately makes a dividend distribution to its non-resident shareholders or is being liquidated.

This being said, as we shall now see, this delineation is relevant when considering the relation between the beneficial ownership limitation and conduit structures.

C. Relation between beneficial ownership and conduit companies cases

As mentioned by Baker, it is pretty clear that the beneficial ownership limitation was introduced to counter treaty shopping by the channelling of the relevant income through a resident of a state with a suitably attractive treaty provision.[58] Conceptually, however, the beneficial ownership limitation, if at all, is only capable of addressing the conduit problem *stricto sensu*. That is, the way in which the treaty protected income transits

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55 Federal Administrative Court Judgments of 23 March 2010, A-2744/2008, RF 2010, 652 et seq. and 31 August 2016, A-5692/2015; see also with further references on the Swiss administrative practice DANON/OBRIST, La théorie des "anciennes réserves", p. 621 et seq.; DANON, distinction entre évasion fiscale, "treaty" et "rule shopping", p. 136 et seq.; OESTERHELT, Altreservenpraxis, p. 99 et seq.

56 See thereupon DANON, distinction entre évasion fiscale, "treaty" et "rule shopping", p. 145.

57 As regards the temporal scope of distributive rules in general, see in particular SCHUCH, Die Zeit, in particular p. 217 et seq.

58 BAKER, Beneficial Ownership: After Indofood, p. 15.

through a conduit company established in the state of residence. By contrast, tax treaty abuse associated with steps taken to establish the conduit in that state or to transfer a shareholding to it prior to a dividend distribution is outside the scope of beneficial ownership. Therefore, the denial of treaty benefits on account of these steps needs to be founded on a specific (SAAR) or general (GAAR) treaty anti-abuse provision, such as the PPT. As shown, an important difference between the beneficial ownership limitation and the PPT, therefore, is that the latter is potentially applicable to the entire fact pattern involving a conduit structure. The inability of the beneficial ownership limitation to deal with the conduit company problem in a holistic and uniform manner will be one of the reasons leading us to question its usefulness after the introduction of a PPT rule in post-BEPS tax treaty policy.

Another difference, finally, is that beneficial ownership only applies to the dividends, interest and royalties. Hence, an abusive restructuring designed, for instance, to take advantage of art. 13(5) OECD MC (capital gains) upon a subsequent sale of shares is thus any rate not covered by the beneficial ownership limitation. Further, this limitation which focuses on the transfer of a flow of income by the recipient would at any rate be conceptually inappropriate to deal with abuse involving capital gains.[59] In the field of capital gains, for instance in relation to art. 13(5) OECD MC which allocates exclusive taxing rights to the state of residence of the alienator, a relevant indicator of tax treaty abuse is rather the (short) temporal connection between the transfer of a shareholding to a resident, respectively the ownership of the shares, and their alienation.

D. Nature of beneficial ownership

Turning to the nature of beneficial ownership, the well-known interpretative question that must be settled is whether this term should receive an autonomous meaning or if it may be defined by the state applying the treaty (i.e. the source state) according to its internal law. In other words, the issue is whether this is a case in which *"the context otherwise requires"* as prescribed by art. 3(2) OECD MC.

This being said, it is widely accepted that beneficial ownership is a term which the context requires to define autonomously[60] and, therefore, on the basis of art. 31 VCLT. The

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59 See BAKER, Possible Extension of the Beneficial Ownership Concept (UN note), N 55.

60 See among others DU TOIT, Beneficial Ownership, p.178; VAN WEEGHEL, Improper use of Tax Treaties, p. 68; VOGEL in Vogel/Lehner, N 15 ad vor Art. 10-12; DANON in Danon *et al.*, N 97 ad art. 1; DANON, Thesis, p. 330; DANON, Bénéficiaire effectif, p. 40; KEMMEREN, Klaus Vogel on Double Taxation Conventions, Preface to Articles 10 to 12, N 25 and, recently, AVERY JONES, GTTC ad Interpretation (2018), sec. 5.1.2.4.2.2: *"The term 'beneficial owner' is used extensively in UK and Australian domestic legislation and case law has given it a meaning that is not necessarily appropriate to tax treaties, for example, there are cases where there is no beneficial owner. This is a term the*

same conclusion was reached at several annual Congresses of the International Fiscal Association (IFA), notably in 1998[61] and in 1999.[62] This position is in particular founded on the fact that countries' domestic laws do not offer a precise and suitable meaning of beneficial ownership.[63] This position is also consistent with the need to avoid a treaty override through domestic law.[64] The 2003 and 2014 updates of the OECD Commentary subsequently clarified this position noting respectively that: *"The term 'beneficial owner' is not used in a narrow technical sense, rather, it should be understood in its context and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance"*[65] and that beneficial ownership: *"was intended to be interpreted in this context and not to refer to any technical meaning that it could have had under the domestic law of a specific country (in fact, when it was added to the paragraph, the term did not have a precise meaning in the law of many countries)"*.[66]

Interestingly, in the preparatory work relating to the 2014 update of the commentaries, reference to domestic law for the purposes of defining beneficial ownership was rejected

purpose of which indicates that a common interpretation should be given that would not be achieved by using domestic law in one of the states and a general meaning in the other; a common meaning should be used in both states".

61 IFA, The concept of beneficial ownership in tax treaties (1998), pp. 15-33. See for example LÜTHI, p. 21 *"I will speak as the Swiss delegate to the OECD [...]. I share the concerns expressed [...] that beneficial ownership should be a treaty concept (emphasis added). The use of Art. 3(2) and the application of given rules in this field of domestic law could in my view undermine treaty solutions and could lead to some kind of treaty override. I think that since one grants benefits by way of a treaty, one should also say under what circumstances such benefits will be denied and this should not be done based on domestic law but on treaty provisions [...]. We should be quite clear to say that it is not up to domestic law to decide who is entitled to treaty benefits [...]".*

62 See the proceeds of the discussions summarized in OLIVER *et al*., Beneficial Ownership, p. 310 et seq., notably p. 314 et seq.

63 VOGEL 1997, N 8 ad art. 10-12.

64 See generally OECD, Treaty Override Report, N 9: *"the general rule of interpretation should be based on the terms of the treaty in their context. This corresponds to the approach taken in Article 3, paragraph 2, of the OECD Model Convention where the context of the treaty takes precedence over an interpretation derived from national laws. Interpretation should thus aim at a coordinated application in both States in order to avoid double taxation"*; VOGEL 1997, Introduction, N 74: *"[...] the mandate to interpret a tax treaty in light of its object and purpose (Art. 31 (1) VCLT leads to the requirement that states should seek the treaty interpretation which is most likely to be accepted in both contracting states (the goal of 'common interpretation')".*

65 2003 OECD Commentary, para. 12 ad art. 10.

66 2014 OECD Commentary, para. 12.1 ad art. 10.

even in cases in which such reference could possibly provide for a meaning consistent with the OECD commentaries.[67]

As we shall see, numerous decisions around the globe have followed the same reasoning either explicitly or implicitly by referring to OECD materials, notably the commentaries and the 1986 OECD Conduit Report.[68] In particular, as noted by the UK Court of Appeal in the famous *Indofood* case: *"the term 'beneficial owner' is to be given an international fiscal meaning not derived from the domestic laws of contracting states"*.[69]

There is little doubt in our mind that conferring an autonomous and contextual treaty meaning to beneficial ownership is the only defendable position.

E. Meaning of beneficial ownership

Because beneficial ownership is a term that must receive a contextual definition such meaning must thus be solely be derived from the interpretative process governed by art. 31 et seq. VCLT. We begin with some preliminary considerations under art. 31 VCLT (2.5.1) and then contrast these considerations with the meaning of beneficial ownership under the OECD commentaries and reports (2.5.2), tax treaty practice (2.5.3) and also consider as a short excursus the meaning given by the CJEU to beneficial ownership in the IRD and PSD cases (2.5.4). We then move to the scholarly debate between the legal and substance-oriented interpretation (2.5.5) which we try to reconcile (2.5.6).

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67 In its discussion draft of April 2011, the OECD had initially envisaged that domestic law could be given some relevance to the extent it did not conflict with the treaty meaning of beneficial ownership, *see* OECD Discussion Draft, April 2011, p. 8 draft Commentary ad art. 12.1 in fine: *"[...] This does not mean, however, that the domestic law meaning of 'beneficial owner' is automatically irrelevant for the interpretation of that term in the context of the Article: that domestic law meaning is applicable to the extent that it is consistent with the general guidance included in this Commentary".* This latter approach was however strongly rejected so that this phrase was never included in the commentaries, OECD Model Tax Convention: Revised Proposals Concerning the Meaning of "Beneficial Owner" in Articles 10, 11 and 12, para. 2-4: *"A number of comments supported the suggestion that 'beneficial owner' should have an autonomous treaty meaning [...]. Whilst the majority of comments supported the conclusion that an autonomous meaning should be given to the term 'beneficial owner', a number of commentators objected to the last sentence of the paragraph dealing with the domestic law meaning of that term. It was noted that this sentence appeared to contradict the conclusion that an autonomous meaning should be preferred [...]. Based on the guidance in existing paragraph 12 and the majority of the comments received on this issue, the Working Party concluded that the interpretation reflected in the proposed paragraph was the correct one but that the last sentence of the paragraph was potentially confusing and should therefore be deleted"*.

68 MARTÍN JIMENEZ, beneficial ownership p. 50.

69 Indofood International Finance Ltd v JPMorgan Chase Bank NA, London Branch, para. 42, 8 ITLR 653, 674.

1. Some preliminary considerations under art. 31 VCLT

According to art. 31(1) VCLT: *"A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose"*. It is settled that art. 31(1) VCLT expresses the primacy of the textual approach in the interpretative process.[70] It consequently follows that the ordinary meaning of terms used by a treaty is deemed to reflect the intentions of its parties.[71] At the same time, by requiring treaty terms to be interpreted in their *"context"*, art. 31(1) VCLT seeks to avoid a pure grammatical and isolated interpretation.[72] Therefore, the meaning of a term such as beneficial ownership can only be determined by taking into consideration the entire article in which this term appears, the rest of the treaty[73] including its preamble.[74]

As we have already argued the literal interpretation undoubtedly supports the argument that beneficial ownership is a test which focuses on ownership attributes.[75] Accordingly, it follows that, subject to the requirements laid down by art. 4 OECD MC (treaty residence), the nature of the recipient's objective connection with the state of residence is immaterial for the purpose of the beneficial ownership requirement. Whether, for example, the recipient of the income carries on a commercial activity, is a stock listed company or simply a pure passive holding company, is of no importance. From this perspective, the beneficial ownership requirement is conceptually different than limitations on benefits provisions, for example an "*active business test*". These tests attempt to detect abuse by scrutinizing the connections existing with the state of residence. Beneficial ownership, on the other hand, looks at the intensity of the ownership attributes of the recipient of the income. A definition of beneficial ownership implying a substance (personnel, offices etc) requirement, is thus not compatible with the literal interpretation of this term. Rather, these elements may only be taken into consideration for purposes of establishing the ability of the recipient to own the treaty protected income within the meaning of the beneficial ownership limitation. Similarly, the tax status of the recipient (ordinary taxation, objective or subjective exemption) is equally not relevant.

Secondly, since art. 10(1) and 11(1) OECD MC already require that dividends and interests be *"paid to"* a resident of the other contracting state the contextual interpretation under art. 31(1) VCLT suggests that the ownership attributes with which beneficial ownership is concerned do not just relate to the fiscal attribution of these items to a recipient.

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70 ENGELEN, Interpretation of Tax Treaties, p. 426; VOGEL 1997, Introduction, N 84.
71 Vienna Convention Commentary, N 11, p. 220.
72 VILLIGER ad art. 31 VCLT (2009), para. 10.
73 VILLIGER ad art. 31 VCLT (2009), para. 10.
74 Art. 31(2) VCLT.
75 DANON, Bénéficiaire effectif, p. 40.

Otherwise, beneficial ownership would have no scope of its own compared to this *"paid to"* requirement,[76] a result which would not be compatible with the principle of effectiveness[77] governing the interpretative process under the VCLT.

Thirdly, the OECD MC refers to *"beneficial owner"* and not to the *"ultimate beneficial owner"* of the income. Accordingly, equating beneficial ownership to a look through approach is erroneous. Rather, in a group structure, it is perfectly conceivable for an intermediary holding company to satisfy the beneficial ownership requirement. Moreover, the OECD MC refers to the beneficial owner of an item of income. Whether, therefore, the recipient of the income is also the owner of the underlying asset is not decisive.

It is fair to say that the foregoing conclusions are reflected in the OECD Commentary (in particular since its 2014 update) and, to some extent, in leading decisions around the globe.

This being said, the context under art. 31 VCLT also includes the preamble of the treaty.[78] The question is therefore to what extent the meaning of beneficial ownership could be influenced by the preamble of the treaty. Since 2003, the OECD Commentary goes in this direction stating that beneficial ownership *"should be understood in its context, [...] in light of the object and purposes of the Convention, including double taxation and the prevention of fiscal evasion and avoidance"*.[79] At the same time, however, one could argue that on this point, the OECD Commentary is stating the obvious: any treaty term should be interpreted in its context and taking into account its object and purpose. In fact, in pre-BEPS tax treaty policy, the issue was never really addressed thoroughly. However, as discussed in the second part of this contribution, the problem becomes more relevant under the 2017 OECD MC whose preamble now provides that the elimination of international double taxation should not create opportunities for non-taxation or reduced taxation *"including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third countries"*. We revert to these issues in the second part of this contribution.

Finally, since it is settled that beneficial ownership was introduced into the OECD MC to deal, at least to some extent, with certain treaty shopping situations, a question also arising is whether the intention of the taxpayer to abuse the relevant DTA should be taken into consideration in the beneficial ownership analysis. There is obviously no support for this reasoning if the beneficial ownership limitation is properly construed in accordance

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76 Art. 12 OECD MC (royalties), by contrast, does not clearly distinguish between the issue of fiscal attribution and beneficial ownership since it only refers to *"royalties [...] beneficially owned by a resident of the other Contracting state"*.

77 DÖRR ad art. 31 VCLT (2018), para. 52 (6).

78 Art. 31(2) VCLT.

79 2003 OECD Commentary, para. 12 ad art. 10.

with art. 31 VCLT. At the same time, the distinction between beneficial ownership and the prohibition of abuse has sometimes proven to be difficult to make in tax treaty practice as illustrated in France by the *Bank of Scotland* case.[80] In the UK further to the *Indofood* case,[81] a subjective element *("main purpose test")* was even built into the beneficial ownership limitation by HMRC but in order to switch it off in the absence of abuse.[82] Therefore, the question of whether the beneficial ownership limitation is a mere technical condition to access tax treaty benefits or a specific anti-abuse rule (with a subjective element) remains controversial. The recent decisions of the CJEU in the PSD and IRD cases, although dealing with directive shopping, have also fuelled the discussion regarding the relation between beneficial ownership and the prohibition of abuse.[83]

2. Meaning under the OECD commentaries: the main milestones

a) The 1977 Commentary

As already mentioned, the 1977 OECD Commentary contained very little information as to the interpretation of the beneficial ownership requirement. The commentaries to art. 10 (dividends), 11 (interest) and 12 (royalties) OECD MC simply provided that: *"the limitation of tax in the State of source is not available when an intermediary, such as an agent or nominee, is interposed between the beneficiary and the payer, unless the beneficial owner is a resident of the other Contracting State"*.[84] There was however also a reference to beneficial ownership in the commentaries to art. 1 relating to cases of improper use of DTAs. According to paragraph 10 of these commentaries: *"Some of these situations are dealt with in the Convention, e.g. by the introduction of the concept of "beneficial owner" (in Articles 10, 11 and 12)"*.[85]

The conciseness of the 1977 OECD Commentary led to some uncertainty as regards the meaning and scope of the beneficial ownership limitation. On the one hand, these commentaries only expressly excluded agents and nominees from tax treaty benefits. On the other hand, the reference to *"such as"*[86] an agent or a nominee suggested that the limitation also applied to other intermediaries of the same kind. A few commentators have supported the idea that the commentaries were in fact exhaustive and that beneficial

80 Ministre de l'Économie, des Finances et de l'Industrie v Société Bank of Scotland, 9 ITLR 683, 711.
81 Indofood International Finance Ltd v JPMorgan Chase Bank NA, London Branch, 8 ITLR 653.
82 See below.
83 See below.
84 1977 OECD Commentary para. 12 ad art. 10; para. 8 ad art. 11; para. 4 ad art. 12.
85 1977 OECD Commentary, para. 10 ad art. 1.
86 1977 OECD Commentary para. 12 ad art. 10; para. 8 ad art. 11; para. 4 ad art. 12.

ownership was only meant to exclude agents and nominees.[87] However, a vast majority of scholars have argued that the reference to agents and nominees was merely intended to be illustrative and that, at least in certain circumstances, the beneficial ownership limitation also applied to conduit companies.[88]

We have subscribed to this analysis. The idea that the beneficial ownership limitation could only target agents and nominees is simply based on a strict reading of the 1977 OECD Commentary requiring one to omit reading the words *"such as"* an agent or nominee. Further and in any event, this position becomes very difficult to defend if the ordinary meaning of beneficial ownership in its context[89] is simply considered. The ordinary meaning of beneficial owner, which focuses on ownership attributes from a general perspective, does not support an exclusion limited to formal agents and nominees.[90] Moreover, the contextual interpretation of beneficial owner in its nexus with other treaty limitations (in particular the *"paid to"* requirement contained in art. 10 and 11 OECD MC), also confirms this analysis.

For these reasons an overwhelming majority of commentators[91] have submitted that the beneficial ownership limitation applies, as a matter of principle, to conduit companies. Therefore, these scholars view the findings of the 1986 OECD Conduit Report, which are presented below, as simply clarifying the interpretation of beneficial ownership under the 1977 OECD Commentary.[92] Over the years, as we shall see, the debate has rather

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87 OLIVER *et al*., p. 324; VAN WEEGHEL, Improper Use of Tax Treaties, pp. 116-117.

88 In his doctoral thesis dedicated to beneficial ownership DU TOIT for example argues that by using the wording *"such as an agent or nominee"* the 1977 OECD Commentary's reference to *"agent or nominee"* is just meant to be illustrative (DU TOIT, Beneficial Ownership, thesis, p. 216). In the same vein, DE BROE observes that: *"Had they wished to restrict the denial of treaty benefits to agents and nominees, the drafters of the OECD MC could have used those words explicitly in the OECD MC or they could have said it expressly in the Commentary. The fact that the 1977 Commentary uses the terms 'such as an agent or nominee' suggests the opposite"* (DE BROE, Prevention of Abuse, pp. 682-683). See also the *Commissaire du Gouvernement* in the *Bank of Scotland* case decided by the French *Conseil d'État*: *"The commentaries of the OECD do not exclude any forms of intermediary but cite in particular agents and nominees" Commissaire du Gouvernement*, Mr. François Seners, Ministre de l'Économie, des Finances et de l'Industrie v Société Bank of Scotland, 9 ITLR 683, 711. See also in the same vein COLLIER, Beneficial ownership, pp. 690-691.

89 Art. 31 VCLT.

90 DE BROE, Prevention of Abuse, pp. 682-683 (68).

91 DE BROE, Prevention of Abuse, p. 720; DU TOIT, Beneficial Ownership, p. 217; COLLIER, Beneficial ownership, pp. 690-691; PIJL, Beneficial Ownership, p. 355.

92 DU TOIT notes that this Report: *"merely explains certain aspects surrounding beneficial ownership. It does not provide any information that did not already apply to beneficial ownership in 1977"* (DU TOIT, Beneficial Ownership, p. 217), while DE BROE believes that: *"the 2003 Commentary is almost identical to the 1986 Conduit Companies Report and such Report was intended to clarify the 'open end' definition of 'beneficial owner' used in the 1977 Commentary"* (DE BROE, Prevention of Abuse, p. 720, footnote N 1111).

concentrated on whether the beneficial limitation should be applied to conduit companies cases on the basis of a substance over form or legal interpretation. In other words, as Baker puts it, the question is: *"how artificial must the conduit arrangement have been for the benefit of the treaty to be denied?"*.[93]

b) The 1986 Conduit Report and 2003 Commentary

On 27 November 1986 the OECD Council adopted the Conduit Report which incorporated important considerations on the beneficial ownership limitation. The Report makes it clear that it built on the 1977 commentaries on improper use of DTAs.[94] The guidance on beneficial ownership is contained in section II.B dealing with anti-avoidance provisions of the report which reads as follows: *"Articles 10 to 12 of the OECD Model deny the limitation of tax in the State of source on dividends, interest and royalties if the conduit company is not its 'beneficial owner'. Thus, the limitation is not available when, economically, it would benefit a person not entitled to it who interposed the conduit company as an intermediary between himself and the payer of the income (paragraphs 12, 8 and 4 of the Commentary to Articles 10, 11 and 12 respectively). The Commentaries mention the case of a nominee or agent. The provisions would, however, apply also to other cases where a person enters into contracts or takes over obligations under which he has a similar function to those of a nominee or an agent. Thus, a conduit company can normally not be regarded as the beneficial owner if, though the formal owner of certain assets, it has very narrow powers which render it a mere fiduciary or an administrator acting on account of the interested parties (most likely the shareholders of the conduit company)"*.[95]

The findings of the Conduit Report were then included in the 2003 update of the OECD Commentary: *"[...] It would be equally inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned. For these reasons, the report from the Committee on Fiscal Affairs entitled 'Double Taxation Conventions and the Use of Conduit Companies' concludes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in rela-*

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93 BAKER, Beneficial Ownership: After Indofood, pp. 15-16.

94 OECD Conduit Report, N 1: *"In its Commentary on Article 1 of the 1977 OECD Model Convention, the Committee on Fiscal Affairs expressed its concern about improper use of tax conventions (see paragraph 9) by a person (whether or not a resident of a Contracting State), acting through a legal entity created in a State with the main or sole purpose of obtaining treaty benefits which would not be available directly to such person"*.

95 OECD, Conduit Report, N 14.

tion to the income concerned, a mere fiduciary or administrator acting on account of the interested parties".[96]

The Conduit Report and 2003 Commentary have confirmed that the beneficial ownership limitation is capable of being used to deny treaty benefits to conduit companies, at least in certain instances. In fact, in a number of jurisdictions courts have referred to the Conduit Report and/or the 2003 Commentary (on several occasions even in cases involving DTAs concluded before these OECD materials) when considering the application of the beneficial ownership limitation to conduit entities. The Conduit Report and 2003 Commentary have also been understood as endorsing an economic or at least a substance over form meaning of beneficial ownership.[97] It is true that the reference made to a conduit entity having *"very narrow powers"* could suggest a strict legal interpretation. However, the Conduit Report also states that the beneficial ownership limitation is not available when: *"when economically"*, it would benefit a person not entitled to it who interposed the conduit company as an intermediary between himself and the payer of the income.[98] In the same vein, the 2003 commentaries indicate that a conduit company may not be regarded as the beneficial owner where it simply acts as a conduit for another person *"who in fact"* receives the benefit and the conduit company has *"as a practical matter"*, very narrow powers.[99] The use of these expressions emphasizes the relevance of the substance over form analysis.[100] Moreover, in 1998 the OECD Report on Harmful Tax Practices, although not primarily dealing with the problem of improper use of tax treaties, provides that: *"Another example involves denying companies with no real economic function treaty benefits because these companies are not considered as beneficial owner of certain income formally attributed to them"*.[101] The reference to *"real economic function"* seems again to be a plea in favour of a substance over form approach analysis.

c) The 2014 Commentary

Further to the adoption of the Conduit Report and the 2003 OECD Commentary, it is fair to say that the beneficial ownership limitation increasingly became the primary response to conduit structures in treaty practice.

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[96] 2003 OECD Commentary, para. 12.1 ad art. 10.
[97] See among others WARD, Treaty Benefits, pp. 17-18.
[98] OECD, Conduit Report, para. 14, p. 8.
[99] 2003 OECD Commentary, para. 12.1 ad art. 10.
[100] While these two expressions are not expressly used by the 1986 OECD Conduit Report, the 2003 Commentary here however merely transposes the findings of this report. This is in particular evidenced by the fact that these expressions are used when a direct reference to the 1986 OECD Conduit Report is made.
[101] 1998 OECD Report on Harmful Tax Practices, para. 119.

Yet, the OECD still felt that beneficial ownership needed further clarification which ultimately lead to important changes introduced in the 2014 update of the Commentaries. These changes did not consist in a revision of the 2003 commentaries but rather in additional paragraphs intended to clarify the meaning of beneficial ownership. Therefore, the passages of the 2003 update remained unchanged with the commentaries continuing to state that: *"a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties"*.[102] The same was true as regards the need to understand beneficial ownership *"in its context, [...] in light of the object and purposes of the Convention, including double taxation and the prevention of fiscal evasion and avoidance"*. At the same time, the 2014 Commentary also took stock of the consolidation introduced in the 2003 Commentary as regards the possibility to deal with tax treaty abuse with other general or specific anti-avoidance rules.[103] Moreover, the 2014 usefully clarified that the beneficial owner should not be confused with the ultimate owner of a legal person or arrangement[104] and that the limitation is concerned with the beneficial ownership of the dividends, interest and royalties and not with the ownership of the assets producing these items.[105]

This being said, the most important changes came with the introduction of new paragraphs stating that in order for beneficial ownership to be denied, the recipient's right to use and enjoy had to be *"constrained by a contractual or legal obligation to pass on the payment received to another person"*.[106] Therefore, *"where the recipient of a dividend does have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person, the recipient is the 'bene-*

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[102] 2014 OECD Commentary, para. 12.3 ad art. 10.

[103] 2014 OECD Commentary, para. 12.5 ad art. 10: *"whilst the concept of 'beneficial owner' deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on the dividend to someone else), it does not deal with other cases of treaty shopping and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases"*. The 2003 Commentary had indeed consolidated the idea that treaty benefits could be denied on the basis of domestic anti-abuse or by relying on an implied prohibition of abuse provided that this was in accordance with a so-called main purpose test taking the form of a guiding principle.

[104] 2014 OECD Commentary, para. 12.6 ad art. 10: *"it would be inappropriate, in the context of that Article, to consider a meaning developed in order to refer to the individuals who exercise 'ultimate effective control over a legal person or arrangement'"*.

[105] 2014 OECD Commentary, para. 12.6 ad art. 10: *"the term 'beneficial owner' is intended to address difficulties arising from the use of the words 'paid to' in relation to dividends rather than difficulties related to the ownership of the shares of the company paying these dividends"*.

[106] 2014 OECD Commentary, para. 12.4 ad art. 10.

ficial owner' of that dividend".[107] At the same time, however, the 2014 commentaries state that such obligation: *"may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person"*.[108] The reference to *"facts and circumstances"* and *"in substance"* used by the commentaries in this passage could suggest that the OECD has, at least not completely, ruled out the possibility to assess beneficial ownership on the basis of a substance over form interpretation. Another possible and reasonable interpretation, by contrast, would be to consider that the facts may here serve as a tool to prove the existence of an unwritten but nevertheless legal or contractual obligation.[109] Under this analysis, beneficial ownership would be subject to a legal interpretation but also considering what could be described as *"legal substance"*. In other words, beneficial ownership could be denied to a conduit company where, for instance, the facts reveal that this entity is transferring the income it receives pursuant to an implied agency agreement and/or that it is a sham.[110] Nevertheless, the question of whether the 2014 OECD Commentary should be understood in this fashion remains controversial.

3. Comparative analysis under Swiss and international tax treaty case law

The debate between a substance over form or legal interpretation of beneficial ownership has also resonated in tax treaty practice. It is however fair to say that a majority of courts around the globe have embraced a substance over form interpretation of beneficial ownership[111] (2.5.3.1). The Canadian *Prévost* and *Velcro* cases are the most well-known

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[107] 2014 OECD Commentary, para. 12.4 ad art. 10.

[108] 2014 OECD Commentary, para. 12.4 ad art. 10.

[109]. In the same vein, KEMMEREN, Klaus Vogel on Double Taxation Conventions, Preface to Articles 10 to 12, N 11; WEIDMANN, Swiss Swaps Case, p. 231.

[110] See below.

[111] In a doctoral thesis dedicated to beneficial ownership and which has *inter alia* surveyed the interpretation given to the treaty limitation of beneficial ownership around the globe, MEINDL-RINGLER, Beneficial Ownership, pp. 288-289 concludes that: *"there have been a lot of court and administrative decisions on beneficial ownership using a number of different approaches to the concept. Although two countries (Belgium and India) apply a very formalistic approach to beneficial ownership by focusing basically on the legal owner, this is not the prevalent view. There are quite a few countries that use beneficial ownership as a broad anti-avoidance rule [...]. The substance-over-form doctrine is applied in a number of countries [...]. By now, beneficial ownership is rarely used as a (pure) attribution-of-income rule; rather the trend seems to go towards understanding beneficial ownership in the forwarding sense (like in the OECD Commentary) or even as a broader anti-avoidance provision"*. In the same vein, MARTÍN JIMENEZ, beneficial ownership, p. 51 observes that: *"It is interesting that most of the judgements studied (with the important exception of Prévost) adopted an economic/substance-over-form approach to decide who the beneficial owner of income is"*.

exceptions to this trend (2.5.3.2). The findings of the CJEU in the PSD and IRD cases which we shall discuss as a short excursus – although based on the prohibition of abuse within the internal market – seem also to implicitly favour a meaning of beneficial ownership based on a substance over form or even economic interpretation (2.5.4).

a) Substance over form approach under Swiss case law

An early illustration of the substance over form interpretation of beneficial ownership may be found in the *Re V SA* case[112] decided on 28 February 2001 by the former Swiss Federal Commission of Appeal for Taxation.[113] *Re V SA* was the first case in which a Swiss Court was given the opportunity to thoroughly analyze the beneficial ownership limitation. The case, which involved the Switzerland-Luxembourg DTA, concerned a corporation, V SA, which had been incorporated in Luxembourg in January 1995 by two companies resident in the United Kingdom and the Isle of Man. After its incorporation, V SA acquired the entire share capital of a wholly owned Swiss subsidiary from a US resident individual. The purchase price, which amounted to CHF 2,000,000, was financed up to 96.35 % by a loan granted by its UK shareholder. At the end of December 1995, the participation in I SA represented 99.94 % of its assets. V SA received dividends from its Swiss subsidiary I SA which were transferred to its non-resident shareholders in the form of deductible interest expenses paid on the loan.

The essential question that needed to be settled by the court was whether V SA could be regarded as the *"beneficiary"* of the dividend within the meaning of art. 10(2)(b) of the DTA.[114] However, the court found that the term *"beneficiary"* could be equated to *"beneficial owner"*.[115] Following closely the steps prescribed by the VCLT the court than began to consider the ordinary meaning[116] of the term *"beneficiary"*, thereby implicitly favouring an international fiscal meaning of this term and excluding a *lex fori* characterization. The court held that a beneficiary is a person having the possibility to really enjoy the benefit it derives and not merely someone transferring this benefit to a third party.[117]

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[112] Re V SA, 4 ITLR 191.

[113] Subsequently replaced by the Federal Administrative Court.

[114] This provision did indeed not expressly refer to beneficial owner but used the term *"beneficiary"* *("bénéficiaire")*.

[115] Moreover, in any event, the Court also held that the beneficial ownership requirement is implicit in every tax treaty.

[116] Art. 31 (1) VCLT.

[117] Re V SA, 4 ITLR 191, 209: *"A beneficiary is the person who receives a benefit, an advantage, etc. (Petit Larousse illustré (Paris 1996). The beneficiary is thus the person who can actually benefit from a payment, and not one who receives it subject to an obligation to transfer it to a third person. Thus, a company which transferred to a third person dividends received without being able actually to dispose of them cannot be considered as the 'beneficiary'. The notion of 'beneficiary' envisages, therefore, according to the ordinary meaning to be attributed to this term, one who effectively re-*

Hence, a company transferring the dividends it receives to a third party without having the possibility to dispose of the latter *("sans pouvoir en disposer réellement")* should not be regarded as a *"beneficiary"* in a treaty context. The court concluded that the ordinary meaning of the term *"beneficiary"* was very much in line with the interpretation conveyed by the 1986 OECD Conduit Report. The court finally turned to the object and purpose[118] of the DTA to confirm the foregoing analysis. On this point, it held that the term *"beneficiary"* should be construed in a way which prevents non-residents from obtaining the benefits of a DTA by interposing a conduit company in a contracting state.

Based on this reasoning, the court ruled that V SA, which was transferring virtually all its Swiss source dividends to non-residents in the form of deductible interest expenses was a mere conduit company and, for this reason, could not be regarded as the beneficiary (beneficial owner) under the Switzerland-Luxembourg DTA.

Switzerland's case law on beneficial ownership was subsequently further consolidated with the famous *Swaps* case decided by the Federal Supreme Court in 2015,[119] whose findings were then confirmed on numerous occasions.[120] However, this case law has refined the interpretation favoured in the *Re V SA* case on two important elements. First of all, the beneficial ownership limitation is now considered by Swiss courts as mere a condition to access tax treaty benefits and, for this reason, should not be confused with a general anti-avoidance rule that incorporates both an objective and a subjective element.[121] For this reason, beneficial ownership is construed in an objective manner. It consequently follows that in order to determine whether the recipient of income qualifies as the beneficial owner the intention and motives to select a particular arrangement or structure are irrelevant. In the same vein, the fact that a transfer of shares to a resident of a contracting state does not lead to a more favourable residual treaty rate than that initially applicable in the state of source has also been found to be irrelevant for the purpose of

ceives a payment and can dispose of it. This definition overlaps with that of the 'effective beneficiary [beneficial owner]' which envisages the person who profits economically from income, and does not apply to conduit companies placed as intermediaries between the payer of income and the person who ultimately receives it (OECD Report on Double Taxation Conventions and the Use of Conduit Companies [hereafter referred to as 'the Conduit Companies Report'], Paris 1987, ch 14, let B)".

118 Art. 31 (1) VCLT.

119 Re Swiss Swaps Case I/A, 18 ITLR 138; for a recent discussion of this case at an international level, see DANON, Tax Treaty Disputes in Switzerland, p. 654 et seq.; WEIDMANN, Swiss Swaps case, pp. 621 et seq.

120 Federal Supreme Court decision of 5 May 2015, 2C_895/2012 (SMI Index future); Federal Supreme Court decision of 2 October 2015, 2C_383/2013 (single stock futures); Federal Supreme Court decision of 22 Nov. 2015, 2C_752/2014 (preferred equity certificates); Federal Supreme Court decision of 5 April 2017, 2C_964/2016.

121 Federal Administrative Court decision of 26 August 2016, A-2902/2014, para. 4.3.3 (partially confirmed by Federal Supreme Court decision of 5 April 2017, 2C_964/2016.

the beneficial ownership analysis[122] Nevertheless, in some decisions a purpose-oriented analysis has been conducted against the taxpayer to confirm the absence of beneficial ownership. We shall revert to this point below.[123] Finally, and perhaps more importantly, this case law confirms and further enhances the substance over form interpretation of beneficial ownership developed in the *V SA* case. That is, for the Federal Supreme Court, beneficial ownership should be examined from the perspective of economic control and focuses on the criterion of interdependence between income and the obligation to transfer such income to non-residents on the basis of a legal arrangement or, more importantly in practice, simply factual circumstances. The Supreme Court generally considers that economic control fails to exist where, on the basis of a legal or factual obligation, all or even just an essential portion of the treaty protected income is being transferred to non-residents.[124] With others we have argued that this reasoning is not in line with the meaning of beneficial ownership conveyed by the 2014 OECD Commentary. Under this case law, the existence of an obligation to transfer the income received may stem from a legal arrangement or simply from the facts. Under the 2014 Commentaries, it is arguable that the facts may only serve as a tool to prove the existence of an unwritten legal or contractual obligation. This definition embodies a subtle but important difference if compared with a pure substance-over-form approach of beneficial ownership such as that which is currently favoured under Swiss case law. That is, under this case law, the existence of an obligation to transfer the income received may stem from a legal arrangement or simply from the facts. Under the 2014 Commentaries, by contrast, the facts may only serve as a tool to prove the existence of a legal or contractual obligation. Whether this is really how the reference to *"facts and circumstances"* and *"in substance"* used by the 2014 commentaries should be understood is however not entirely clear.

A recent decision rendered in 2018 by the Federal Administrative Court in relation to a conduit structure, which is an incarnation of this case law and is currently pending before the Swiss Supreme Court, also deserves attention.[125] The case concerned a company incorporated in Ireland which was the sole shareholder of a Swiss subsidiary. The Irish company had been acquired through a loan granted by the grandparent company of the group. The question that needed to be settled by the court was whether the Irish company

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[122] CH: FAT, 20 Dec. 2016, A-1426/2011, 5.3.2.3.

[123] For example, in a case decided in 2014, the FAT held that, where the interposition of an entity in the state of residence is regarded as abusive, there is a presumption that such entity may not be regarded as the beneficial owner (CH: FAT, 25 June 2014, A-4693/2013 (partially confirmed by CH: FT, 3 Dec. 2015, 2C_753/2014) and A-4689/2013 (partially confirmed by CH: FT, 27 Nov. 2015, 2C_752/2014), para. 8.4.). In a recent judgment, the FAT even referred to a purpose alien to treaty benefits, namely the objective to benefit from a favourable regime in Luxembourg (FAT judgment of 20 Dec. 2016, *supra* n. 26, at para. 5.2.2.3).

[124] Re Swiss Swaps Case I/A, para. 5.2.4, 18 ITLR 138, 180.

[125] A AG v Federal Tax Administration, 20 ITLR 625.

could be regarded as the beneficial owner of a Swiss source dividend stemming from non-recurrent profits under art. 15(1) of the former 2005 Swiss-EU Savings Agreement and, therefore, be entitled to a full refund of the Swiss withholding.[126] On the facts, the Irish company and the grandparent company of the group shared the same registered address in Dublin.[127] Moreover, the board of directors of both companies was, to a large extent, composed of the same persons.[128] For the reasons, the court considered that the grandparent company as the loan provider and the controlling shareholder was thus ultimately able to determine not only the timing but also the size of dividend payments. In other words, the Irish company's receipt of dividend income as an intermediary company was fully dependent on the Grandparent Company as the controlling company. Therefore, the Federal Administrative Court arrived at the conclusion that the Irish company was not the beneficial owner of the Swiss source dividends.[129] The relation established by the court between on the one hand beneficial ownership and, on the other hand, the composition of board of directors in a group is an important practical question to which we shall revert when trying to reconciling the substance over form and legal interpretation of beneficial ownership.

b) Substance over form approach under foreign case law

In France, the *Conseil d'État* also endorsed a substance over form approach in the *Bank of Scotland* case.[130] Unlike the Swiss Federal Supreme Court, the French Court established by contrast a clear connection between beneficial ownership and the reservation of abuse *("fraude à la loi")*. We revert to this case when discussing the relation between beneficial ownership and the notion of abuse.

In the United Kingdom, the findings of the Court of Appeal in the *Indofood* case, decided in 2006,[131] were equally based on a substance over form interpretation of beneficial ownership. The case concerned the public issuance of an interest-bearing note by the Mauritius subsidiary of an Indonesian resident company, Indofood. The company wanted

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126 The Savings Agreement entered into force on 1 July 2005. This agreement was renamed as of 1 January 2017, with a protocol dated 27 May 2015, and partially altered (Amending Protocol of 27 May 2015 to the Agreement between Switzerland and the European Community providing for measures equivalent to those laid down in EC Council Directive 2003/48 on taxation of savings income in the form of interest payments, AS 2016 5003; Agreement between the Swiss Confederation and the European Union on the automatic exchange of financial account information to improve international tax compliance [hereafter EU-AIA, SR 0.641.926.81]), see A AG v Federal Tax Administration, 20 ITLR 625, 648-649.

127 A AG v Federal Tax Administration, 20 ITLR 625.

128 A AG v Federal Tax Administration, 20 ITLR 625, 654-655.

129 A AG v Federal Tax Administration, 20 ITLR 625, 655.

130 Ministre de l'Économie, des Finances et de l'Industrie v Société Bank of Scotland, 9 ITLR 683.

131 Indofood International Finance Ltd v JPMorgan Chase Bank NA, London Branch, 8 ITLR 653.

to proceed with the issuance but in order to avoid Indonesian withholding tax on interest payments, the note was formally issued by a Mauritius company. The proceeds of the issuance were then lent under the same terms and conditions to the Indonesian company which acted as parent guarantor. Under this structure, the sums were thus paid by the parent guarantor to a special purpose vehicle (SPV). Shortly after, the same amount would finally be paid to the UK agent of the noteholders. Yet, Indonesia announced its intention to terminate its DTA with Mauritius. Therefore, in accordance with the agreement, the issuer had contemplated an early redemption of the note.

The connection of this case with UK Courts was unexpected. However, under the agreement, the UK Courts were required to determine whether the redemption of the notes could be avoided by taking a *"reasonable measure"* aiming at reducing the Indonesian withholding tax through the interposition of an SPV in another treaty jurisdiction. For this reason, the Court of Appeal had to examine whether a Dutch SPV, subject to the same terms and conditions than the Mauritius company, could satisfy the beneficial ownership requirement under these circumstances.

The UK Court of Appeal began its analysis by restating the fact that beneficial ownership had been introduced into the 1977 OECD MC in order to prevent treaty shopping: *"The requirement that the recipient of the dividends be the 'beneficial owner' (the French version of the Model uses: bénéficiaire effectif – both language versions of the Model are equally authoritative) was added when the text of the Model was revised in 1977, and was added to prevent abuse in the form of treaty-shopping"*.[132] Secondly, relying on the OECD Commentary and on the opinion of Baker, the Court confirmed that beneficial ownership is a term which ought to receive an *"international fiscal meaning"*.[133] Thirdly and perhaps most important, the court held that beneficial ownership was to be assessed on the basis of the *"substance of the matter"*.[134] Following this reasoning, the Court arrived at the conclusion that the SPV could not be the beneficial owner as it could not *"derive any direct benefit from the interest payable by its Parent Guarantor"*. Indeed, under the agreements, the SPV would be *"bound to pay on the Principal Agent that which it receives from the Parent Guarantor"*. In other words, the SPV was simply regarded as an administrator of the income received.[135]

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[132] Indofood International Finance Ltd v JPMorgan Chase Bank NA, London Branch, para. 34, 8 ITLR 653, 671.

[133] Indofood International Finance Ltd v JPMorgan Chase Bank NA, London Branch, para. 42, 8 ITLR 653, 674.

[134] Indofood International Finance Ltd v JPMorgan Chase Bank NA, London Branch, para. 44, 8 ITLR 653, 675.

[135] Indofood International Finance Ltd v JPMorgan Chase Bank NA, London Branch, para. 44, 8 ITLR 653, 675: *"In both commercial and practical terms the Issuer is, and Newco would be, bound to pay on to the Principal Paying Agent that which it receives from the Parent Guarantor. This is recog-*

The subsequent reading of the Indofood case by HMRC is also interesting as, in essence, it states that the international fiscal meaning of beneficial ownership only applies in the case of abuse. This is yet another example of the intimate link which courts and tax authorities may choose to establish between the beneficial ownership limitation and the prohibition of abuse. We revert to HMRC's interpretation below.

Finally, another example of economic interpretation of beneficial ownership may also be found in the Spanish *Real Madrid* cases decided in 2006 and 2007.[136] The cases, which involved the soccer club Real Madrid, concern the payments of royalties to Hungarian entities. Since these entities would in turn transfer almost the full income received to other entities based in the Netherlands or Cyprus, the question to be settled was whether the Hungarian entities could be regarded as the beneficial owners of the Spanish source royalties under the Spain-Hungary DTA. Moreover, the use of Hungarian entities had a clear goal: the tax treaty between Hungary and Spain was a well-known exit route for royalties, since, at that time, it was (together with the tax treaty with Bulgaria) the only tax treaty in the Spanish treaty network with no withholding tax for royalties at source.[137]

The Spanish Court ruled that the Hungarian entities were not the beneficial owners of the royalties, in essence for the following reasons. First of all, the court also confirmed that beneficial ownership is a term that ought to receive an international fiscal meaning. Secondly, the court understood beneficial ownership as a wide anti-avoidance rule aiming at tackling treaty shopping. Further, for the court the 1986 OECD Conduit Report confirms that beneficial ownership must be looked at from an economic perspective. Based on this analysis, the Court concluded that since the Hungarian entities received and immediately paid royalties out to Netherlands or Cypriot companies, they did not

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nised by what we were told actually happens now as recorded in paragraph 13 above. The Parent Guarantor is bound to ensure that such an arrangement continues lest it is required to pay again under its guarantee to the noteholders contained in the Trust Deed. In practical terms it is impossible to conceive of any circumstances in which either the Issuer or Newco could derive any 'direct benefit' from the interest payable by the Parent Guarantor except by funding its liability to the Principal Paying Agent or Issuer respectively. Such an exception can hardly be described as the 'full privilege' needed to qualify as the beneficial owner, rather the position of the Issuer and Newco equates to that of an 'administrator of the income'".

136 AN, 18 July 2006, JUR\2006\204307, JUR\2007\8915 and JUR\2007\16549, AN, 10 Nov. 2006, JUR\2006\284679, AN, 20 July 2006, JUR\2007\16526, AN, 13 Nov. 2006, JUR\2006\284618 and AN, 26 Mar. 2007, JUR\2007\101877 quoted by MARTÍN JIMÉNEZ, Beneficial Ownership as a Broad Anti-Avoidance Provision, p. 128 et seq.

137 We are relying here on the factual description by MARTÍN JIMÉNEZ, Beneficial Ownership as a Broad Anti-Avoidance Provision, pp. 128-129.

have any control over the income and, therefore, were not the beneficial owners of the income they had derived.[138]

Among many others, decisions favouring a similar interpretation have also been reported in Austria[139] and Denmark.[140]

c) Legal interpretation: the Canadian *Prévost* and *Velcro* cases

The Prévost and Velcro cases which are discussed hereunder are of course the most emblematic examples of the legal interpretation of beneficial ownership.

aa) Prévost

In the *Prévost* case, the Canadian Tax court[141] and the Federal court of appeal[142] ruled that a Dutch holding company *("PH B.V.")* was the beneficial owner of dividends paid by its Canadian subsidiary (Prévost Car) despite the fact that these profits were immediately distributed to its Swedish (Volvo, 51 %) and UK (Henlys, 49 %) shareholders. This distribution policy stemmed from a shareholders' agreement.[143] PHB.V. had no employees in the Netherlands and its registered office was in the premises of a local trust company. Moreover, its participation in Prévost Car was its sole investment.[144] The board of directors of PHB.V was composed of the directors of Prévost. These directors frequently discussed PHB.V.'s affairs, including future declarations and payments of dividends.[145] At some point in time, the board of directors of PHB.V. had executed a power of attorney in favour of a trust company to allow it to transact business on a limited scale on behalf

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[138] In the absence of an English translation of these cases, I am relying here on the findings of the Court as they are summarized by MARTÍN JIMÉNEZ, Beneficial Ownership as a Broad Anti-Avoidance Provision, pp. 130-131.

[139] N AG v Regional Tax Office for Upper Austria, 2 ITLR 884.

[140] See for example Decision of 22 December 2010, Case 09-00064 / SKM No. 2011.57, Tax Treaty Case Law IBFD (Summary) and Decision of 25 May 2011, Case 09-03189 / SKM No. 2011.485, Tax Treaty Case Law IBFD (Summary) concerning the 1996 Denmark-Sweden DTA.

[141] Prévost Car Inc v R, 10 ITLR 736.

[142] Prévost Car Inc v R, 11 ITLR 757.

[143] Prévost Car Inc v R, para. 12, 10 ITLR 736, 742. The shareholders's agreement provided inter alia that: "*not less than 80 percent of the profits of the appellant and PHB.V. and their subsidiaries, if any, (together called the 'Corporate Group') were to be distributed to the shareholders. The distribution of the profits was subject to the Corporate Group having sufficient financial resources to meet its normal and foreseeable working capital requirements at the time of payment unless the shareholders otherwise agreed. Amounts were to be distributed by way of dividend, return of capital or loan. The distribution for a fiscal year was to be declared and paid to shareholders 'as soon as practicable' after the end of the fiscal year*".

[144] Prévost Car Inc v R, para. 25, 10 ITLR 736, 745.

[145] Prévost Car Inc v R, para. 12, 10 ITLR 736, 742.

of PHB.V.[146] It appears from the facts that this power of attorney was designed to allow the trust company to arrange for the execution of payment orders in respect of interim dividend payments decided by PHBV in favour of its shareholders.[147]

Justice Rip held that for the purpose of the Canada-Netherlands DTA: *"[…] the 'beneficial owner' of dividends is the person who receives the dividends for his or her own use and enjoyment and assumes the risk and control of the dividend he or she received. The person who is beneficial owner of the dividend is the person who enjoys and assumes all the attributes of ownership. In short the dividend is for the owner's own benefit and this person is not accountable to anyone for how he or she deals with the dividend income"*. As a result, *"Where an agency or mandate exists or the property is in the name of a nominee, one looks to find on whose behalf the agent or mandatory is acting or for whom the nominee has lent his or her name"*.[148] Like the current OECD commentaries,[149] it was also emphasized that beneficial ownership should be distinguished from ultimate beneficial ownership.[150] Piercing the corporate veil remains however exceptionally possible where it is established that: *"the corporation is a conduit for another person and has absolutely no discretion as to the use or application of funds put through it as conduit, or has agreed to act on someone else's behalf pursuant to that person's instructions without any right to do other than what that person instructs it, for example, a stockbroker who is the registered owner of the shares it holds for clients"*.[151]

In the present instance, however, Justice Rip found that the Dutch holding company was the beneficial owner of the Canadian source dividends. First of all, there was *"no evidence that the dividends from Prévost were ab initio destined for Volvo and Henlys with PHB.V. as a funnel of flowing dividends from Prévost. There was no predetermined or automatic flow of funds to Volvo and Henlys even though Henlys' representatives were*

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146 Prévost Car Inc v R, para. 24, 10 ITLR 736, 745.

147 Prévost Car Inc v R, para. 24, 10 ITLR 736, 742.

148 Prévost Car Inc v R, para. 100, 10 ITLR 736, 767; Prévost Car Inc v R, para. 13, 11 ITLR 757, 767-768.

149 2014 OECD Commentary, para. 12.6 ad art. 10: *"it would be inappropriate, in the context of that Article, to consider a meaning developed in order to refer to the individuals who exercise 'ultimate' effective control over a legal person or arrangement"*.

150 Prévost Car Inc v R, para. 100, 10 ITLR 736, 767; Prévost Car Inc v R, para. 13, 11 ITLR 757, 767-768: *"When the Supreme Court in Jodrey stated that the 'beneficial owner' is one who can 'ultimately' exercise the rights of ownership in the property, I am confident that the Court did not mean, in using the word 'ultimately', to strip away the corporate veil so that the shareholders of a corporation are the beneficial owners of its assets, including income earned by the corporation. The word 'ultimately' refers to the recipient of the dividend who is the true owner of the dividend, a person who could do with the dividend what he or she desires. It is the true owner of property who is the beneficial owner of the property"*.

151 Prévost Car Inc v R, para. 100, 10 ITLR 736, 767; Prévost Car Inc v R, para. 13, 11 ITLR 757, 767-768.

trying to expedite the process".[152] Secondly, the Shareholders' Agreement on which the dividend policy was founded was not binding on the Dutch entity.[153] Finally, PHB.V had full enjoyment and control over the dividends received and could use these dividends as it wishes.[154]

As a result, both the Canadian Tax court and the Federal court of appeal ruled in favour of the taxpayer and considered that the Dutch holding company was the beneficial owner of the Canadian source dividends and, for this reason, was entitled to tax treaty benefits.

bb) Velcro

The reasoning followed in *Prévost* was subsequently applied in the *Velcro* case which involved a royalty structure with base eroding payments. In this case, beneficial ownership was also upheld even though a company established in the Netherlands was under the obligation to transfer approximately 90 % of the royalties received to a company based in the Netherlands Antilles. The court focused in particular on the fact that the royalties were commingled with other funds of the Dutch entity: *"There was no predetermined flow of funds. What there is a contractual obligation by VHBV to pay to VIBV a certain amount of monies within a specified time frame. These monies are not necessarily identified as specific monies, they may be identified as a percentage of a certain amount received by VHBV from VCI, but there is no automated flow of specific monies because of the discretion of VHBV with respect to the use of these monies"*.[155] Further, the court also relied on the fact that: *"it is not 100 % of the royalties amount that are paid to VIBV but only approximately 90 %. The other 10 % is subject to the discretionary use, enjoyment, and control of VHBV"*.[156]

cc) Critical thoughts

The *Prevost* and *Velcro* cases were undoubtedly decided on the basis of a legal interpretation of beneficial ownership. This being said, as a number of commentators have pointed out, several factual and legal uncertainties continue to surround these decisions which

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[152] Prévost Car Inc v R, para. 102, 10 ITLR 736, 768.

[153] Prévost Car Inc v R, para. 104, 10 ITLR 736, 768: *"I cannot find any obligation in law requiring PHB.V. to pay dividends to its shareholders on a basis determined by the Shareholders' Agreement. When PHB.V. decides to pay dividends it must pay the dividends in accordance with Dutch law"*.

[154] Prévost Car Inc v R, para. 105, 10 ITLR 736, 769: *"the monies represented by the dividend continue to be property of, and is owned solely by, PHB.V. The dividends are an asset of PHB.V. and are available to its creditors, if any. No other person other than PHB.V. has an interest in the dividends received from Prévost. PHB.V. can use the dividends as it wishes and is not accountable to its shareholders except by virtue of the laws of the Netherlands"*.

[155] Velcro Canada Inc v R, para. 45, 14 ITLR 613, 633.

[156] Velcro Canada Inc v R, para. 43, 14 ITLR 613.

undermine their outcome and their relevance as appropriately reflecting the international fiscal meaning of beneficial ownership.

Turning first to the *Prévost* case, the reasoning followed by the court could at first sight suggest that practically any holding company redistributing its profits to its shareholders qualifies as the beneficial owner. In our opinion, this is not how the decision of the court should be understood. Rather, the court reserved the presence of a conduit arrangement where the distributing company has *"absolutely no discretion as to the use or application of funds"*[157] and there is *"a predetermined or automatic flow of funds"*.[158] Presumably, in accordance with the legal interpretation of beneficial ownership, this could be case if, for instance, the corporate interests of the conduit entity are ignored and its apparent right to own, enjoy and make use of its income is akin to a sham arrangement. From this perspective, some elements of the facts could have deserved further consideration for the purpose of establishing the legal reality of the arrangements put in place. The facts submitted to the court indeed suggest that, in some instances, amounts had been transferred by the holding company without a proper resolution by its directors.[159] Moreover, in the documentation provided to its banker, PHB.V had declared that the shares of its Canadian subsidiary were beneficially owned by its Swedish and UK shareholders. For the court, this was *"at least sloppy maintenance of corporate records but also could be an indication of something more significant. Minutes of a meeting of shareholders of Prévost held on May 9, 2002 however do state that the shareholder of Prévost is PHB.V"*.[160]

The second element which may have driven the findings of the Court in *Prévost* relates to the specific Canadian tax treaty policy background when the case was decided. During the fiscal years concerned, the DTA concluded between Canada and the Netherlands provided, in line with the OECD MC, for a 5 % residual tax rate on dividends. By contrast, under the tax treaties concluded with the states of residence of PHB.V, Sweden and the United Kingdom, the withholding tax rate on dividends was only reduced to respectively 10 % and 15 %.[161] While the interposition of an entity in the Netherlands had thus clearly increased possible tax treaty benefits, Canadian tax treaty policy was at the time

[157] Prévost Car Inc v R, para. 100, 10 ITLR 736, 767; Prévost Car Inc v R, para. 13, 11 ITLR 757, 767.

[158] Prévost Car Inc v R, para. 102, 10 ITLR 736, 768.

[159] Prévost Car Inc v R, para. 100, 10 ITLR 736, 744: *"On February 27, 1996 Mr. Brian Chivers, Finance Director of Henlys, wrote to Volvo stressing the importance that Volvo and Henlys agree to a regular dividend stream before the next directors meeting of Prévost. Henlys was always pressing for quick payment of dividends since it required money to service the loan it undertook to finance its purchase of Prévost or, more accurately, its purchase of PHB.V. In one instance $5,684,523 was transferred to Henlys on fax instructions by Mr. Chivers without a resolution of the managing directors of PHB.V. having been signed"*.

[160] Prévost Car Inc v R, para. 16, 10 ITLR 736, 742.

[161] ARNOLD, Beneficial Ownership, p. 43.

in a transitional phase with the DTAs with Sweden and the United Kingdom being renegotiated. An exchange of emails between senior officials of Canada Revenue Agency and Finance Canada, reproduced by Ward in a research report prepared for the Advisory Panel on Canada's System of International Taxation, provides a useful insight in this respect. One of these emails mentions for example that: *"Given that we were negotiating with Sweden and UK at this time and our apparent willingness to provide the 5 percent rate as a matter of policy in any new treaty, I think it will be difficult for a court to smell the nastiness of this scheme by two multinationals resident in treaty countries, to avail themselves of the policy rate"*.[162]

For this reason, some Canadian leading scholars have concluded that the decision in *Prévost* makes sense in *"policy and practical terms"*.[163] Therefore, one may at least wonder whether the outcome of the case would have been different had, for example, PHB.V been instead owned by two offshore shareholders with which Canada had not concluded any DTA.

The question is legitimate as the reasoning in the *Velcro* case, completely based on the *Prévost* reasoning, has been heavily criticized by leading Canadian scholarly writing. Arnold observes for example that relying on the fact that treaty protected income is: *"commingled with other funds"* to uphold beneficial ownership is inconsistent with what the OECD Commentaries says about *"a conduit company not being the beneficial owner 'if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties'. On the facts, VHBV was contractually obligated to pay to VIBV the amount of the royalties received from Velcro Canada (net of Canadian withholding tax) within 30 days. VHBV had the discretionary use, control and risk of the royalties received for 30 days, subject to the obligation to pay the same amount to VIBV. Therefore, there appears to be a strong argument that VHBV had 'very narrow powers' with respect to the royalties received"*.[164] Secondly, the idea that the Dutch holding received 100 % of the royalties and only paid out a corresponding amount of 90 % appears to have been based on a misunderstanding of the facts by the Court. Indeed, given that a 10 % withholding tax had been levied on the Canadian source royalties, only 90 % of these royalties was available to be paid out by the Dutch entity. Therefore, contrary to what the court found, the Dutch company did not have discretionary use of 10 % of the royalties and in fact paid out the entire amount. Seen in this fashion, *"the arrangement*

[162] WARD, Treaty Benefits, p. 47, Attachment B.
[163] ARNOLD, Beneficial Ownership, p. 43.
[164] ARNOLD, Beneficial Ownership, p. 47.

looks like an artificial conduit arrangement".[165] Therefore, Arnold concludes that: *"although the decision is clearly wrong in my opinion, the government did not appeal".*[166]

Finally and more fundamentally, the problem with *Prévost* and *Velcro* is the fact that it is very doubtful whether the reasoning adopted in these cases was really founded on the international fiscal meaning of beneficial ownership, as conveyed by the OECD commentaries and 1986 Conduit Report. The Canadian Tax Court and Federal Court of Appeal certainly referred to the 1977 OECD Commentary and, in line with the position defended in the present opinion, confirmed that the OECD 1986 Conduit Report and 2003 update of the Commentary were only clarifying the original meaning of beneficial ownership.[167]

At the same time, however, it is unclear whether the Court really relied on these materials for the purpose of arriving at its decision. In his report to the Canadian Advisory Panel Ward notes that: *"In fact, in Prévost Car, the Tax Court of Canada did not apply this expanded explanation of the term 'beneficial owner' even though it referred extensively to the Conduit Companies Report and the recent commentaries [...] the apparent reluctance of the court to adopt the narrower interpretation of beneficial owner arising out of the Conduit Companies Report and now in the commentary on Article 10 of the OECD Model which would have required a substance-over-form or an economic approach to be taken to determine the facts".*[168] In other words, according to Ward a proper application of OECD principles would have required the court to apply instead *"a substance-over-form or an economic approach"* which was not the case as the Court applied instead a legal interpretation.

In fact, the following passage of the *Prévost* clearly indicates that a Canadian meaning of beneficial ownership was at least predominantly *favoured: "I am being asked to determine what the words 'beneficial owner' and 'bénéficiare effectif'(and the Dutch equivalent) mean in Article 10(2) of the Tax Treaty. Article 3(2) of the Tax Treaty requires me to*

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[165] ARNOLD, Beneficial Ownership, p. 47.
[166] ARNOLD, Beneficial Ownership, p. 48.
[167] Prévost Car Inc v R, para. 96, 10 ITLR 736, 765: *"The Commentary for Article 10(2) of the Model Convention explains that one should look behind 'agents and nominees' to determine who is the beneficial owner. Also, a 'conduit' company is not a beneficial owner. In these three examples, the person the agent, nominee and conduit company never has any attribute of ownership of the dividend. The 'beneficial owner' is another person"* and 742: *"I therefore reach the conclusion, that for the purposes of interpreting the Tax Treaty, the OECD Conduit Companies Report (in 1986) as well as the OECD 2003 Amendments to the 1977 Commentary are a helpful complement to the earlier Commentaries, insofar as they are eliciting, rather than contradicting, views previously expressed. Needless to say, the Commentaries apply to both the English text of the Model Convention ('beneficial owner') and to the French text ('bénéficiaire effectif')".*
[168] WARD, Treaty Benefits, pp. 17-18.

look to a domestic solution in interpreting 'beneficial owner'. The OECD Commentaries on the 1977 Model Convention with respect to Article 10(2) are also relevant".[169]

In the end, therefore, it seems that *Prévost* and *Velcro* were decided on the basis of the Canadian law meaning of beneficial ownership. As mentioned by Arnold: *"Although in both the Prévost Car and Velcro cases the Tax Court did not deal explicitly with the question of which country's meaning of beneficial owner should apply, the Court clearly applied the meaning under Canadian law [...]. However, the application of the domestic-law meaning of the country in which the payer is resident is not self-evident [...]. In addition, the recent OECD proposals to revise the Commentary dealing with beneficial ownership suggest that the 'beneficial owner' should have an autonomous treaty meaning rather than a domestic law meaning".*[170]

Therefore, the *Prévost* and *Velcro* decisions do not in our opinion appropriately reflect the international and autonomous fiscal meaning of beneficial ownership conveyed by the 1977 OECD Commentary and the 1986 Conduit Report.

4. Meaning of beneficial ownership in the CJEU judgments on directive shopping

As indicated, it is not the purpose of the present contribution to discuss the meaning of beneficial ownership given by the CJEU its recently decided cases on directive shopping.[171] However, as a short excursus, we wish to make a few observations which may be useful from a tax treaty perspective.

First of all, it is remarkable that in its judgement relating to the IRD case, the CJEU favoured an economic interpretation of beneficial ownership. Of course, this conclusion was also supported by the text of the directive.[172] The CJEU concludes based on a reading of the directive in different languages that: *"the use of those various expressions underscores that the term 'beneficial owner' concerns not a formally identified recipient but rather the entity which benefits economically from the interest received and accordingly has the power freely to determine the use to which it is put".*[173] However, according to the Court, on this point the directive *"draws upon Article 11 of the OECD 1996*

[169] Prévost Car Inc v R, para. 95, 10 ITLR 736, 765.

[170] ARNOLD, Beneficial Ownership, pp. 48-49.

[171] CJEU, 26 February 2019, Case C-116/16 (Joined cases); CJEU, 26 February 2019, Case C-115/16 (joined cases).

[172] DE BROE/GOMMERS, beneficial ownership cases, sec. 5.4.1. See art. 1(4) IRD: *"A company of a Member State shall be treated as the beneficial owner of interest or royalties only if it receives those payments for its own benefit and not as an intermediary, such as an agent, trustee or authorised signatory, for some other person".*

[173] CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 89.

Model Tax Convention and pursues the same objective"[174] and *"it is clear from the development […] of the OECD Model Tax Convention and the commentaries relating thereto that the concept of 'beneficial owner' excludes conduit companies and must be understood not in a narrow technical sense but as having a meaning that enables double taxation to be avoided and tax evasion and avoidance to be prevented"*.[175]

Secondly, in both the IRD and PSD cases, the OECD Commentary on beneficial ownership – more specifically the language of its 2014 update – although not mentioned expressly resonates again when the Court attempts to provide indicators of what constitutes an abusive artificial conduit arrangement. These implicit references to beneficial ownership fuel the controversial relation between this limitation and the general prohibition of abuse as discussed below. However, the way in which the CJEU refers implicitly to the 2014 OECD Commentary casts further doubts on its exact meaning when it comes to the existence of a legal or factual obligation to transfer the treaty protected income. The Court indeed notes that: *"such indications are capable of being constituted not only by a contractual or legal obligation of the company receiving interest to pass it on to a third party but also by the fact that, 'in substance' […] without being bound by such a contractual or legal obligation, does not have the right to use and enjoy those sums"*.[176] It has been observed that this statement goes beyond the 2014 OECD Commentary a reasonable reading of which suggests that the facts may only be used to prove the existence of a legal obligation.[177] As shown, however, the problem lies in the fact that the 2014 OECD Commentary is not perfectly clear on this point.

In sum, therefore, the CJEU's findings, although not directly dealing with tax treaty law, add up to the current trend of construing beneficial ownership in tax treaty practice on the basis of a substance over form approach while, at the same time, fuelling the controversy as regards the exact meaning of beneficial ownership under the 2014 OECD Commentary.

5. Debate on legal versus substance-oriented interpretation

In scholarly writing there is also a corresponding discussion as regards the way in which beneficial ownership should be tested at the level of the conduit company.

Some authors argue that the question should be settled from a legal perspective.[178] For instance, du Toit has argued that a conduit company is not the beneficial owner only

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174 CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 90.
175 CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 92.
176 CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 132.
177 CFE Opinion Statement ECJ-TF 2/2019, pp. 498-499; DE BROE/GOMMERS, beneficial ownership cases, sec. 5.4.1.
178 See for example DE BROE, Prevention of Abuse, p. 723; DU TOIT, Beneficial Ownership, p. 228.

where it has a legal or contractual obligation to pay the specific income it receives.[179] By contrast, several other commentators[180] hold the view that the existence of beneficial ownership should be determined on the basis of a substance over form approach. VOGEL has consistently maintained that: *"the old dispute of form versus substance should be decided in favor of substance"*.[181] This interpretation is in particular supported by the meaning of the French term *"effectif"* used in the French version of the OECD MC *("bénéficiaire effectif")*.[182] Accordingly, *"the fetters that exclude beneficial ownership may be legal or merely factual (effectif)"*.[183] VOGEL regards economic control as the most important attribute to ascertain beneficial ownership. Accordingly, for this commentator the beneficial owner is the person: *"[...] who is free to decide (1) whether or not the capital or other assets should be used or made available for use by others or (2) on how the yields therefrom should be used or (3) both"*.[184]

We have expressed our view on the meaning of beneficial ownership in several publications.[185] In our opinion, beneficial ownership focuses exclusively on the intensity of the ownership attributes enjoyed by the recipient of the income. The literal meaning of the term *"effectif"* used in the French version of the OECD MC reveals indeed, as VOGEL has argued, that beneficial ownership should be tested on the basis of a substance over form analysis. We have therefore submitted that in a tax treaty context the beneficial owner refers to the person who legally, economically or factually has the power to control the attribution of the income.[186] In essence, the core element of this definition is the actual control of the recipient over the income received and the effective ability to freely decide on whether such income is to be transferred to a third person. Under this analysis

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179 DU TOIT, Beneficial Ownership, p. 228.

180 See for example others VOGEL 1997, p. 562, n° 9; KEMMEREN, Klaus Vogel on Double Taxation Conventions, Preface to Articles 10 to 12, N 47; BAUMGARTNER, Das Konzept des beneficial owner, p. 136; HELMINEM, GTTC ad Article 11 (2018), sec 6.1.1.

181 VOGEL 1997, p. 562, n° 8.

182 VOGEL 1997, p. 562, n° 10.

183 VOGEL 1997, p. 562, n° 10.

184 VOGEL 1997, p. 562, n° 9; BAUMGARTNER, Das Konzept des beneficial owner, p. 410 equally supports the substance over form analysis. For this author, a conduit company may not be regarded as the beneficial owner if, not only from a legal but also a factual perspective, it is under the obligation to forward the income it receives to another person. For such an obligation to exist, there must be a legal or factual interdependence between the income received and paid out by entity (BAUMGARTNER, Das Konzept des beneficial owner, p. 410). Such factual interdependence exists where, for example, a conduit company distributes all the income it receives without taking into consideration its own interest in terms of strategy as well as liquidity and investment planning (BAUMGARTNER, Das Konzept des beneficial owner, p. 136).

185 See among others, DANON, le concept de bénéficiaire effectif, pp. 38-55; DANON, Thesis, pp. 326-347.

186 DANON, Thesis, p. 340.

an entity will not be regarded as the beneficial owner only where, from an economic standpoint, its position is comparable to that of an agent or nominee. The references made by the OECD 1986 Conduit Report and 2003 commentaries to income *"economically"* benefiting to a person[187] or to a person *"who in fact"* receives the benefit while the conduit company has *"as a practical matter"*, very narrow powers,[188] confirms this interpretation. By contrast, it is unclear whether, and if so to what extent, the 2014 OECD Commentary has actually reversed this interpretation. These commentaries state indeed that beneficial ownership may also be denied where the intermediary is subject to an obligation which is: *"found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person"*.[189] As discussed, it is debatable whether the OECD intended to narrow the discussion to the existence of unwritten legal obligations stemming from the facts or whether the foregoing passage is an incarnation of a substance over form analysis. When implicitly referring to the 2014 OECD Commentary, the CJEU in its recent decisions on directive shopping, as shown, continue to fuel this controversy.

6. Reconciling common denominator: legal substance

In light of the foregoing considerations, an important question arising is whether the legal and substance over form interpretations of beneficial ownership are so far apart that they are likely to produce fundamental different results in cases involving conduit structures. This conclusion could *prima facie* be reached if one compares the outcome in *Prévost* with the majority of cases in which courts have favoured a more economic interpretation of beneficial ownership. In our opinion, this perception should be nuanced assuming of course that what constitutes a legal interpretation of beneficial ownership is properly applied. A legal interpretation of beneficial ownership does indeed not exclude an analysis based on legal substance. In fact, none of the commentators who argue in favour of a legal interpretation consider that the existence of a formal or written obligation is a prerequisite to deny beneficial ownership.[190] Rather, a conduit company should equally not be regarded as the beneficial owner where the facts reveal that the income it receives is subject to an implied contractual obligation (typically an agency agreement).[191] As observed by du Toit: *"It was concluded that a formal agency agreement is not prerequisite for exclusion from beneficial ownership. All other persons, who may be called by many different names who act in a similar representative capacity and whose*

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[187] OECD, Conduit Report, para. 14, p. 8.
[188] 2003 OECD Commentary, para. 12.1 ad art. 10.
[189] 2014 OECD Commentary, para. 12.4 ad art. 10.
[190] DU TOIT, Beneficial Ownership, p. 229.
[191] As observed by DU TOIT, Beneficial Ownership, p. 229.

weight of ownership attributes held less than that of another person (the beneficial owners) are excluded. Even though the application of the ownership attributes test does not, in the first place, involve an investigation as to whether an agency or other representative relationship is present, it follows that if it can be proven that such relationship does exist, it is conclusive evidence that such person is not a beneficial owner".[192] In the same vein, the legal interpretation also implies that beneficial ownership should be denied if the conduit entity has no right to dispose of the income, assets or claims but is compelled to follow the instructions of its creditor/shareholder,[193] irrespective of its own corporate interests and the arrangement in place is a sham. In these instances, the conduit entity would then be regarded as an agent or nominee.[194]

This being said, when dealing with conduit cases – particularly in the framework of the beneficial ownership limitation - courts rarely seriously investigate the existence of a sham (or simulation) despite the fact that these notions are common to the legal systems of most OECD member states and that their application in a tax treaty context is uncontroversial as it relates to the establishment of the facts. An exception is which this point was addressed more clearly was the Argentinean Molinos case.[195] The case involved an intermediary holding company simply redistributing all of its income. The Court held: *"Although the present case is not in any manner a fiduciary one, the parties here behave in a similar way to actors in the [fiduciary context], leaving aside all type of fiduciary property or separated property, which is evident, since [this case] is not about the incorporation of a trust. Thus, once the dividends were received by the intermediary (Holding), this latter transferred the dividends to the parent [Molinos Argentina], which we assimilate to the 'settlor', and now we also must consider as 'beneficial owner' of such dividends"*.[196] JIMÉNEZ also draws a similar link with the sham and simulations exceptions: *"If one steps back for a moment and thinks about the outcome of the cases [...], it is difficult to conclude that the Hungarian companies in the Spanish cases,[197] Luxco in the Swiss V SA[198] or the intermediate Mauritian/Netherlands company in Indofood[199] are*

[192] DU TOIT, Beneficial Ownership, p. 229.
[193] DE BROE, Prevention of Abuse, p. 723.
[194] DE BROE, Prevention of Abuse, p. 723.
[195] Molinos Rio de la Plata SA v Revenue Service, 16 ITLR 616, 672.
[196] Molinos Rio de la Plata SA v Revenue Service, 16 ITLR 616, 672.
[197] Referring to the so-called *"Real Madrid cases"* AN, 18 July 2006, JUR\2006\204307, JUR\2007\8915 and JUR\2007\16549, AN, 10 Nov. 2006, JUR\2006\284679, AN, 20 July 2006, JUR\2007\16526, AN, 13 Nov. 2006, JUR\2006\284618 and AN, 26 Mar. 2007, JUR\2007\101877 quoted by MARTÍN JIMÉNEZ, Beneficial Ownership as a Broad Anti-Avoidance Provision, p. 128 et seq.
[198] Referring to Re V SA, 4 ITLR 191.
[199] Referring to Indofood International Finance Ltd v JPMorgan Chase Bank NA, London Branch, para. 44, 8 ITLR 653.

more than agents or nominees from a legal (not economic) point of view. No 'economic' or 'substance over form' analysis is needed to reach this conclusion, since a recharacterization of the legal relations or the analysis inherent to simulation cases is enough to conclude that what the parties are saying (income can be attributed to the 'intermediary') is different from what they in fact do (there is an agency–administration relationship rather than a legal entitlement of the intermediary to the income)".[200]

If one now returns to the facts of the cases decided by the CJEU, Advocate General Kokott made the following interesting observations: *"Y Cyprus has no staff and apparently no office premises of its own either. As a result, the company does not incur costs for either staff or premises. Also, the remuneration paid to the members of the management board suggests little activity on their part. Furthermore, asset management activities clearly generated no income of its own for the company. This all appears to be artificial. A natural person would have ceased trading long ago under such circumstances".*[201] Further *"If a validly incorporated company does not even have tangible and human resources at its disposal on site to achieve its object (in this case treasury activities) on its own, there would certainly be cause to see it as an arrangement that does not reflect economic reality. This applies in particular if it is structurally unable to generate income of its own that would enable it to do so"*[202] and *"a legal entity that is passive to the point that any conceivable involvement in transactions is, at most, via third parties and that develops no business of its own from which its own income and costs result is a wholly artificial arrangement".*[203]

The features of the conduit entities in these recent cases were remarkably similar those of *A Holding ApS* in the leading case decided by the Swiss Supreme Court in 2005[204] to which we shall also revert in the course of our analysis. In these instances, it is submitted that the existence of a sham (simulation) with respect to either the existence of the conduit company itself and/or the artificial ownership of the treaty protected income it derives is plausible. In the affirmative, the analysis of beneficial ownership on the basis of a genuine substance (economic) over form approach or in legal substance converge.

F. Relation between beneficial ownership and abuse of rights

We now explore another issue namely the relation between beneficial ownership and the notion of abuse. We shall see that several configurations have emerged in tax treaty

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200 JIMÉNEZ, beneficial ownership, pp. 51-52.
201 Case C–117/16 *Skatteministeriet v Y Denmark Aps* [2019], Opinion of AG Kokott, para. 54.
202 Case C–117/16 *Skatteministeriet v Y Denmark Aps* [2019], Opinion of AG Kokott, para. 56.
203 Case C–117/16 *Skatteministeriet v Y Denmark Aps* [2019], Opinion of AG Kokott, para. 57.
204 A Holding ApS v Federal Tax Administration, 8 ITLR 536.

practice which thus add to the uncertainty surrounding the application of the beneficial ownership limitation. In some instances, courts have neglected the beneficial ownership limitation to settle a particular conduit situation on the basis of a prohibition of abuse analysis while, on the facts, it was apparent that the relevant entity was equally not the beneficial owner (1). In other instances, by contrast, the notion of abuse was simply built into the beneficial ownership limitation, either to further expand the scope of beneficial ownership or, by contrast, to exclude its application in the absence of abuse (2).

1. Neglecting beneficial ownership for a prohibition of abuse analysis

a) General Observations

An overwhelming majority of commentators,[205] including the present author[206] have supported the idea that tax treaties are subject to an implied prohibition of abuse. In essence, this position is based on art. 26 and/or 31 VCLT. VOGEL was one of the first

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[205] WARD, Abuse of Tax Treaties, p. 180: *"in light of the fact that the International Court of Justice has already given recognition to the principle of abuse of rights in interpreting treaties generally, that Article 23 of the Vienna Convention requires parties to a treaty to perform the treaties in good faith, that the principle of abuse of rights has been incorporated into the Convention of the Law of the Sea and, more specifically in a tax context, that anti-abuse principles have developed judicially or been enacted by statute in a great number of countries (albeit with some differences in the frequency of application and in the formulation of the rules and in the labels applied to them), one can say that an anti-abuse rule in taxation matters is one of the general legal principles recognized by civilized nations. From this one may argue that a general anti-abuse doctrine should be recognized by tax administrations and courts generally in interpreting and applying tax treaties"*; PROKISCH in Vogel/Lehner, N 117 ad art. 1; ENGELEN, On Values and Norms, p. 36: *"in my opinion, it would indeed be unreasonable and unfair in certain situations if contracting States could require each other to perform the treaty also in cases where the conditions laid down for obtaining the benefits from the treaty are created by means of wholly artificial arrangements only set up for the purpose of avoiding tax, and the granting of these benefits would be against the object and purpose of the treaty. […] [T]he principle of good faith, which is codified in Articles 26 and 31(1) of the Vienna Convention, provides a sound legal basis for the application of the doctrine of fraus pacti […] . [I]t would not be necessary, in my opinion, that support for this is found either in the text of the treaty or in the explanations of the parties"*; DE BROE, Prevention of Abuse, pp. 374-375; VOGEL/RUST, Klaus Vogel on Double Taxation Conventions, Introduction, N 57, Annex C ad art. 1: *"A Contracting State is not obliged to grant treaty benefits in an abusive situation. According to Article 26 VCLT, a treaty has to be performed 'in good faith' by the Contracting Parties. Article 31 (1) VCLT states that a treaty has to 'be interpreted in good faith' and 'in the light of its object and purpose'. As a consequence, treaty benefits may be denied although – according to a literal interpretation – the transaction would fall within the ambit of a treaty provision. A substance over form principle should be regarded as inherent in tax treaties"*.

[206] DANON in Danon *et al.*, N 144 ad art. 1. Contra: VAN WEEGHEL, Improper Use of Tax Treaties, pp. 116-117.

scholars to express this view.[207] According VOGEL treaty law itself embodies a *"substance over form"* principle. Therefore, whether two contracting states have adopted a general prohibition of abuse and, in the affirmative, what constitutes abuse under domestic law is by itself not relevant.[208]

While they recognize that tax treaties are subject to an implied prohibition of abuse, most commentators are however of the opinion that the notion of abuse should be defined restrictively.[209] ENGELEN has argued that a breach of the implied prohibition of abuse requires a wholly artificial arrangement which defeats the principal purpose of the applicable DTA (i.e. promoting the free movement of goods, persons, services and capital by avoiding international double taxation is frustrated).[210] The notion of wholly artificial is inspired by the settled case law of the CJEU in particular the *Cadbury Schweppes* case[211] and subsequent decisions based on the same principles. According to the ECJ, *"in order to find that there is such an arrangement there must be, in addition to a subjective element consisting in the intention to obtain a tax advantage, objective circumstances showing that, despite formal observance of the conditions laid down by Community law, the objective pursued by freedom of establishment […] has not been achieved"*.[212] Further, for the ECJ: *"This element of artificiality would typically materialize in the case of a 'letterbox' or 'front' subsidiary"*.[213] DE BROE follows a similar reasoning. DTAs should be construed in accordance with art. 31 VLCT to give effect to their object and purpose i.e. the development of international trade, business and investment.[214] Accordingly: *"a taxpayer does not pursue such objective if he enters into a transaction which does not or only very marginally contributes to the development of such international activity but which is only or predominantly motivated by the desire to derive treaty benefits"* .[215]

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207 VOGEL 1991, Introduction, N 121.

208 VOGEL 1991, Introduction, N 122: *"It might be assumed that the 'threshold' for application of anti-avoidance rules to DTCs - i.e. for assumption of 'abuse', for determining legal consequences according to the substance of an entity or transaction instead of to its form - should be derived from the domestic law of the States concerned. In other words, it might be suggested that 'substance' instead of 'form' should apply under the treaty always when (but only when) both contracting States consider it to be applicable under domestic law […]. This, however, would imply that contracting States would be forced to take into account very different 'thresholds' in applying their various DTCs. The harmonization of treaty law accomplished by using MCs in the past few decades would thus be counteracted by a re-nationalization of treaty application through the various anti-avoidance standards […]"*.

209 VOGEL 1991, Introduction, N 123.

210 ENGELEN, On Values and Norms, p. 36.

211 CJEU 12 September 2006, Case C-196/04.

212 CJEU 12 September 2006, Case C-196/04, para. 64.

213 CJEU 12 September 2006, Case C-196/04, para. 64.

214 DE BROE, Prevention of Abuse, pp. 374-375.

215 DE BROE, Prevention of Abuse, p. 375.

However, DE BROE submits that a taxpayer only abuses a tax treaty if his *"sole or predominant motive"* to structure a transaction in a particular fashion is to avail himself of the benefits provided for by the treaty and the granting of those benefits in such circumstances would frustrate the object and purpose of the provision of which the taxpayer seeks advantage.[216]

Since 1992, the OECD commentaries have also evolved in the same direction recognizing that substance over form principles are inherent to DTAs. At the time, this position was considered to reflect the view of the majority of member countries.[217] Moreover, the 1992 OECD Commentary shows that an inherent substance over form approach to counter abusive situations may also be derived directly from a contextual interpretation of a particular treaty provision.[218] In 2003, this position was further consolidated by the OECD Commentary. The 2003 commentaries confirm indeed that that substance over form approaches may be applied to DTAs,[219] whether these principles are rooted in domestic law[220] or result from a correct interpretation of the applicable DTA pursuant to art. 31 VCLT. As regards this latter case, the commentaries state that: *"These States, however, then consider that a proper construction of tax conventions allows them to disregard abusive transactions, such as those entered into with the view to obtaining unintended benefits under the provisions of these conventions. This interpretation results from the object and purpose of tax conventions as well as the obligation to interpret them*

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216 DE BROE, Prevention of Abuse, p. 375.

217 1992 OECD Commentary, para. 24 ad art. 1: *"The main problem seems to be whether or not general principles such as 'substance-over-form' are inherent in treaty provisions, i.e. whether they can be applied in any case, or only to the extent they are expressly mentioned in bilateral conventions. The dissenting view argues that to give domestic rules precedence over treaty rules as to who, for tax purposes, is regarded as the recipient of the income shifted to a base company, would erode the protection of taxpayers against double taxation (e.g. where by applying these rules, base company income is taxed in the country of the shareholders even though there is no permanent establishment of the base company there). However, it is the view of the wide majority that such rules, and the underlying principles, do not have to be confirmed in the text of the convention to be applicable"*.

218 At that time, new commentaries were for instance introduced in relation to treaty abuse involving *"international hiring-out of labour"*. Paragraph 8 of the 1992 commentaries to art. 15 OECD MC (employment income) provide in this respect that international hiring-out of labor has given rise to numerous cases of abuse and *"to prevent such abuse, in situations of this type, the term 'employer' should be interpreted in the context of paragraph 2. [...] In this context, substance should prevail over form, i.e. each case should be examined to see whether the functions of employer were exercised mainly by the intermediary or by the user"* (1992 OECD Commentary, para. 8 ad art. 15. See also WARD, Abuse of Tax Treaties, p. 177, footnote 12 noting that: *"express support for the application of the 'substance-over-form' principle to cases of treaty abuse is mentioned in para. 8 of the Commentary to Article 15 of the 1992 OECD Model"*.

219 2003 OECD Commentary, para. 22 et seq. ad art. 1.

220 2003 OECD Commentary, para. 9.2 ad art. 1.

in good faith (see Article 31 of the Vienna Convention on the Law of Treaties".[221] Both approaches should however comply with a so-called *"guiding principle"* according to which *"the benefits of a double taxation convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions".*[222] Under this guiding principle, therefore, tax treaty benefits may be denied where subjective *("a main purpose")* and objective *("more favourable treatment contrary to the object and purpose of the relevant provisions")* requirements are satisfied. There is a discussion in scholarly writing as to whether *"main purpose test"* reflects an implied prohibition of abuse. Some commentators have indeed argued that a *"sole or predominant"* test would be more appropriate. As it well known, the guiding principle inspired the PPT which will be discussed. Unlike the 2017 commentaries to the PTT,[223] the 2003 OECD Commentary do not however describe how the guiding principle (or domestic anti-avoidance rules complying with it) could specifically apply to conduit cases.

With the exception the findings of the Tax Court of Canada in the *MIL (Investments) SA* case,[224] several court decisions around the globe have also endorsed the idea that DTAs are subject to an implied prohibition of abuse. This was the case for instance in the *Yanko-Weiss Holdings* case[225] decided in 2007 the District Court of Tel Aviv.

b) The Swiss *A Holding ApS case*

This being said, the decision which best illustrates the application of the implied prohibition of abuse to a conduit case is certainly the *A Holding ApS* case decided by the Swiss Federal Supreme Court in 2005.[226] This case concerned a Danish holding company (*A Holding ApS*) which was wholly owned by a company in Guernsey (C Ltd), the latter being in turn controlled by a Bermuda shareholder (D Ltd). In 1999, *A Holding ApS* acquired the share capital of a Swiss subsidiary (W SA) which represented its only asset.

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[221] 2003 OECD Commentary, para. 9.3 ad art. 1.

[222] 2003 OECD Commentary, para. 9.5 ad art. 1.

[223] 2017 OECD Commentary, para. 187 ad art. 29.

[224] MIL (Investments) SA v Canada, 9 ITLR 29, 52: *"In particular, in light of the OECD commentary and the decision by Canada and Luxembourg not to include an explicit reference to anti-avoidance rules in their carefully negotiated treaty, I find there is no ambiguity in the treaty permitting it to be construed as containing an inherent anti-abuse rule. Simply put, the 'ordinary meaning' of the treaty allowing the appellant to claim the exemption must be respected".* See also Tax Court of Canada and Federal Court of Appeal, 9 ITLR 1111. For a critical discussion of this case, see among others DUFF, Responses to Treaty Shopping, pp. 93-94; ARNOLD, Beneficial Ownership, p. 49.

[225] Yanko-Weiss Holdings 1 (1996) Ltd v Holon Assessing Office, 10 ITLR 524.

[226] A Holding ApS v Federal Tax Administration, 8 ITLR 536.

The director and ultimate shareholder of these entities was also a resident of Bermuda. *A Holding ApS* did not have any premises or any personnel of its own. This was in particular evidenced by the fact that *A Holding ApS* had not booked any other asset, lease or personnel costs in its statutory accounts. It was also apparent from the facts that the director and ultimate shareholder resident in Bermuda was controlling the whole group and performing all management functions. Therefore, *A Holding ApS* was not carrying out any effective activity in Denmark with its day-to-day business and management activities being performed in Bermuda.[227]

W SA made a dividend distribution to *A Holding ApS*. Two weeks later, *A Holding ApS* distributed roughly the same amount to Y Ltd in Guernsey. *A Holding ApS* sought to obtain a refund of the Swiss withholding tax on the basis of art. 10 of the Switzerland-Denmark DTA which, at the time, provided that dividends were exclusively taxable in the State of residence. The Federal Supreme Court confirmed the lower court's decision and denied tax treaty benefits on the basis of an implied prohibition of abuse. For the Federal Supreme Court, this implied prohibition of abuse is directly rooted in the customary rules embodied in the VCLT:[228] *"Therefore, good faith, the aim and purpose of a convention are to be taken into account when an international convention is applied. Every contracting state can expect that the other contracting state acts in accordance with these principles (cp art 26 of the Vienna Convention on the Laws of Treaties [...]. This includes the tackling of abuses. Because the prohibition of abuses is part of the principle of good faith. (cp para 9.3 of the OECD-commentary to art 1 of the OECD-model 2003; Rainer Prokisch, in: Klaus Vogel/Moris Lehner, cited above, para 117 to art 1). It prohibits the use of an institute of law against its purpose to realise interests which are not protected by it [...]. Accordingly, the prohibition of an abuse of rights as regards conventions is not only recognised in Switzerland as a general principle of law but also on the European level without being necessary to adopt an explicit provision in the respective convention"*.[229] The Federal Supreme Court also confirmed this conclusion by relying on the OECD commentaries as supplementary means of interpretation and made it very clear that the 2003 OECD Commentary merely clarified an existing

[227] A Holding ApS v Federal Tax Administration, para. 3.6.4, 8 ITLR 536, 561.

[228] A Holding ApS v Federal Tax Administration, para. 3.4.1, 8 ITLR 536, 555: *"When construing and applying a double tax convention one can principally refer to the principles of the Vienna Convention to the Laws of Treaties of 23 May 1969 [...]. This is not prevented by the fact that the double tax convention stems from a time before the Vienna Convention on the Laws of Treaties became legally binding for Switzerland [...]"* and 556 *"A treaty is binding upon the parties and must be performed by them in good faith pursuant to art 26 of the Vienna Convention on the Laws of Treaties. Thus the parties have an agreement which shall be interpreted 'in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose' (art 31 para 1 of the Vienna Convention on the Laws of Treaties)"*.

[229] A Holding ApS v Federal Tax Administration, para. 3.4.3, 8 ITLR 536, 557-558.

international principle. With respect to the existence of an implied prohibition of abuse, the Court made it very clear that the 2003 update of the OECD Commentary merely clarified an existing international principle which also applied to DTAs concluded before 2003.[230]

The Federal Supreme Court defined the concept of implied prohibition of abuse by referring to limitations on benefits clauses suggested by the OECD Commentary, namely the *"look-through"*, *"bona fide"* and *"activity"* provisions.[231] The Court also referred to the main purpose test clause relating to dividends, interest and royalties which was added in the OECD Commentary in 2003.[232] Based on the foregoing guidance, the Federal Supreme Court concluded that the interposition of *A Holding ApS* in Denmark was indeed abusive. The Court noted first of all that *A Holding ApS,* which was completely administered and controlled by a resident of Bermuda, was not carrying out an effective commercial activity in Denmark[233] and that it was just a letterbox company.[234] Moreover, *A Holding ApS* was merely passing on to its offshore shareholder the Swiss source dividends it received.[235] Finally, the Federal Supreme Court considered that the outcome would be same under a main purpose test as it was apparent from the facts that a main purpose for the interposition of *A Holding ApS* in Denmark was to take advantage of the Switzerland-Denmark DTA[236] This analysis in effect equates denying tax treaty benefits on the basis of the guiding principle incorporated in the 2003 OECD Commentary. The conclusion would remain the same if, instead, the facts had been considered under a higher threshold of abuse, namely an *"artificiality"* test. Following the reasoning advocated in particular by Engelen, it is indeed obvious that the interposition of *A Holding ApS* in Denmark represented a wholly artificial arrangement defeating the principal purpose of the Denmark-Switzerland DTA (i.e. promoting the free movement of goods, persons, services and capital by avoiding international double taxation).[237] First of all, *A*

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[230] A Holding ApS v Federal Tax Administration, para. 3.4.5, 8 ITLR 536, 558: *"According to para 9.4 of the OECD-commentary to art 1 of the OECD-model 2003 it may be regarded as an internationally accepted principle that states do not have to grant advantages of double tax conventions if arrangements have been chosen which constitute an abuse of a convention [...]"*.

[231] 2003 OECD Commentary, para. 14 and 19 ad art. 1.

[232] 2003 OECD Commentary, para. 21.4 ad art. 1: *"The provisions of this Article shall not apply if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the [Article 10: 'shares or other rights'; Article 11: 'debt-claim'; Articles 12 and 21: 'rights'] in respect of which the [Article 10: 'dividend'; Article 11: 'interest'; Articles 12 'royalties' and Article 21: 'income'] is paid to take advantage of this Article by means of that creation or assignment"*.

[233] A Holding ApS v Federal Tax Administration, para. 3.6.4, 8 ITLR 536, 561.

[234] A Holding ApS v Federal Tax Administration, para. 3.6.4, 8 ITLR 536, 561.

[235] A Holding ApS v Federal Tax Administration, para. 3.6.4, 8 ITLR 536, 561.

[236] A Holding ApS v Federal Tax Administration, para. 3.6.4, 8 ITLR 536, 562.

[237] ENGELEN, On Values and Norms, p. 36.

Holding ApS was not carrying any activity in Denmark. Moreover, the legal construct according to which *A Holding ApS* derived the Swiss source dividends was wholly artificial: these dividends were simply channelled by *A Holding ApS* to its offshore shareholders with the Danish company not exercising any genuine corporate functions. In other words, the arrangement whereby *A Holding ApS* was the *"owner"* of the dividends it received was akin to a sham.

Therefore, as the structure put in place in the *A Holding ApS* case was found to be abusive, the Federal Supreme Court did not find it necessary to address the issue of beneficial ownership.[238] This is remarkable. First of all, although during the relevant period, the Switzerland-Denmark DTA did not incorporate a beneficial ownership limitation, Swiss case law and several commentators had already argued that such limitation was at any rate implicit in the dividends, interest and royalties articles of all Swiss DTAs. One may thus wonder it would not have been more appropriate to deal first with the application of the beneficial ownership limitation as a condition to access tax treaty benefits and, if necessary, as a second step and subsidiarily only, to consider a possible abuse. In fact, we have argued that that the Federal Supreme Court would have reached the same conclusion by considering that *A Holding ApS* was not the beneficial owner of the dividends it received. On the facts submitted to the Court, *A Holding ApS* exercised no decisional autonomy. In particular, the immediate redistribution of dividends was not the expression of the intermediary entity's corporate autonomy but rather an arrangement that placed this entity in a position similar to that of an agent or nominee.[239] In fact, this approach was subsequently favoured by the Federal Supreme Court in 2015 when it was again confronted to the Switzerland-Denmark DTA in the context of the Swaps case: beneficial ownership of the Danish bank was first considered and denied so that it was not necessary for the court to address a possible abuse. It is fair to say that since the Swaps case, this order of preference is systematically followed. For instance, in a subsequent decision relation to the Luxembourg-Switzerland DTA, the Federal Supreme Court ruled in that a Luxembourg company, which was established with low equity, employed no personnel, maintained no infrastructure and was financially controlled by its foreign shareholders, could not be regarded as the beneficial owner of the dividends it received.[240]

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[238] A Holding ApS v Federal Tax Administration, para. 3.5.3 8 ITLR 536, 559: *"The question as regards the entitlement to use the dividends as an additional criterion can be left open with regard to the following considerations"*.

[239] DANON, Bénéficiaire effectif, p. 48 ; BAUMGARTNER, Das Konzept des beneficial owner, pp. 136-137 ; OBERSON, Précis de droit fiscal international, N 793, pp. 245-246 (94).

[240] Federal Supreme Court decision of 22 Nov. 2015, 2C_752/2014 (preferred equity certificates).

c) Comparison with the CJEU judgments on directive shopping

From a comparative perspective and of course for different reasons, it is interesting to observe that the reasoning of the CJEU in its recent decisions on directive shopping mirrors by contrast the one adopted in the *A Holding ApS* case. The reasoning of the CJEU was indeed structured in such a way that it was in the end unnecessary to address the application of the beneficial ownership limitation.[241] In essence, the court found that, irrespective of the existence of a specific domestic or agreement-based implementation of anti-abuse provisions, the general principle that abusive practices are prohibited EU law could be relied upon to deny the application of the PSD and IRD.[242] Moreover, the Court revisited its findings in the *Kofoed* judgment relating to the merger directive[243] with a view to align it with its case law in VAT matters.[244] Accordingly, even where it transpires that national law does not contain rules which may be interpreted in compliance with the reservation of domestic or agreement-based provisions found in the PSD and IRD, the benefits of these directives may still be denied on the basis of the EU notion of prohibition of abuse of rights.[245] An in-depth analysis of the judgments of the CJEU[246] would of course be beyond the scope of the present contribution which focuses on beneficial ownership from a tax treaty perspective. It is nevertheless interesting to dwell on the indicators that the court provided for the purposes of detecting the existence

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[241] See CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 121; CJEU, 26 February 2019, Case C-116/16 (Joined cases), para. 93 and 94; ZALASINSKI, Beneficial Ownership, p. 17; CFE Opinion Statement ECJ-TF 2/2019, p. 494.

[242] CFE Opinion Statement ECJ-TF 2/2019, p. 495. See in particular CJEU, 26 February 2019, Case C-116/16 (Joined cases), para. 70-76; CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 96-98.

[243] CJEU, 5 July 2007, Case C-321/05, para. 37-42.

[244] CJEU, 18 December 2014, Case C-131/13 (joined cases), para. 54; CJEU, 22 November 2017, Case C-251/16, para. 38 et seq.

[245] CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 117; CJEU, 26 February 2019, Case C-116/16 (Joined cases), para. 89. See also thereupon CFE Opinion Statement ECJ-TF 2/2019, p. 496; DE BROE/GOMMERS, beneficial ownership cases, sec. 3.1 and 3.2.2. In the mind of the court, the application of this general principle does not amount to imposing an obligation on the individual under the directives but *"is merely the consequence of the finding that the objective conditions required for obtaining the advantage sought, prescribed by the directive as regards that right, are met only formally"*, CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 119; CJEU, 26 February 2019, Case C-116/16 (Joined cases), para. 91. Scholars have accepted that the prohibition of abuse of rights is today a general principle of Union law (DE BROE/GOMMERS, beneficial ownership cases, sec. 3.3). While one might argue that on this point the findings of the CJEU will not have an important practical impact in the future given the recent adoption of GAAR clauses in direct tax directives and, more generally, in light of the GAAR included in ATAD (art. 6) (CFE Opinion Statement ECJ-TF 2/2019, p. 496) one may at the same time wonder how the general unwritten principle laid down by the court will interact with these recently adopted written GAARs.

[246] See DE BROE.

of an abuse of rights within the meaning of its settled case law, in particular the *Emsland-Stärke* case.[247] Pursuant to this case law, the CJEU noted that: *"proof of an abusive practice requires, first, a combination of objective circumstances in which, despite formal observance of the conditions laid down by the EU rules, the purpose of those rules has not been achieved and, second, a subjective element consisting in the intention to obtain an advantage from the EU rules by artificially creating the conditions laid down for obtaining it"*.[248] As evidenced by this double test, the notion of abuse under EU law thus comes into play after it has been established that the conditions provided by the directive are satisfied and thus operates as an *ultima ratio*.[249]

It is therefore on the basis of the foregoing that the court provided its guidance aiming at detecting an abuse of the PSD and IRD.[250] Some of the indicators provided by the court are not linked to the beneficial ownership limitation but rather focus on the absence of genuine economic activity by the interposed entity. According to the CJEU, a conduit company may be regarded as an artificial legal construction where it exercises no *"actual economic activity"*[251] which must: *"in the light of the specific features of the economic activity in question, be inferred from an analysis of all the relevant factors relating, in particular, to the management of the company, to its balance sheet, to the structure of its costs and to expenditure actually incurred, to the staff that it employs and to the premises and equipment that it has"*.[252] From this perspective, the reasoning adopted by the CJEU very much mirrors the one adopted by the Federal Supreme Court in the *A Holding ApS* case. Likewise, the difference with a beneficial ownership analysis is also reflected in the fact that, for purposes of determining an abuse of rights, the court considers not just one entity but rather the *"group of companies"*[253] itself which may be regarded as an artificial arrangement *"where it is not set up for reasons that reflect economic reality, its structure is purely one of form and its principal objective or one of its principal objectives is to obtain a tax advantage running counter to the aim or purpose*

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[247] CJEU, 16 March 2006, Case C-94/05.

[248] CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 124; CJEU, 26 February 2019, Case C-116/16 (Joined cases), para. 97. Further, according to the court that would also be the case: *"where the accrual of a tax advantage constitutes the essential aim of the transactions at issue [...]"* (CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 107).

[249] DE BROE/GOMMERS, beneficial ownership cases, sec. 3.2.2.

[250] CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 126; CJEU, 26 February 2019, Case C-116/16 (Joined cases), para. 100.

[251] CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 131; CJEU, 26 February 2019, Case C-116/16 (Joined cases), para. 104.

[252] CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 131; CJEU, 26 February 2019, Case C-116/16 (Joined cases), para. 104.

[253] CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 127; CJEU, 26 February 2019, Case C-116/16 (Joined cases), para. 100.

of the applicable tax law".[254] At the same time, however, the concepts of abuse law and beneficial ownership remain intertwined in the court's analysis.[255] Indeed, after the foregoing passage the court adds: *"That is so inter alia where, on account of a conduit entity interposed in the structure of the group between the company that pays interest and the entity which is its beneficial owner, payment of the tax on the interest is avoided".*[256] In fact, other indicators used by the court could well have been used in a pure beneficial ownership analysis. For instance, reference is made to the fact that an interposed entity may be characterized as an artificial conduit where it passes *"all or almost all"*[257] of the dividends or interest it receives. On this point, the CJEU seems to give importance to the fact that the conduit: *"makes only an insignificant taxable profit when it acts as a conduit company in order to enable the flow of funds from the debtor company to the entity which is the beneficial owner of the sums paid".*[258] The question of the existence of a profit *("spread")* made by the conduit company is often discussed in the context of a beneficial ownership analysis. However, this passage also indirectly refers to the level of risks and functions requiring an appropriate remuneration) assumed by the conduit entity,[259] an analysis which one also finds in the commentaries to the PPT.

This being said, the most obvious references to beneficial ownership are made when the CJEU refers to the *"the conduit companies inability to have economic use of the interest received may also be used as indications of such an arrangement".*[260] The court then goes on with what may be clearly be read as an indirect reference to the 2014 commentaries[261] noting *that: "such indications are capable of being constituted not only by a contractual or legal obligation of the parent company receiving the dividends to pass them on to a third party but also by the fact that, 'in substance', as the referring court states, that company, without being bound by such a contractual or legal obligation, does not have the right to use and enjoy those dividends".*[262] On this point, commenta-

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254 CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 127; CJEU, 26 February 2019, Case C-116/16 (Joined cases), para. 100.

255 CFE Opinion Statement ECJ-TF 2/2019, p. 498.

256 CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 127; CJEU, 26 February 2019, Case C-116/16 (Joined cases), para. 100.

257 CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 128; CJEU, 26 February 2019, Case C-116/16 (Joined cases), para. 101.

258 CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 130; CJEU, 26 February 2019, Case C-116/16 (Joined cases), para. 103.

259 DE BROE/GOMMERS, beneficial ownership cases, sec. 4.1.

260 CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 132; CJEU, 26 February 2019, Case C-116/16 (Joined cases), para. 105.

261 See 2014 OECD Commentary, para. 12.4 ad art. 10 and CFE Opinion Statement ECJ-TF 2/2019, p. 492; DE BROE/GOMMERS, beneficial ownership cases, sec. 4.1.

262 CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 132; CJEU, 26 February 2019, Case C-116/16 (Joined cases), para. 105.

tors have argued that the reference to the 2014 commentaries is however not fully accurate as the reference made to *"facts and circumstances"* and *"in substance"* by these commentaries is only intended to allow to take into consideration the existence of an unwritten but legal or contractual obligation to pass on the income received. Yet, as we have seen, whether the 2014 commentaries are limited to *"legal substance"* or would also accommodate a substance over form analysis remains unclear.[263]

2. Building the notion of abuse rights into beneficial ownership

While, as just discussed, some cases which could have been analyzed on the basis of the beneficial ownership limitation have settled pursuant to an abuse of rights doctrine, in some countries, by contrast, the notion of abuse has been built into the beneficial ownership limitation for various reasons.

In France, a leading example of this trend is of course the *Bank of Scotland* case decided in 2006.[264] In his conclusions, the *Commissaire du Gouvernement*, Mr. François Seners, considered in particular that beneficial ownership incorporated the notion of abuse prevention: *"The notion of beneficial or real owner [...] was inserted into the Model Convention of the OECD in 1977 and, according to the commentaries of the Committee for Fiscal Affairs of that organisation, a beneficial owner is a person who acts through the interposition of another legal entity created in a state, with the essential objective of obtaining a reduction in taxation provided for by the treaties concluded by that state to which the person would not have been directly entitled [...].The notion of beneficial ownership cannot be reduced to cases of transfer of intended benefits and that, by its nature, it encompasses situations of fraud on the law. It appears to me in effect quite natural that the recognition of a fraud on the law leads one to reject the image portrayed by an arrangement [...]. Since it tends to exclude the fiscally advantageous effects of a misleading appearance, the notion of beneficial owner also leads to the neutralisation of situations where the envisaged sums are paid back in one form or another as well as situations where an abusive arrangement has permitted X to be substituted for Y to benefit from treaty advantages, to the detriment of the taxing state"*.[265]

In Switzerland, as we have seen, a clear distinction is formally made between the beneficial ownership limitation and the notion of abuse. At the same time, in some decisions, courts have conducted a purpose-oriented analysis has been conducted against the tax-

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[263] CFE Opinion Statement ECJ-TF 2/2019, p. 492; DE BROE/GOMMERS, beneficial ownership cases, sec. 4.1.

[264] Ministre de l'Économie, des Finances et de l'Industrie v Société Bank of Scotland, 9 ITLR 683.

[265] *Commissaire du Gouvernement*, Mr. François Seners, Ministre de l'Économie, des Finances et de l'Industrie v Société Bank of Scotland, 9 ITLR 683, 711 et seq.

payer to confirm the absence of beneficial ownership.[266] For example, in a case decided in 2014, the Federal Administrative Court held that, where the interposition of an entity in the state of residence is considered as abusive, there is a presumption that such entity may not be regarded as the beneficial owner.[267] In a subsequent decision, the Federal Administrative Court even referred to a purpose alien to treaty benefits, namely the objective to benefit from a favourable regime in Luxembourg.[268]

In the United Kingdom, the substance over form meaning given to beneficial ownership in the *Indofood* decision[269] gave rise to uncertainties, for example in the field of capital market transactions involving SPVs. Therefore, in its guidance, HM Revenue & Customs choose to refer to the notion of abuse, but this time rather in order to carve out the application of beneficial ownership in *bona fide* situations: *"However, as indicated above in applying the beneficial ownership concept in the context of Double Taxation Conventions (DTCs), regard should be had to the objective of the DTC. Where there is no abuse of the DTC, there is no need, in practice, to apply the 'international fiscal meaning' of beneficial ownership"*.

This policy seems to mirror the one embodied in the so-called *"conduit arrangement clause"* which was for example inserted at the request of the UK in its 2001 DTA with the US.[270] This clause indeed combines an anti-conduit rule with a main purpose test in the sense that in order for treaty benefits to be denied it must also be established that the main purpose (or one of the purpose purposes) for the interposition of a conduit entity was to obtain increased tax treaty benefits. We shall revert to this clause when discussing the PPT in the second part of this contribution as it has directly inspired the 2017 OECD commentaries.

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266 CH: FAT, 25 June 2014, A-4693/2013 (partially confirmed by CH: FT, 3 Dec. 2015, 2C_753/2014) and A-4689/2013 (partially confirmed by CH: FT, 27 Nov. 2015, 2C_752/2014), para. 8.4.

267 CH: FAT, 25 June 2014, A-4693/2013 (partially confirmed by CH: FT, 3 Dec. 2015, 2C_753/2014) and A-4689/2013 (partially confirmed by CH: FT, 27 Nov. 2015, 2C_752/2014), para. 8.4.

268 FAT judgment of 20 Dec. 2016, *supra* n. 26, at para. 5.2.2.3.

269 Indofood International Finance Ltd v JPMorgan Chase Bank NA, London Branch, 8 ITLR 653.

270 Art. 3(1)(n) 2001 US-UK DTA: *"the term 'conduit arrangement' means a transaction or series of transactions: (i) which is structured in such a way that a resident of a Contracting State entitled to the benefits of this Convention receives an item of income arising in the other Contracting State but that resident pays, directly or indirectly, all or substantially all of that income (at any time or in any form) to another person who is not a resident of either Contracting State and who, if it received that item of income direct from the other Contracting State, would not be entitled under a convention for the avoidance of double taxation between the state in which that other person is resident and the Contracting State in which the income arises, or otherwise, to benefits with respect to that item of income which are equivalent to, or more favourable than, those available under this Convention to a resident of a Contracting State; and (ii) which has as its main purpose, or one of its main purposes, obtaining such increased benefits as are available under this Convention"*.

G. What if the beneficial owner is in a Contracting State?

We now consider the case in which the beneficial owner of the dividends, interest or royalties is resident either in the same or in another contracting state than the conduit entity. Assuming that this entity does not qualify as the beneficial owner, a question arising in practice is often whether the benefits provided by DTA concluded between the state of source and that of the beneficial owner remain available. These benefits could either be identical, or more frequently in practice, less favourable.[271] It is interesting to consider this issue from the perspective of the beneficial ownership limitation (2.8.1) and then contrast the outcome reached under an abuse of rights doctrine analysis (2.8.2). As we shall see, in both instances, uncertainties remain while it will be argued that the notion of abuse of rights is conceptually more promising to resolve the problem.

1. From the perspective of the beneficial ownership limitation

The OECD Commentary has consistently provided that where the recipient and the beneficial owner of dividends, interest and royalties are not the same persons, the benefits of the DTA concluded between the state of source and the state of residence of the beneficial owner remain available. The commentaries state that subject: *"to other conditions imposed by the Article, the limitation of tax in the State of source remains available when an intermediary, such as an agent or nominee located in a Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State"*.[272] Before 2014 and with respect to dividends, there was a slight point of tension between this interpretation and paragraph one and two of art. 10 OECD MC. Paragraph one referred indeed to *"dividends paid [...] to a resident of the other Contracting"* while paragraph 2 stated that: *"such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed"*. Because paragraph 2 made reference to *"such dividends"*, it was arguable that paragraph 2 could not operate independently from paragraph 1 and, therefore, that the DTA between the state of source and the state of residence of the beneficial owner was not directly applicable. With a view to further clarify the interpretation conveyed by the commen-

[271] A classic example is the situation in which the DTA between the state of source and the state of residence of the beneficial owner provide for a 5 % residual withholding tax on dividends whereas the DTA between the state of source and the state of residence of the conduit (unavailable) lower such withholding tax to nil.

[272] 2014 OECD Commentary, para. 12.7 ad art. 10.

taries, the reference to *"such dividends"* has been replaced by *"dividends"* in art. 10(2) of the 2014 OECD MC.[273]

This issue is not problematic where the recipient of the income and the beneficial owner are resident of the same contracting state. For example, assume that a conduit entity resident in state R derives dividends from state S and that the sole shareholder and beneficial owner of this entity is also an individual resident in state R. In this case, there is no doubt that the benefits provided by the S-R DTA – albeit a 15 % residual withholding tax[274] – continue to be available as both the recipient of the income and the beneficial owner are resident of the same contracting state.[275] By contrast, where the beneficial owner is in a different contracting state, the interpretation supported by the commentaries requires one to consider that the benefits of the DTA between the state of residence of this person and the state of source are available even if such person is not the recipient of the dividends, interest and royalties for tax purposes under the laws of the state of source and/or residence.[276] Of course, there is some support for this position as the text of art. 10(2), 11(2)[277] and 12 (1)[278] OECD MC do not expressly refer to such requirement. However, a conceptual tension remains if it is assumed that distributive rules are generally subject to the condition that income arising in the state of source be fiscally attributed to a resident of the other contracting state, either under the laws of the state of source or, as we have argued, under those of the state of residence.[279]

In certain countries at least, courts have had difficulties to subscribe to the interpretation advocated by the OECD Commentary. Interesting in this respect is a decision rendered

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[273] As from 2014 art. 10 OECD MC reads as follows: *"1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State. 2. However, dividends paid by a company which is a resident of a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed [...]"*.

[274] Art. 10(2)(b) OECD MC.

[275] In Switzerland, the Federal Administrative Court erroneously arrived at a different conclusion and denied treaty benefits in a case concerning the application of the Switzerland-Germany DTA and involving a conduit entity in Germany whose shareholders were however all residents of this country (CH: FAT, 30 Oct. 2008 (A-2744/2008) consid. 10 et ss), see thereupon DANON, distinction entre évasion fiscale, "treaty" et "rule shopping", p. 136 et seq.

[276] DANON/DINH in Danon *et al*., N 94 et seq. ad art. 1.

[277] See art. 11(2) OECD MC: *"However, interest arising in a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10 per cent of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation"*.

[278] See art. 12(1) OECD MC: *"Royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State"*.

[279] DANON/DINH in Danon *et al*., N 94 et seq. ad art. 1.

by the Swiss Federal Supreme Court in relation to a conduit entity established in Luxembourg and whose beneficial owners were residents of the United States. As it was found that the conduit entity was not the beneficial owner of Swiss source dividends within the meaning of the Switzerland-Luxembourg DTA, the question arose as to whether the benefits of the Switzerland-US DTA could alternatively and directly be available. This question was answered in the negative with the Federal Supreme Court making no reference to the OECD Commentary. Rather, the Federal Supreme Court simply observed that, from a procedural standpoint, the possibility for the shareholders of the Luxembourg entity to claim the benefits of the Switzerland-US DTA concerned a different person and was thus unrelated to the matter at hand.[280] From a comparative perspective but in relation to the IRD, the CJEU seemed by contrast to favour an interpretation in line with the OECD Commentary at least with respect to interest payments being made within the internal market: *"It should also be stated that the mere fact that the company which receives the interest in a Member State is not its 'beneficial owner' does not necessarily mean that the exemption provided for in Article 1(1) of Directive 2003/49 is not applicable. It is conceivable that such interest will be exempt on that basis in the source State when the company which receives it transfers the amount thereof to a beneficial owner who is established in the European Union and furthermore satisfies all the conditions laid down by Directive 2003/49 for entitlement to such an exemption"*.[281]

It appears that the OECD Commentary assumes that the DTA concluded between the state of source and the state of residence of the beneficial owner applies directly and not as a result of a recharacterization mechanism deeming the beneficial owner to also be the recipient of the income for tax purposes. Therefore, courts may find it difficult to consider that benefits provided by the DTA concluded between the state of source and that of the beneficial owner should be made available while at the same time these benefits are not actually claimed by this person.

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[280] Federal Supreme Court decision of 22 Nov. 2015, 2C_752/2014 (preferred equity certificates), para. 7: *"Enfin, il n'y a pas lieu d'entrer en matière sur l'argumentation nouvelle de la recourante dans laquelle celle-ci semble se prévaloir d'une éventuelle application de la Convention du 2 octobre 1996 entre la Confédération suisse et les États-Unis d'Amérique en vue d'éviter les doubles impositions en matière d'impôts sur le revenu (CDI-EU; RS 0.672.933.61) et de la possibilité pour ses associés d'obtenir le remboursement de l'impôt anticipé sur la base de leur domicile aux États-Unis. Dans la mesure où le remboursement de l'impôt anticipé selon la CDI-Lux n'a pas le même objet qu'un remboursement de l'impôt anticipé fondé sur la CDI-EU et ne concerne pas directement la recourante, on ne saurait considérer qu'il s'agit d'une même prétention issue du même contexte de fait dont seul le fondement juridique différerait (cf. arrêt 2C_642/2014 précité, consid. 7). Par conséquent, en évoquant pour la première fois devant le Tribunal fédéral la possibilité d'obtenir un remboursement de l'impôt anticipé sur la base du domicile de ses associés aux États-Unis, la recourante élargit l'objet du litige, ce qui n'est pas admissible. Son argumentation n'est donc pas recevable"*.

[281] CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 94.

2. From the perspective of an abuse of rights doctrine

It would seem that the foregoing difficulties would not come into play where tax treaty benefits are instead denied to a conduit entity on the basis of an abuse of rights doctrine. In these instances, the application of such doctrine, whether rooted in treaty or domestic law, would normally entail a re-characterization of the facts. Therefore, one would expect that a proper operation of such doctrine implies that the tax treaty benefits which would have been applicable in the absence of the interposition of the conduit entity (i.e. in particular the benefits provided by the DTA concluded between the state of source and that of the beneficial owner) are normally granted. For example, this outcome is expressly provided by the US conduit financing regulations.[282] In Switzerland, this practice is generally applied in the case of an abusive cross-border share transfer in the sense that the distributable reserves existing prior to such transfer remain subject to the residual withholding tax which would have been applicable under the DTA concluded between Switzerland and the state of residence of the transferor *("old reserve theory")*.[283]

Until recently and pursuant to the principle of proportionality, one could safely assume that the foregoing reasoning was the only one consistent with European Union law. In particular, in the *Halifax* case, the CJEU clearly held that *"[i]t must also be borne in mind that a finding of abusive practice must not lead to a penalty, for which a clear and*

[282] See US Treasury Regulations § 1.881-3 Conduit financing arrangements: *"Where the participation of a conduit entity in a conduit financing arrangement is disregarded pursuant to this section, it is disregarded for all purposes of section 881, including for purposes of applying any relevant income tax treaties. Accordingly, the conduit entity may not claim the benefits of a tax treaty between its country of residence and the United States to reduce the amount of tax due under section 881 with respect to payments made pursuant to the conduit financing arrangement. The financing entity may, however, claim the benefits of any income tax treaty under which it is entitled to benefits in order to reduce the rate of tax on payments made pursuant to the conduit financing arrangement that are recharacterized in accordance with paragraph (a)(3)(ii)(B) of this section"*.

[283] CH: FAT, 23 Mar. 2010, A-2744/2008, RF 2010, para. 4.4; see also thereupon DANON/OBRIST, La théorie des "anciennes réserves", p. 627 et seq.; See also the practice of the Federal Tax Administration in: STOCKAR/HOCHREUTENER, Praxis, N 32 ad art. 21 al. 2: *"Wäre indessen bereits aufgrund des DBA eine teilweise Rückerstattung in das Land möglich gewesen, aus welchem die betroffene Beteiligung veräussert wurde, lässt sich die volle Rückerstattungsverweigerung nicht rechtfertigen, da die Konsequenz eine Schlechterstellung gegenüber dem Status Quo bewirkt. Vielmehr ist in einem solchem Fall für alle nach der Übertragung der fraglichen Beteiligung erbrachten Ausschüttungen aus den ‹Altreserven› die Rückerstattung (ab sofort) in dem Umfang zu gewähren, wie ihn die übertragende Inhaberin bereits hätte geltend machen können"*. However, as outlined above and according to the Swiss Federal Supreme Court's recent case law, this reasoning is not applicable where tax treaty benefits are by contrast denied to a conduit entity pursuant to the beneficial ownership limitation.

unambiguous legal basis would be necessary"[284] and *"it follows that transactions involved in an abusive practice must be redefined so as to re-establish the situation that would have prevailed in the absence of the transactions constituting that abusive practice"*.[285] This reasoning was again reaffirmed in the *Cussens* case recently decided in 2017 by the CJEU.[286]

Quite unsurprisingly, Advocate General Kokott relied on this case law in the IRD and PSD directive shopping cases and considered that: *"In order for abuse of possible legal arrangement to exist, a legal arrangement must be chosen that differs from the arrangement normally chosen and gives a more favourable result than the 'normal' arrangement. In the present case, the 'normal arrangement' would be a direct dividend disbursement between the capital investment companies and the claimant in the main proceedings. That 'normal arrangement' would also have to result in a higher tax burden"*.[287] Following this line of reasoning there is no abuse if *"disregarding the conduit company, the actual dividends recipient were also an undertaking with its seat in a different Member State or the dividends recipient were resident in a State with which Denmark had concluded a DTC"*[288] providing for equivalent treaty benefits. It also follows from the opinion of the Advocate General that if an abuse is found to exist, benefits which would have been available in the absence of the conduit entity should be granted based on a *"redefined situation"*.[289] Therefore, according to the Advocate General a Member State wishing to refuse the benefits of the PSD and IRD has a corresponding obligation to identify the beneficial owners of the dividends or interest, the taxpayer having an enhanced duty to assist.[290]

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[284] UK: ECJ, 21 Feb. 2006, Case C-255/02, Halifax plc, Leeds Permanent Development Services Ltd, County Wide Property Investments Ltd v. Commissioners of Customs & Excise, BUPA Hospitals Ltd, Goldsborough Developments Ltd v. Commissioners of Customs and Excise and University of Huddersfield Higher Education Corporation v. Commissioners of Customs and Excise, para. 93, ECJ Case Law IBFD.

[285] UK: ECJ, 21 Feb. 2006, Case C-255/02, Halifax plc, Leeds Permanent Development Services Ltd, County Wide Property Investments Ltd v. Commissioners of Customs & Excise, BUPA Hospitals Ltd, Goldsborough Developments Ltd v. Commissioners of Customs and Excise and University of Huddersfield Higher Education Corporation v. Commissioners of Customs and Excise, para. 94, ECJ Case Law IBFD.

[286] IE: ECJ, 22 Nov. 2017, Case C-251/16, Edward Cussens, John Jennings, Vincent Kingston v. T.G. Brosman, para. 46, ECJ Case Law IBFD: *"Where an abusive practice has been found to exist, the transactions involved must be redefined so as to re-establish the situation that would have prevailed in the absence of the transactions constituting that abusive practice. That redefinition must, however, go no further than is necessary"*.

[287] Opinion of AG Kokott, 1 March 2018, C-116/16, T Denmark, para. 88.

[288] Opinion of AG Kokott, 1 March 2018, C-116/16, T Denmark, para. 90.

[289] Opinion of AG Kokott, 1 March 2018, C-116/16, T Denmark, para. 90.

[290] Opinion of AG Kokott, 1 March 2018, C-116/16, *T Denmark,* para. 91.

This being said, in its judgments, the CJEU departed from the foregoing principles.

First of all, the CJEU considered that: *"when examining the structure of the group it is immaterial that some of the beneficial owners of the dividends paid by the conduit company are resident for tax purposes in a third State which has concluded a double taxation convention with the source Member State. The existence of such a convention cannot in itself rule out an abuse of rights. Thus, a convention of that kind cannot call into question that there is an abuse of rights where its existence is duly established on the basis of a set of facts showing that economic operators have carried out purely formal or artificial transactions devoid of any economic and commercial justification, with the essential aim of benefiting improperly from the exemption from withholding tax [...]"*.[291] The CJEU also found that it was not necessary for the tax authorities to identify the beneficial owners in order to deny the benefit of the PSD and IRD to a conduit entity.[292] At the same time, the court noted that: *"it remains possible, in a situation where the dividends would have been exempt had they been paid directly to the company having its seat in a third State, that the aim of the group's structure is unconnected with any abuse of rights. In such a case, the group cannot be reproached for having chosen such a structure rather than direct payment of the dividends to that company"*.[293] As observed by commentators, the findings of the court on this point are unsatisfactory and confusing.[294] If one takes into consideration that, according to the court's settled case law, the existence of an abuse must entail an advantage,[295] it is quite clear that the existence of a DTA between the state of source and that of the beneficial owner must be taken into consideration.

The second troubling observation made by the court is the following: *"It should be added that, whilst taxation must correspond to economic reality, the existence of a double taxation convention is not, as such, capable of establishing that a payment was really made to recipients resident in the third State with which that convention has been concluded. If the company owing the dividends wishes to benefit from the advantages of such a convention, it is open to it to pay the dividends directly to the entities that are resident for tax purposes in a State which has concluded a double taxation convention with the source State"*.[296] By requiring that a payment *"was really made to recipients resident in the third state"*, the court seems here to adopt a formal position which is very similar to

[291] CJEU, 26 February 2019, Case C-116/16 (Joined cases), para. 108; CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 135.

[292] CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 120.

[293] CJEU, 26 February 2019, Case C-116/16 (Joined cases), para. 110; CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 137.

[294] DE BROE/GOMMERS, beneficial ownership cases, sec. 4.2.

[295] CJEU, 16 March 2006, Case C-94/05.

[296] CJEU, 26 February 2019, Case C-116/16 (Joined cases), para. 109; CJEU, 26 February 2019, Case C-115/16 (joined cases), para. 136.

the one favoured by the Swiss Federal Supreme Court in the case discussed above and involving the alternative application of the Switzerland-US DTA under a beneficial ownership analysis.[297] In our opinion, this reasoning is again inconsistent. Because the CJEU relied on the notion of abusive of rights under EU law to deny the benefits of the PSD and IRD, it consequently follows that the application of this notion requires by essence a re-characterization of the facts. Therefore, contrary to what the court seems to suggest, the question is not whether a payment *"was really made to recipients resident in the third state"*, but rather whether the benefits of DTA, and in the affirmative to what extent, would have been available had the payment been made directly to such recipients.

II. Beneficial ownership as a response to conduit companies cases after BEPS

We now move to the last part of this contribution and explore how the beneficial ownership limitation fits into post-BEPS tax treaty policy. In order to keep the discussion within manageable proportions, we consider the relation between beneficial ownership and the new preamble to the 2017 OECD MC (3.1) as well the PPT rule included in its art. 29(9) (3.2) which, under BEPS Action 6 and the Multilateral Instrument (MLI), represent minimum standards[298] and, arguably, the most important changes introduced in the OECD MC. As we shall see, one of the collateral effects of these additions to the OECD MC is to further exacerbate the uncertainties surrounding the interpretation of the beneficial ownership limitation

[297] Federal Supreme Court decision of 22 Nov. 2015, 2C_752/2014 (preferred equity certificates), para. 7.

[298] In accordance with BEPS Action 6, states may choose to adopt the PPT alone or, alternatively, combine it with a simplified limitation on benefits provision (LOB). On the other hand, states wishing to opt out of the PPT and adopt instead a detailed LOB clause are required to supplement such clause with a mechanism designed to deal with conduit arrangements. This mechanism may take the form of a treaty PPT restricted to conduit arrangements, domestic anti-abuse rules or simply judicial doctrines achieving a similar result. A good example of this policy is of course the US conduit financing Treas. Reg. (§ 1.881-3 – Conduit financing arrangements). The policy principle, however, is that these various options should achieve a similar result to that of the PPT (para. 187 *OECD Model: Commentary on Article 29*).

A. Beneficial ownership and the new preamble to the OECD MC

Prior to the BEPS initiative, the importance given by courts to the preamble of DTAs for the purposes of defining what constitutes tax treaty abuse was not uniform. For instance, in the *Verdannet* case, the French *Conseil d'État* seemed to give weight to the objectives pursued by France and Luxembourg when concluding their 1958 DTA and, therefore, indirectly to the preamble of such agreement. The *Conseil d'État* considered indeed that: *"the States that are parties to the Franco-Luxembourg tax treaty cannot be regarded as admitting, in the distribution of the power of taxation, the application of its provisions to situations arising from artificial transactions devoid of any economic substance. It follows that in finding that the operation in question was contrary to the objectives pursued by the two signatory States, the Court did not commit any error of law in its judgment"*.[299] In the Alta Energy case, by contrast, the Canadian Tax Court found that: *"A tax treaty is a multi-purpose legal instrument. The preamble of the Treaty states that the two governments desired 'to conclude a Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital.' While indicative of the general purpose of the Treaty, this statement remains vague regarding the application of specific articles of the Treaty"*.[300]

It is submitted that these differences of approaches are due to the fact that prior to the BEPS initiative the preambles of DTAs were formulated in rather general terms so that it was not evident for courts to genuinely make use of it in the interpretative process. At the same time, however, it is undisputed that the preamble forms part of the context under art. 31 VCLT[301]. Therefore, it is reasonable to consider that the new preamble to the 2017 OECD MC, which specifically alludes to the need to prevent tax treaty shopping will play an increased role in tax treaty interpretation. According to the new preamble contracting states are indeed *"Intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions)"*. Quite logically, the 2017 OECD Commentary confirms that this new preamble will have to be taken into consideration when interpreting post-BEPS DTAs in light of art. 31 VCLT[302].

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299 Re Verdannet, 20 ITLR 832, 856-857.
300 Alta Energy Luxembourg SARL v R, 21 ITLR, para. 77.
301 Art. 31(2)(a) VCLT.
302 Introduction to the 2017 OECD MC, para. 16.2.

The 2017 commentaries do not however provide a specific definition of *"treaty-shopping arrangements"* under the preamble. Rather, the commentaries simply provide that: *"it was [...] decided to refer expressly to such arrangements as one example of tax avoidance that should not result from tax treaties, it being understood that this was only one example of tax avoidance that the Contracting States intend to prevent"*.[303] Yet the commentaries to art. 1 OECD MC remain unchanged on this point and continue to state that treaty abuse occurs: *"for example, if a person (whether or not a resident of a Contracting State), acts through a legal entity created in a State essentially to obtain treaty benefits that would not be available directly. Another case would be an individual who has in a Contracting State both his permanent home and all his economic interests, including a substantial shareholding in a company of that State, and who, essentially in order to sell the shares and escape taxation in that State on the capital gains from the alienation (by virtue of paragraph 5 of Article 13), transfers his permanent home to the other Contracting State, where such gains are subject to little or no tax"*.[304] At the same time, however, there is now a subtle change in this section of the commentaries. Until 2017, the OECD Commentary provided that: *"the extension of double taxation conventions increases the risk of abuse by facilitating the use of artificial legal constructions aimed at securing the benefits of both the tax advantages available under certain domestic laws and the reliefs from tax provided for in double taxation conventions"*.[305] Further to the 2017 update, the commentaries no longer refer to "*artificial legal constructions"* but simply state that: *"The extension of the network of tax conventions increases the risk of abuse by facilitating the use of arrangements aimed at securing the benefits of both the tax advantages available under certain domestic laws and the reliefs from tax provided for in these conventions"*.[306] As observed by VAN WEEGHEL, the question therefore arises as to whether this marks an intention to expand the notion of treaty shopping beyond artificial legal constructions as also defined by the CJEU in its case law[307] and, recently, in the PSD and IRD cases. In our opinion, the convergence between the notion of treaty shopping and artificial legal constructions remains identical after the BEPS initiative, at least with respect to conduit arrangements on which the present contribution focuses. This is in particular evidenced by the examples of the 2017 OECD Commentary to art. 29[308] in relation to conduit arrangements which illustrate what constitutes an artificial legal construction in this area. In fact, these examples have all been imported from pre-BEPS tax treaty practice, namely from the exchanges of notes relating to the

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303 Introduction to the 2017 OECD MC, para. 16.1.
304 2017 OECD Commentary, para. 56 ad art. 1.
305 2014 OECD Commentary, para. 8 ad art. 1.
306 2017 OECD Commentary, para. 55 ad art. 1.
307 VAN WEEGHEL, PPT, p. 3 et seq.
308 2017 OECD Commentary, para. 187 ad art. 29.

US-UK DTA concluded in 2001, a time at which the notion of treaty shopping under the OECD Commentaries still expressly referred to *"artificial legal constructions"*.

B. Beneficial ownership and the PPT

Assuming that the new preamble to the OECD MC does not fundamentally alter the notion of treaty shopping, the question nevertheless arises as to whether, and if so to what extent, this new preamble could affect the interpretation of the beneficial ownership limitation. On a number of occasions, the 2017 OECD Commentary refers to the relation between the preamble and the PPT included in art. 29(9) MC. The commentaries state for instance that: *"Article 29 reflects the intention of the Contracting States, incorporated in the preamble of the Convention, to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements"*[309] and that art. 29(9) MC *"must be read in the context of paragraphs 1 to 7 and of the rest of the Convention, including its preamble. This is particularly important for the purposes of determining the object and purpose of the relevant provisions of the Convention"*.[310] Furthermore, in many examples relating to the interpretation of the PPT, *"the object and purpose of the tax convention"*[311] is referred to in order to determine whether treaty benefits should be granted. Hence, to deny treaty benefits, it is contended that *"it would be contrary to the object and purpose of the tax convention to grant the benefit of that exemption under this treaty-shopping arrangement"*,[312] and in cases in which the PPT rule does not apply, the fact that *"the general objective of tax conventions is to encourage cross-border investment"*[313] is put forward.

By contrast, the articulation between the beneficial ownership limitation and the new preamble is not discussed in the commentaries. This is quite surprising as the commentaries continue to state that term *"beneficial owner"* should also be interpreted: *"in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance"*.[314] In fact, irrespective of the foregoing passage of the commentaries, art. 31(2)(a) VCLT requires the preamble to be considered

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[309] 2017 OECD Commentary, para. 1 ad art. 29.

[310] 2017 OECD Commentary, para. 173 ad art. 29.

[311] See, for example, Action 6 Final Report, at 59 et seq.; 2017 OECD Commentary, para. 182 ad art. 29, Examples A, B, C, D, art. 29 N 182.

[312] See, for example, Action 6 Final Report, at 59; OECD Model: Commentary on Article 29 para. 182, Example A (2017).

[313] See, for example, Action 6 Final Report, at 59; OECD Model: Commentary on Article 29 para. 182, Example C (2017).

[314] 2017 OECD Commentary, para. 12.1 ad art. 29.

when interpreting the beneficial ownership limitation (as well as any other treaty term). Therefore, it is arguable that among various possible ordinary meanings of beneficial ownership under art. 31(1) VCLT, the one which, within the meaning of the preamble, best prevents *"treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement"* should be preferred. Along these lines, the question arises as to whether this line of reasoning could strengthen the idea that beneficial ownership should be construed on the basis of a substance over form interpretation (a position already taken by several jurisdictions) and lead treaty practice to place a particular emphasis on the passages of the OECD commentaries stemming from the 1986 OECD Conduit Report stating that: *"It would be equally inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned. For these reasons, the report from the Committee on Fiscal Affairs entitled 'Double Taxation Conventions and the Use of Conduit Companies' concludes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties"*.[315] In the same vein, the passage of the commentaries making reference to the fact that an obligation to pass on the income and affecting the beneficial ownership of the recipient may *"may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person"*[316] could be read as a reference to a substance over form interpretation as the judgments of the CJEU in the PSD and IRD cases seem to implicitly suggest or, alternatively, be minimized.

As we shall now see when considering the PPT, there are other elements in the commentaries which, by contrast, suggest that the beneficial ownership should receive a restrictive meaning

C. The PPT and beneficial ownership

Art. 29(9) OECD MC which includes the PPT provides that: *"Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal*

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[315] 2017 OECD Commentary, para. 12.3 ad art. 29.

[316] 2017 OECD Commentary, para. 12.41 ad art. 29.

purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention".

The PPT has a broader scope than the beneficial ownership limitation in the sense that it applies to all distributive rules and to all forms of treaty abuse, in particular abusive restructurings[317]. and conduit situations[318] As mentioned, the examples illustrating the application of the PPT rule in relation to conduit arrangements have been directly inspired from those laid down in the exchange of letters to the conduit arrangement clause of article 3(1)(n) of the 2001 US-UK DTA.

Therefore, as regards conduit arrangements there is a possible overlap between the beneficial ownership limitation and the PPT which raises the order of application of both rules. The structure of the 2017 OECD MC suggests that the beneficial ownership limitation should be applied first when considering the access to tax treaty benefits under art. 10, 11 and 12 MC and, if satisfied, art. 29(9) MC could still come into play to neutralize these benefits. The commentaries confirm this interpretation. First of all, in relation to article 29, the commentaries state that the PPT rule covers: *"limitations on the taxing rights of a Contracting State in respect of dividends, interest or royalties arising in that State, and paid to a resident of the other State (who is the beneficial owner) under Article 10, 11 or 12"*.[319] The commentaries to articles 10, 11 and 12 also mirror this policy: *"The provisions of article 29 and the principles put forward […] will apply to prevent abuses, including treaty shopping situations where the recipient is the beneficial owner of the dividends"*.[320]

Based on the foregoing interpretation, one would thus expect the beneficial ownership limitation to neutralize at least some conduit arrangements (i.e. those, where based on a restrictive reading of commentaries, there is a legal obligation to pass on the income which is derived from a written document or from the facts). However, in some of the examples provided by the commentaries in relation to the PPT and conduit arrangements, it is debatable whether the interposed entity would really qualify as the beneficial owner it receives. Illustrative in this respect is example C.[321] In this example, TCO is a company resident in state T, which does not have a DTA with state S, and loans 1,000,000 to SCO, a company resident in state S that is a wholly-owned subsidiary of TCO, in exchange for a note issued by SCO. TCO later realizes that it can avoid the withholding tax on interest levied by state S by assigning the note to its wholly-owned subsidiary RCO, a

[317] 2017 OECD Commentary, para. 182 ad art. 29.
[318] 2017 OECD Commentary, para. 187 ad art. 29.
[319] 2017 OECD Commentary, para. 175 ad art. 29.
[320] 2017 OECD Commentary, para. 12.5 ad art. 10.
[321] 2017 OECD Commentary, para. 187 ad art. 29.

resident of state R (the treaty between states R and S does not allow source taxation of interest in certain circumstances). Therefore, TCO assigns the note to RCO in exchange for a note issued by RCO to TCO. The note issued by SCO bears interest at 7 % and the note issued by RCO bears interest at 6 %. The 2017 updated OECD Commentaries note that: *"[t]he transaction through which RCO acquired the note issued by SCO constitutes a conduit arrangement because it was structured to eliminate the withholding tax that TCO would otherwise have paid to State S"*.[322]

Therefore, while the introduction of a PPT into the OECD MC and its application to conduit arrangements could be seen as a confirmation of the fact that beneficial ownership has a limited scope in this area we agree with some commentators that the foregoing passages of the commentaries are troubling in that they seem to refer to conduit situations which, arguably, could be neutralized by the beneficial ownership limitation.[323] Of course, a possible explanation is the lack of coordination between the commentaries to art. 10-12 and art. 29 which would however be unfortunate.

D. Can beneficial ownership and the PPT lead to different results?

In light of the foregoing, a conclusion undoubtedly emerges: the delineation in scope between beneficial ownership and the PPT remains unclear, at least for two reasons. First of all, as shown, it is unclear whether the new preamble to the OECD MC could expand the meaning of beneficial ownership or consolidate the idea that the term should be construed on the basis of a substance over form interpretation (an idea already accepted by numerous jurisdictions). Secondly, the commentaries to art. 29 OECD MC are unclear in the sense that they seem to also target blatant conduit situations which, possibly, could fall within the scope of the beneficial limitation.

From a practical perspective, therefore, the question may be asked whether, in a given conduit situation, the outcome would be the same depending on whether the beneficial ownership limitation or the PPT is applied. In our opinion, this would not always be the case. In Switzerland, for example, the focus is on the criterion of interdependence between the income and the obligation to transfer such income to non-residents. However, as previously shown, the intention and motives that have led the taxpayer to select a particular arrangement or structure are normally irrelevant. By contrast, the PPT rule is based on a different policy in which the purpose and business rationale of the transaction are taken into account. The PPT rule will thus not simply apply because there is some

[322] 2017 OECD Commentary, para. 187 ad art. 29.
[323] VAN WEEGHEL, PPT, p. 37.

sort of interdependence between the two income streams but, rather, because the purpose of the transaction was to eliminate withholding tax in the source state.

From this perspective, therefore, the approach taken under the PPT rule is different from the one that could be favoured under a broad interpretation of beneficial ownership which only focuses on the existence of an interdependence between two income streams and tends to ignore the underlying purposes of the structure or arrangement. Consequently, it follows that there may be instances in which treaty benefits could be denied on the basis of an objective and broad interpretation of beneficial ownership, whereas this would not have been the case under the PPT.

Is the foregoing result in line with the BEPS outcome? At first sight, the question could be answered in the affirmative using the argument that the introduction of the PPT rule merely constitutes a minimum standard and that states are free to adopt stricter measures or practices and judicial doctrines to counter treaty abuse (such as a broad interpretation of beneficial ownership). In our view, this interpretation may, however, not be supported. First of all, the outcome of BEPS Action 6 expresses a consensus as regards the way to address conduit situations (through a PPT rule). This consensus around this policy is so strong that, if states wish to opt out of the PPT rule, they must then adopt anti-conduit mechanisms that *"achieve a similar result"*.[324] It would therefore be at odds with these principles if states adopting the PPT rule could nevertheless continue to address conduit structures on the basis of principles based on a different policy.

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