

UNIVERSITY OF LAUSANNE

SCHOOL OF LAW  
FACULTY OF LAW, CRIMINAL JUSTICE  
AND PUBLIC ADMINISTRATION

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THE CONCEPT OF BENEFICIAL OWNERSHIP  
IN TAX TREATY PRACTICE

Master Thesis

by

**Benjamin Malek**

under the supervision of

**Prof. Dr. Robert Danon**

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## LIST OF ABBREVIATIONS AND ACRONYMS

Archives	Archives de droit fiscal suisse (=ASA, periodical, Switzerland)
art.	article
AN	<i>Audiencia Nacional</i>
ASA	Archiv für schweizerisches Abgaberecht (=Archives, periodical, Switzerland)
ATF	Recueil officiel des arrêts du Tribunal fédéral suisse
BEPS	Base Erosion and Profit Shifting
BV	<i>Besloten vennootschap</i>
CIV	collective investment vehicle
de	in German
DTC	double taxation convention
e.g.	<i>exempli gratia</i>
ECJ	European Court of Justice
ed.	edition
eds.	editors
et al.	<i>et alii</i>
et seq.	<i>et sequentia</i>
etc.	<i>et cetera</i>
EU	European Union
FAC	Federal Administrative Court <i>Bundesverwaltungsgericht</i> [de] <i>Tribunal administratif fédéral</i> [fr] <i>Tribunale amministrativo federale</i> [it]
FC	Federal Constitution of the Swiss Confederation of 18 April 1999 (RS 101)
fr	in French
FSC	Federal Supreme Court <i>Bundesgericht</i> [de] <i>Tribunal fédéral</i> [fr] <i>Tribunale federale</i> [it]
GAAR	general anti-avoidance rule
IV	

i.e.	<i>id est</i>
IBFD	International Bureau of Fiscal Documentation
Ibid.	<i>Ibidem</i>
IFA	International Fiscal Association
it	in Italian
JdT	Journal des Tribunaux (periodical, Switzerland)
LIBOR	London Interbank Offered Rate
LOB	Limitation-on-benefits
Ltd.	Limited liability company
MLI	Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting
m.no.	marginal number
no.	number
OECD	Organisation for Economic Co-operation and Development
OECD MC	OECD Model Tax Convention on Income and on Capital
p.	page
para.	paragraph
pp.	pages
PPT	Principal purpose test
Prof.	Professor
TRS	Total return swap
RDAF	Revue de droit administratif et de droit fiscal (periodical, Switzerland)
RF	Revue fiscale (periodical, Switzerland =StR)
RO	Recueil officiel du droit fédéral
RS	Classified compilation of federal law <i>Systematische Sammlung des Bundesrechts</i> [de] <i>Recueil systématique du droit fédéral</i> [fr] <i>Raccolta sistematica del diritto federale</i> [it]
SA	<i>société anonyme</i> [fr]

SAAR	specific anti-avoidance rule
StR	Steuer Revue (= RF, periodical, Switzerland)
UK	United Kingdom of Great Britain and Northern Ireland
UN Model	United Nations Model Double Taxation Convention between Developed and Developing Countries
US	United States of America
VCLT	Vienna Convention on the Law of Treaties of 23 May 1969 (RS 0.111)
v.	versus
vol.	volume
WHT	withholding tax
WHTA	Federal Act on Withholding Tax of 13 October 1965 (RS 642.21) <i>Bundesgesetz über die Verrechnungssteuer vom 13. Oktober 1965</i> [de] <i>Loi fédérale sur l'impôt anticipé du 13 octobre 1965</i> [fr] <i>Legge federale sull'imposta preventiva del 13 ottobre 1965</i> [it]



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# 1 INTRODUCTION

## 1.1 Preliminary remarks

Beneficial ownership is perhaps the most important of undefined treaty terms in international tax law,<sup>1</sup> and has, since its introduction in the OECD Model, been the topic of numerous discussions and controversies,<sup>2</sup> remaining to this day a highly disputed issue.<sup>3</sup> Beneficial ownership still lacks a precise international definition. Indeed, no definition is provided by the OECD Model, the UN Model nor is the concept usually defined in tax treaties.<sup>4</sup> Courts and tax authorities have held different interpretations of the concept, which in turn has led to a greater risk of double taxation and double non-taxation.<sup>5</sup>

## 1.2 Methodology

The present contribution will begin by determining the scope and purpose of beneficial ownership. A historical analysis of the concept and its evolution in the OECD Commentary will be provided to this effect. The focus will then be set on the interpretation of double taxation conventions, which will lead the way to defining beneficial ownership and assessing its nature. The case law of Switzerland and other OECD member states will then be reviewed and commented on a selective basis. The jurisdictions in question were chosen for their varying interpretations of beneficial ownership, as illustrated in landmark cases, all of which present specific particularities. Beneficial ownership in the European Union will be referred to briefly as this contribution is centred on beneficial ownership in tax treaties. In the context of the implementation of BEPS Action 6 in the MLI, the principal purposes rule and its interaction with beneficial ownership will be explored. Finally, as a premise to a conclusion, the alternatives and the future of beneficial ownership will be discussed.

Owing to the similarities of distribution rules set by articles 10, 11 and 12 of the OECD MC, this contribution will address the issue of beneficial ownership without systematically

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<sup>1</sup> DU TOIT, Evolution of the Term “Beneficial Ownership”, p. 500.

<sup>2</sup> DANON/DINH, La clause du bénéficiaire effectif, m.no. 86 *ad* art. 1.

<sup>3</sup> MEINDL-RINGLER, Beneficial Ownership in International Tax Law, p. 2.

<sup>4</sup> KEMMEREN, Klaus Vogel on Double Taxation Conventions, Preface to Articles 10 to 12, m.no. 24.

<sup>5</sup> OECD, Beneficial Owner Discussion Draft 2011, p. 2.

differentiating the particularities of dividends, interests, and royalties; at times the neutral terminology ‘income’ will be used.

### 1.3 Double Taxation Conventions and Treaty Shopping

Double taxation conventions contain rules which aim to prevent double taxation and double non-taxation. As a principle, treaty benefits should not be unduly granted; tax treaties have a bilateral nature which restricts the scope of persons who may benefit from them. This study focuses on the concept of beneficial ownership, or beneficial ownership test, which is one of the pre-BEPS provisions designed to prevent unjustified benefit of double taxation conventions.<sup>6</sup> Under the OECD and UN Models, the treaty benefits at stake when beneficial ownership is considered are the reduction (or exemption) of the source taxation on passive incomes (i.e. dividends, interest, and royalties) in the source state.

In international taxation, the state of source (or source state) is the country in which an income arises; the state of residence is the country in which the ‘recipient’ of that income resides. Other provisions pursue anti-avoidance goals: The Limitation-on-Benefits rule (hereafter LOB rule), the principal purpose test rule (hereafter PPT rule), subject-to-tax clauses, general anti-avoidance rules (hereafter GAAR) and specific anti-avoidance rules (hereafter SAAR).

Treaty shopping occurs when a person not resident of a contracting state to a double taxation convention, attempts to obtain benefits granted to residents of that state.<sup>7</sup> Treaty shopping generally occurs through conduit situations or abusive restructurings. There are two types of conduit arrangements: direct conduits and stepping stone conduits.

Direct conduits are achieved by interposing an entity in the state of residence, said entity then forwards the income, inbound from the source state, to an entity in a third state, through the form of a dividend distribution. Direct conduits lead to no erosion of the taxable base of a company as dividends are usually not a deductible expense. In Swiss case law, the *X Holding ApS* case<sup>8</sup> is a typical example of a direct conduit structure.

Stepping stone conduits function similarly, but instead of dividend distribution, the payment takes the form of a deductible expense. More precisely, the tax base of the company interposed

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<sup>6</sup> This has been debated and will be addressed hereafter.

<sup>7</sup> OECD, Action 6 Final Report, p. 17.

<sup>8</sup> FSC Judgment of 28 November 2005, 2A.239/2005; see *infra* 5.2.

in the state of residence is reduced with deductible expenses (e.g. interests, royalties, management fees) paid to the final beneficiary.<sup>9</sup> Unlike companies involved in a direct conduit strategy, the interposed company in the stepping stone strategy, often, but not always, provides services to companies resident of high tax jurisdictions.<sup>10</sup> This strategy has been used to transfer the profits of multinational enterprises to low tax jurisdictions.

Abusive restructurings refer to situations where a restructuring takes place to allow the application of tax treaty (i.e. treaty shopping) or a more favourable treaty rule (i.e. rule shopping). The abusive nature of such restructurings is usually assessed by the timing and sequence of events.<sup>11</sup>

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<sup>9</sup> DE VRIES REILINGH, *Droit fiscal international*, p. 69.

<sup>10</sup> *Ibid.*, pp. 69-70.

<sup>11</sup> DANON/SALOMÉ, *The BEPS Multilateral Instrument*, p. 214.

## 2 BENEFICIAL OWNERSHIP

### 2.1 Scope of Beneficial Ownership

The term ‘beneficial owner’ was introduced in articles 10, 11 and 12 of the OECD Model in 1977. These provisions attribute taxing rights, between the state of residence and the state of source, on three different types of passive income: dividends, interest and royalties. Most countries, whether they are member states of the OECD or not, base their tax treaties on the OECD MC. Consequently, the term ‘beneficial owner’ appears in most treaties signed after 1977.

The taxing rights of the source state are only restricted (by reduction of source taxation or full exemption) if the resident of the other contracting state (i.e. the state of residence) qualifies as beneficial owner of dividends, interests and royalties.

More specifically, in matters of dividends and interests, articles 10(1) and 11(1) provide that the ‘other state’ (i.e. state of residence) may tax said incomes. Conversely, articles 10(2) and 11(2) OECD MC provide that the state of source may tax outbound income. However, under the OECD Model rules, the tax levied by the state of source may not:

Exceed 5 per cent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 25 per cent of the capital of the company paying the dividends.<sup>12</sup>

In all other cases, i.e. when the shareholder is a natural person or a company holding less than 25 percent of the capital, the tax may not exceed 15 percent of the gross amount of the dividend.<sup>13</sup> The tax retained by the source state on interest payments is set at 10 percent in the Model.<sup>14</sup> Regarding royalties, article 12(1) OECD MC provides that they “shall only be taxable in [the state of residence]”; thus exempting such payments in the state of source.

The aforementioned tax rates are of course purely indicative and non-binding as the OECD Model is a mere template for bilateral negotiations amongst sovereign states. Indeed, tax treaties are “diplomatic agreements of a fiscal nature”<sup>15</sup> and, hence, primarily the reflection of

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<sup>12</sup> Art. 10(2)(a) OECD MC.

<sup>13</sup> Art. 10(2)(b) OECD MC.

<sup>14</sup> Art. 11(2) OECD MC.

<sup>15</sup> JAIN, Effectiveness of the Beneficial Ownership Test, p. 15.



commercial negotiations. In practice, contracting states often adopt tax rates that differ from the Model's.

Moreover, the differences in tax rates, or even full exemption by the state of source, dictate which countries are chosen for conduit strategies: states benefiting from advantageous tax treaties with the state of source on one part and the 'real' state of residence on the other part, being the obvious choice.

## 2.2 Purpose of Beneficial Ownership

Commentators are not unanimous on the purpose of beneficial ownership; the issue is subject to debate.<sup>16</sup> Some have argued that its purpose is to ensure that only the *real* beneficiary may benefit from the advantages of a double taxation convention and to prevent that an apparent beneficiary is substituted to the former.<sup>17</sup> Others have argued that beneficial ownership, more precisely, addresses a specific form of abuse affecting the state of source:<sup>18</sup> income being transferred from the source state to residents of a third state, whom, unlike residents of the state of residence, are not entitled to treaty benefits.<sup>19</sup>

It has also been argued that 'beneficial ownership' was never necessary,<sup>20</sup> and that it was only introduced because loopholes in domestic tax laws prompted the United Kingdom to influence the OECD into adopting the term 'beneficial owner'.

However, what is clear is that from 1977 onwards, the taxing rights of the source state on dividends, interest and royalties can only be reduced if the resident of the other contracting state, i.e. the state of residence, is considered the beneficial owner of the income.<sup>21</sup>

The OECD Commentary, throughout its modifications, has not been consistent with the concept of beneficial ownership.<sup>22</sup> To determine the true purpose of beneficial ownership, a historical approach, taking into consideration the amendments to the OECD Commentary is necessary.

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<sup>16</sup> KEMMEREN, Klaus Vogel on Double Taxation Conventions, Preface to Articles 10 to 12, m.no. 21.

<sup>17</sup> DE VRIES REILINGH, Droit fiscal international, p. 75.

<sup>18</sup> DANON, Clarification of the Meaning of « Beneficial Owner », p. 437.

<sup>19</sup> DANON/DINH, La clause du bénéficiaire effectif, m.no. 90 *ad* art. 1; DU TOIT, Beneficial Ownership of Royalties, p. 209.

<sup>20</sup> AVERY JONES, The Beneficial Ownership Concept Was Never Necessary in the Model, pp. 333-339.

<sup>21</sup> KEMMEREN, Klaus Vogel on Double Taxation Conventions, Preface to Articles 10 to 12, m.no. 19.

<sup>22</sup> *Ibid.*, m.no. 21.

Since the OECD is inconsistent in its understanding of beneficial ownership,<sup>23</sup> the evolution of the concept in the OECD's documentation should not only be subject to scrutiny but also to criticism.

### 2.2.1 'Beneficial Owner' and 'Paid to'

Beneficial ownership has also been considered a clarification of the expression 'paid to...a resident' found in articles 10, 11, and 12 OECD MC; commentators have argued that there is, at the very least, a strong connection between the terms 'paid to' and 'beneficial owner'.<sup>24</sup> Furthermore, the OECD Commentary has also mentioned that 'beneficial ownership' was added to address potential difficulties arising from the words 'paid to'.<sup>25</sup> There is no consensus on this position and it has been challenged by numerous commentators.<sup>26</sup> Indeed, the OECD Commentary of 2014 is less explicit than the 2003 version; the latter stated that the term beneficial owner was a 'mere clarification' of 'paid to...a resident',<sup>27</sup> whereas the 2014 version is somewhat less resolute on the issue.

If beneficial ownership were to be considered a clarification of 'paid to', the concept would essentially be no more than an attribution of income rule. Moreover, it has been argued that the OECD's intent was to "make the limitation of tax at source dependent on more substantive characteristics of the claimant."<sup>28</sup>

### 2.2.2 Beneficial Ownership Before 1977

The term 'Beneficial owner' made its first appearance in a tax treaty in the 1966 Protocol to the US-UK double taxation convention of 1945.<sup>29</sup> An explanatory note attached to the copy of the Protocol stated that:

Relief from tax on dividends, interests and royalties... in the country of origin will no longer depend on whether the recipient is subject to tax in the other country, but will depend on the income being beneficially owned by a resident of the other country.<sup>30</sup>

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<sup>23</sup> MEINDL-RINGLER, *Beneficial Ownership*, p. 385; KEMMEREN, Klaus Vogel on Double Taxation Conventions, Preface to Articles 10 to 12, m.no. 20.

<sup>24</sup> REIMER, *How to Conceptualize Beneficial Ownership*, pp. 258-260.

<sup>25</sup> OECD Commentary 2014, para. 12.1 *ad art.* 10; para. 9.1 *ad art.* 11; para. 4.5 *ad art.* 12; see *infra* 2.3.5.3.

<sup>26</sup> KEMMEREN, Klaus Vogel on Double Taxation Conventions, Preface to Articles 10 to 12, m.no. 6.

<sup>27</sup> See *infra* 2.3.5.

<sup>28</sup> MEINDL-RINGLER, *Beneficial Ownership*, p. 44.

<sup>29</sup> DU TOIT, *Evolution of the Term "Beneficial Ownership"*, para. 1.

<sup>30</sup> *Ibid.* para. 3.2.1.

This amendment eliminated a subject to tax provision by introducing what seems to have been the first beneficial ownership test. As both jurisdictions follow common law, the meaning of the term was presumably the one found therein<sup>31</sup> and therefore caused no interpretation difficulty other than understanding what beneficial ownership means in common law.<sup>32</sup>

## 2.3 Evolution of Beneficial Ownership in the OECD Model and Commentary

As previously mentioned, there is no consensus on the purpose of beneficial ownership, part of this is to be attributed to the changes in the OECD's documentation. Indeed, the concept of beneficial ownership and the provisions where it appears have been substantially modified since 1977. Consequently, an overview of these modifications is essential to grasp and construe the concept of beneficial ownership.

### 2.3.1 1977 OECD Model and Commentary

#### 2.3.1.1 Articles 10 and 11

Following the 1974 Model Tax Convention Draft, beneficial ownership was added to the 1977 OECD Model.<sup>33</sup> The OECD Commentary of 1977 on articles 10(2) and 11(2) was rather brief,<sup>34</sup> and only 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.<sup>35</sup>

This restrictive interpretation<sup>36</sup> was, at least, designed to prevent treaty benefits from being granted to agents and nominees,<sup>37</sup> it thus seems that beneficial ownership was not originally meant to deal with conduit companies or income attribution conflicts.<sup>38</sup> It was, however, later argued that agents and nominees were only illustrative examples, and that the concept was initially meant to exclude conduit companies.<sup>39</sup>

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<sup>31</sup> DU TOIT, Evolution of the Term "Beneficial Ownership", dissenting: AVERY JONES et al., The Origins of Concepts and Expressions Used in the OECD Model, p. 249.

<sup>32</sup> See *infra* 2.4.2.

<sup>33</sup> AVERY JONES et al., The Origins of Concepts and Expressions Used in the OECD Model, p. 249.

<sup>34</sup> DANON/DINH, La clause du bénéficiaire effectif, m.no. 109.

<sup>35</sup> OECD Commentary 1977, para. 12 *ad* art. 10, see also OECD Commentary 1977, para. 8 *ad* art. 11.

<sup>36</sup> DANON/DINH, La clause du bénéficiaire effectif, m.no. 109.

<sup>37</sup> OLIVER et al., Beneficial Ownership, p. 320.

<sup>38</sup> VANN, Beneficial Ownership, p. 295 et seq.

<sup>39</sup> OECD, Conduit Companies Report, p. 8, para. 14(b).

The discussions of the Working Parties that drafted the 1977 OECD Commentary did not deal with beneficial ownership in a conduit context.<sup>40</sup> Vann has argued that “the OECD original elaboration of the meaning of beneficial ownership has nothing to do with holding and conduit companies, conflicts of attribution or related issues.”<sup>41</sup>

Interestingly, the beneficial ownership test was preferred to a subject-to-tax clause,<sup>42</sup> allegedly because of various problems this choice would have created.<sup>43</sup> The wording ‘final recipient’ was also envisaged.<sup>44</sup>

### 2.3.1.2 Article 1

Since 1977, the OECD Commentary of article 1 has stated that “some forms of tax avoidance have already been expressly dealt with in the Convention, e.g. by the introduction of the concept of ‘beneficial owner’ [...]”<sup>45</sup> As this example provided by the OECD shows, an initial contradiction already appeared in early publications of the organisation. Indeed, paragraph 10 under article 1 of the OECD Commentary seems to consider the introduction of a beneficial ownership test to be akin to that of an anti-avoidance provision. However, in 1977, the OECD Commentary simply mentioned<sup>46</sup> that the role of ‘beneficial ownership’ was to prevent agents and nominees from being granted a tax relief by the source state.

### 2.3.2 1995 and 1997 Amendments

Articles 10(2) and 11(2) OECD MC were amended in 1995, the modification was a reformulation from “if the recipient is the beneficial owner of the dividends” to “if the beneficial owner of the dividends is a resident of the other Contracting State”. The amendment to the Model was explained, in the Commentary, as being a clarification since all member states had consistently shared this position.<sup>47</sup>

Before 1997, article 12 of OECD MC and the Commentary did not provide for a beneficial ownership test as a condition to benefit from the tax exemption of royalties arising in the source

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<sup>40</sup> MEINDL-RINGLER, *Beneficial Ownership*, p. 32.

<sup>41</sup> VANN, *Beneficial Ownership*, p. 288.

<sup>42</sup> KEMMEREN, Klaus Vogel on Double Taxation Conventions, Preface to Articles 10 to 12, m.no. 21.

<sup>43</sup> VANN, *Beneficial Ownership*, p. 282 et seq.

<sup>44</sup> OLIVER et al., *Beneficial Ownership*, p. 318.

<sup>45</sup> OECD Commentary 2014, para. 10 *ad art.* 1.

<sup>46</sup> OECD Commentary 1977, para. 12 *ad art.* 10 and OECD Commentary 1977 para. 8 *ad art.* 11.

<sup>47</sup> OECD Commentary 1995, para. 12 *ad art.* 10 and para. 8 *ad art.* 11.

state. Following the 1997 amendment to article 12(1) of the OECD Model, the Commentary mentioned that the “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 [emphasis added].”<sup>48</sup>

### 2.3.3 2003 OECD Commentary

The OECD published the Conduit Companies Report in 1987 which stated that:

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 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* [emphasis added].<sup>49</sup>

In other words, the report equated nominees and agents to conduit companies that have ‘very narrow powers’.<sup>50</sup> However, not all conduit companies were concerned as the report also stated that if a conduit company’s “main function is to hold assets or rights [that] is not itself sufficient to categorise it as a mere intermediary”.<sup>51</sup>

The 2003 OECD Commentary was accordingly amended to provide that:

The requirement of beneficial ownership was introduced in paragraph 2 of Article 10 *to clarify the meaning of the words ‘paid ... to a resident’* as they are used in paragraph 1 of the Article. It makes plain that the State of source is not obliged to give up taxing rights over dividend income merely because that income was immediately received by a resident of a State with which the State of source had concluded a convention. Furthermore, *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 [emphasis added].<sup>52</sup>

The relationship between ‘paid to’ and ‘beneficial owner’ was first mentioned by the OECD in this amendment, the issue is covered under section 2.2.1 of this paper.

The Commentary provides that beneficial ownership is not to be understood in a ‘narrow technical sense’; the precise meaning of this statement was explained in more detail in the 2014

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<sup>48</sup> OECD Commentary 1997 para. 5 *ad art.* 12.

<sup>49</sup> OECD, Conduit Companies Report of 1987, p. 8.

<sup>50</sup> OLIVER et al., Beneficial Ownership, p. 320.

<sup>51</sup> OECD, Conduit Companies Report of 1987, p. 8.

<sup>52</sup> OECD Commentary 2003, para. 12 *ad art.* 10 and para. 8 *ad art.* 11.

amendment.<sup>53</sup> It follows, that contrary to a ‘narrow technical sense’, beneficial ownership was here intended to be interpreted in the context and object of the double taxation convention, i.e. given a broad interpretation.

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* [emphasis added].<sup>54</sup>

Agents, nominees and conduit companies share an attribute: very limited power and control over the income they receive.<sup>55</sup> The inclusion of conduit companies to the OECD Commentary marks a more defined anti-avoidance nature with regards to beneficial ownership. Indeed, the Commentary here provides for an exclusion of conduit companies through the beneficial ownership test if the conduit company, although formal owner of an income, only disposes of very narrow power on it.

It is clear that the OECD shifted its approach, to an economic one, in the 2003 OECD Commentary, as opposed to the attribution of income rule<sup>56</sup> or narrow anti-abuse provision<sup>57</sup> beneficial ownership was previously considered to be.

#### 2.3.4 The CIV Report and Hybrid Entities

The extent to which hybrid entities can be considered beneficial owners, and thus benefit from double taxation conventions, is a complex question. Indeed, hybrid entities are not usually recognised as legal persons, yet the individuals to whom they benefit do not commonly hold enough control over them to be considered ‘beneficial owners’. For instance, the situation of collective investment vehicle (hereafter CIV) investors is substantially (legally and

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<sup>53</sup> See *infra* 2.3.5.3.

<sup>54</sup> OECD Commentary 2003, para. 12.1 *ad* art. 10; see also para. 8.1 *ad* art. 11.

<sup>55</sup> MEINDL-RINGLER, Beneficial Ownership, p. 52.

<sup>56</sup> *Ibid.*, p. 54.

<sup>57</sup> See *supra* 2.3.1.2.

economically) distinct, in most countries, from that of investors who own underlying assets.<sup>58</sup> Thus, considering CIV investors to be beneficial owners would be inappropriate.

Several updates to the OECD documentation were published to address the issue. Following the publication of the CIV Report, the OECD Commentary was amended in 2010 to address the question of CIVs. The Report states:

[...] a widely-held CIV, as defined in paragraph 4, should be treated as the beneficial owner of the income it receives, so long as the managers of the CIV have discretionary powers to manage the assets on behalf of the holders of interests in the CIV and, of course, so long as it also meets the requirements that it be a “person” and a “resident” of the State in which it is established. This conclusion, however, relates only to those economic characteristics that are specific to a CIV. *It does not suggest that a CIV is in a different or better position than other investors with respect to aspects of the beneficial ownership requirement that are unrelated to the CIV’s status as such. For example, where an individual receiving an item of income in certain circumstances would not be considered as the beneficial owner of that income, a CIV receiving that income in the same circumstances could not be deemed to be the beneficial owner of the income* [emphasis added].<sup>59</sup>

The OECD considers that managerial discretionary powers and widely-held capital are determinant in considering a CIV to be the beneficial owner of income. However, an important caveat is mentioned in the CIV report: a CIV may not be considered beneficial owner of an income if an individual resident of the state, receiving the income in the same circumstances would not have been considered beneficial owner.<sup>60</sup>

Trusts were somewhat considered in the 2011 Discussion Draft and its revised 2012 version<sup>61</sup> which mentions, regrettably in a simple footnote, that:

For example, where the trustees of a discretionary trust do not distribute dividends earned during a given period, these trustees, acting in their capacity as such [...], could constitute the beneficial owners of such income for the purpose of Article 10 *even if they are not the beneficial owners under the relevant trust law* [emphasis added].<sup>62</sup>

Danon and Salomé have held that under this definition, the trustees of a discretionary accumulation trust may be considered beneficial owners,<sup>63</sup> to the extent that the trustee’s

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<sup>58</sup> OECD, CIV Report, p. 9.

<sup>59</sup> *Ibid.*, p. 10.

<sup>60</sup> DANON/SALOMÉ, La notion de bénéficiaire effectif, m.no. 43 *ad art.* 1.

<sup>61</sup> See *infra* 2.3.5.1 and 2.3.5.2.

<sup>62</sup> OECD, Revised Draft 2012, p. 3.

<sup>63</sup> DANON/SALOMÉ, La notion de bénéficiaire effectif, m.no. 44 *ad art.* 1.

powers allow him to decide on income attribution to the trust's beneficiaries.<sup>64</sup> Conversely, the trustees of a fixed trust, wherein an obligation to distribute income to determined beneficiaries is found, do not satisfy the beneficial ownership test.<sup>65</sup> It should be noted that Danon had already previously argued that the discretionary powers of the trustees should be the decisive criterion in attributing beneficial ownership.<sup>66</sup>

Moreover, the authors consider that beneficial ownership must be distinguished from personal attribution of income.<sup>67</sup> Consequently, the source state income must be fiscally attributed to the hybrid entity according to the attribution rules of the state of residence.<sup>68</sup> In this only case, the beneficial ownership test is to be conducted on the hybrid entity. However, if the residence state considers that the income is to be directly fiscally attributed to the persons benefiting from the hybrid entity (i.e. the entity is considered transparent for tax purposes or an anti-abuse rule is applied), beneficial ownership of the income is to be examined in consideration of the persons benefiting from the hybrid entity.<sup>69</sup>

In my opinion, the OECD was correct in finding that the trustees could be considered beneficial owners for the purpose of article 10 despite not being beneficial owners in the applicable (domestic) trust law. Indeed, there was, and arguably still is, a necessity to distinguish beneficial ownership as understood in trust law and beneficial ownership as an autonomous treaty concept of international tax law, regardless of the lexical origin of beneficial ownership being common law.<sup>70</sup>

### 2.3.5 2014 OECD Commentary

Prior to the 2014 revision of the OECD Commentary, a Discussion Draft (2011) and its revised version (2012) were published by the OECD. This process allowed numerous commentators to express ongoing issues relating to beneficial ownership. Both drafts have proven useful to somewhat assert what is and is not meant in the 2014 Commentary. Two landmark decisions,

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<sup>64</sup> DANON, Clarification de la notion de bénéficiaire effectif, p. 586.

<sup>65</sup> DANON, Clarification of the Meaning of « Beneficial Owner », p. 440.

<sup>66</sup> DANON, Switzerland's direct and international taxation of private express trusts, p. 343 et seq.

<sup>67</sup> DANON/SALOMÉ, La notion de bénéficiaire effectif, m.no. 42 *ad art.* 1.

<sup>68</sup> Ibid.

<sup>69</sup> Ibid.

<sup>70</sup> See *infra* 2.4.2.



*Indofood*<sup>71</sup> and *Prévost*,<sup>72</sup> were issued before this update, and arguably were amongst the reasons that prompted the OECD to attempt to clarify beneficial ownership.

### 2.3.5.1 2011 Discussion Draft

The 2011 Discussion Draft, presumably the first attempt by the OECD to define beneficial ownership, proposed a new paragraph 12.4 under article 10, which stated that:

The recipient of a dividend is the “beneficial owner” of that dividend where he *has the full right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass the payment received to another person* [emphasis added].<sup>73</sup>

This definition focused on the attributes of the beneficial owner, namely: full right of use and enjoyment. The focus on enjoyment rather than economic control was criticised.<sup>74</sup> Furthermore, a rephrasing of paragraphs 12 and 12.1 to article 10 OECD MC, in which the verb ‘received’ was replaced by ‘paid’, was suggested.

The 2011 Discussion Draft and the 2012 Revised Discussion Draft mentioned the relation between domestic law and beneficial ownership. This topic is covered hereafter in section 4.1.

The proposed amendments were commented by numerous authors and institutions. The OECD’s objective of clarifying the concept of beneficial ownership was welcomed<sup>75</sup> and regarded as an excellent initiative.<sup>76</sup> However, the commentators mentioned that some of the proposed amendments would likely increase confusion.<sup>77</sup>

### 2.3.5.2 2012 Revised Discussion Draft

The 2012 Revised Discussion Draft was published following the comments on the 2011 version. The 2011 Discussion Draft was welcomed as a long-awaited clarification to the concept of beneficial ownership but was nonetheless met with some criticism.<sup>78</sup> As a result, the 2012

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<sup>71</sup> See *infra* 7.2.

<sup>72</sup> See *infra* 7.1.1.

<sup>73</sup> OECD, Discussion Draft 2011, p. 3.

<sup>74</sup> DANON, Clarification of the Meaning of « Beneficial Owner », p. 439.

<sup>75</sup> MEINDL-RINGLER, Beneficial Ownership p. 63.

<sup>76</sup> AVERY JONES/VANN/WHEELER, Response to the 2011 OECD Discussion Draft, p. 1.

<sup>77</sup> AVERY JONES/VANN/WHEELER, Response to the 2011 OECD Discussion Draft, p. 1 ; DANON, Clarification of the Meaning of « Beneficial Owner », p. 441.

<sup>78</sup> Ibid.

version presented substantial modifications. Perhaps most important was the amended definition of beneficial ownership, which now read:

[t]he recipient of the dividend is not the beneficial owner because that recipient's right to use and enjoy the dividend is *constrained by a contractual or legal obligation* to pass on the payment received to another person.<sup>79</sup>

It is crucial to note that under this definition, contractual and legal obligations that are unrelated to the received payment are not considered to constrain the right to use and enjoy the dividend. The fact that the recipient uses such payment to meet unrelated obligations is thus irrelevant.

### 2.3.5.3 2014 Amendments

Following the 2014 amendments, the OECD Commentary no longer states that 'beneficial ownership was a mere clarification of 'paid to'.<sup>80</sup> This has been considered an important change which may affect future case law,<sup>81</sup> as some cases on beneficial ownership were judged by courts who had specifically taken into account this consideration (e.g. the *Diebold* case in France<sup>82</sup>). Furthermore, some courts might decide not to confirm past decisions following this evolution of the OECD Commentary.<sup>83</sup> Kemmeren argues that "it can be upheld that this case law [on beneficial ownership] has been based on a wrong assumption and can no longer be upheld."<sup>84</sup>

The suggestions of the 2012 Revised Discussion Draft were implemented in the 2014 OECD Commentary with minor changes.<sup>85</sup> The OECD considered that the amendments were a mere clarification that beneficial ownership was not to be construed in a 'narrow technical sense'.

Furthermore, a new paragraph 12.4 to article 10, was introduced :

In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the direct recipient of the dividend is not the "beneficial owner" because that recipient's right to use and enjoy the dividends constrained by a contractual or legal obligation to pass on the payment received to another person. Such an obligation will normally derive from relevant legal documents *but may also be found to exist on the basis of facts and circumstances showing that, in substance, the*

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<sup>79</sup> OECD, Revised Proposals 2012, pp. 6-7.

<sup>80</sup> See *supra* 2.2.1.

<sup>81</sup> KEMMEREN, Klaus Vogel on Double Taxation Conventions, Preface to Articles 10 to 12, m.no. 6.

<sup>82</sup> *infra* 7.4.1

<sup>83</sup> KEMMEREN, Klaus Vogel on Double Taxation Conventions, Preface to Articles 10 to 12, m.no. 6.

<sup>84</sup> *Ibid.*, m.no. 23.

<sup>85</sup> MEINDL-RINGLER, Beneficial Ownership, p. 72.

*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.*

It follows that the OECD clearly adopts a substance over form approach in this amendment. The 2014 modifications result in what has been described as a ‘targeted hybrid approach’ to beneficial ownership.<sup>86</sup> Under this conception, legal factors are determinant in assessing beneficial ownership (e.g. a contractual obligation), however, when confronted with aggressive treaty shopping cases, economic considerations take importance.<sup>87</sup>

The approach taken by the 2014 OECD Commentary on the question of domestic law is addressed hereafter under section 4.1.

### 2.3.6 Modifications: Conclusion

Under the OECD’s conception, beneficial ownership was initially defined restrictively, only agents and nominees were excluded. As of 2003, the concept was substantially modified, the focus shifting on teleological considerations. In the 2010 CIV Report the notion of beneficial ownership seems to have been centred on discretionary powers, i.e. economic control.

Moreover, the OECD Commentary can be inconsistent. For the sake of example, the Commentary provides that “[f]or instance, some forms of tax avoidance have already been expressly dealt with in the Convention, e.g. by the introduction of the concept of ‘beneficial owner’ [...]”<sup>88</sup> but previously also mentioned that beneficial ownership was added to clarify the meaning of the words ‘paid to a resident’.<sup>89</sup>

The modifications to the OECD material, although numerous, did not precisely define ‘beneficial ownership’. Furthermore, some modifications, although they were considered clarifications by the organisation, were unclear. This uncertainty has led to lack of consensus, and thus contrasting judicial interpretation in different states.

It can be agreed upon that as of 2014, the OECD Commentary provides for a narrower meaning of beneficial ownership than the one provided for in the 2003 Commentary. As of 2014, beneficial ownership as understood in the Commentary does not have the narrow “technical

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<sup>86</sup> WARDZYNSKI, Hybrid Approach to Beneficial Ownership, p. 183.

<sup>87</sup> Ibid., p. 186 et seq.

<sup>88</sup> OECD Commentary 2014, para. 10 *ad art.* 1.

<sup>89</sup> OECD Commentary 2014, para. 12 *ad art.* 10.

meaning it [may have] under [the] domestic law of a specific country”.<sup>90</sup> Agents, nominees and some conduit companies are excluded from treaty benefits by the beneficial ownership requirement. More specifically, conduit companies acting as mere fiduciaries or administrators are excluded as they lack the “right to use and enjoy” income<sup>91</sup> without being constrained by a contractual or legal obligation to forward to another person the received income. However, such obligations do not include “obligations that are not dependent on the receipt of the payment by the direct recipient.”<sup>92</sup>

## 2.4 Origin of Beneficial Ownership

### 2.4.1 Beneficial Ownership in Early Tax Treaties

The term ‘beneficial owner’ was incorporated in articles 10 and 11 of the OECD Model in 1977, but the concept of beneficial ownership antedates this amendment of the Model. Indeed, the first occurrence of the term ‘beneficial owner’ in international tax law can be traced to the Canada-United States 1942 tax treaty, the United Kingdom later used the term in some of its treaties throughout the 1940s and 1950s.<sup>93</sup>

### 2.4.2 Beneficial Ownership in Common Law

Prior to its use in tax treaties, beneficial, or equitable, ownership was conceived in opposition to legal ownership, the latter being somewhat the position of a trustee in relation to a trust’s assets. In English law for instance, a trustee is the ‘legal owner’ of the trust property and holds it for the benefit of the beneficiaries. The trustee has fiduciary responsibilities to the beneficial owner of the property, who has no title to the property but does have rights in the property.<sup>94</sup>

The origin of the concept of beneficial ownership is in common law, more precisely trust law, wherein it is often used in contrast to legal ownership.<sup>95</sup> According to different domestic common law courts, which have varying interpretations, the essence of beneficial ownership lies in enjoying the economic benefits of the underlying property as well as control over the disposition of said property.<sup>96</sup> The concept is not identical to economic ownership, a concept

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<sup>90</sup> OECD Commentary 2014, para. 12.1 *ad art.* 10 and para. 9.1 *ad art.* 11.

<sup>91</sup> Dividends, interests or royalties.

<sup>92</sup> OECD Commentary 2014, para. 12.4 *ad art.* 10.

<sup>93</sup> VANN, Beneficial Ownership, p. 271.

<sup>94</sup> AVERY JONES et. al, The Origins of Concepts and Expressions Used in the OECD Model, p. 246.

<sup>95</sup> IBFD Tax Research Platform, Glossary: Beneficial owner.

<sup>96</sup> *Ibid.*

found in civil law, as the latter usually refers to contractual rights whereas a beneficial owner can usually uphold his rights against third parties.<sup>97</sup>

Despite common law jurisdictions sharing many rules and concepts, there is no single meaning of beneficial ownership shared by those states, on the contrary, the meaning sometimes even varies in one jurisdiction. For instance, in the *Prévost* case,<sup>98</sup> the Tax Court of Canada referred to the publications of two commentators<sup>99, 100</sup> both of whom agreed that “beneficial ownership has different meanings under the Canadian Income Tax Act depending on the provision and that *there is no settled definition of beneficial ownership even under common law* [emphasis added].”<sup>101</sup>

Moreover, to find a term with origins in common law in the OECD Model is somewhat of an oddity when considering that most terms found in the Model are derived from civil law. The importance of civil law in the OECD Model can be attributed in part to its precursors, the League of Nations Models<sup>102</sup> (wherein the term ‘beneficial owner’ was not used<sup>103</sup>) – which were mostly influenced by civil law European countries’ treaty practice<sup>104</sup> – and probably to the membership of the OECD. In 1977, when the term ‘beneficial ownership’ was added to the OECD Model, only 6<sup>105</sup> of the 24 member states were common law jurisdictions.<sup>106</sup> Despite the difficulties beneficial ownership has raised in common law, the term ‘beneficial owner’ has been introduced in EU directives.<sup>107</sup>

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<sup>97</sup> Ibid.

<sup>98</sup> *Prévost Car Inc. v. The Queen*, para. 65 and 66; see *infra* 7.1.1.

<sup>99</sup> BROWN, Beneficial Ownership in Canadian Income Tax Law, p. 424 et seq.

<sup>100</sup> BRENDER, Beneficial Ownership in Canadian Income Tax Law, p. 315 et seq.

<sup>101</sup> DU TOIT, Evolution of the Term “Beneficial Ownership”, para. 3.2.1.

<sup>102</sup> AVERY JONES et. al, The Origins of Concepts and Expressions Used in the OECD Model, p. 220.

<sup>103</sup> VANN, Beneficial Ownership, p. 268.

<sup>104</sup> AVERY JONES et. al, The Origins of Concepts and Expressions Used in the OECD Model, p. 220.

<sup>105</sup> Australia, Canada, Ireland, New Zealand, the United Kingdom and the United States.

<sup>106</sup> *Prévost Car Inc. v. The Queen*, para. 59.

<sup>107</sup> AVERY JONES et. al, The Origins of Concepts and Expressions Used in the OECD Model, p. 247; see *infra* 6.

### 3 INTERPRETATION OF TAX TREATIES

Beneficial ownership is undefined in the OECD MC and most double taxation conventions. As a result, courts dealing with the concept are often required to interpret it. The interpretation of tax treaties is a complex matter which can pose numerous issues. Before attempting to interpret and define beneficial ownership, an overview of the rules of treaty interpretation is necessary.

#### 3.1 Vienna Convention on the Law of Treaties

The Vienna Convention on the Law of Treaties (hereafter VCLT), governs the interpretation of international treaties. Commentators agree that the VCLT is not only an international treaty but also corresponds to the general principles of customary international law,<sup>108</sup> therefore, states that have not ratified the VCLT are still bound by it.<sup>109</sup>

Article 1 VCLT stipulates that “the present Convention applies to treaties between states”. The VCLT defines a treaty as an “international agreement concluded between states in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation.”<sup>110</sup> These provisions clearly indicate that tax treaties fall under the scope of the VCLT and that their interpretation is thus governed by the rules therein. This opinion has been followed by Swiss courts and is prevalent amongst commentators.<sup>111</sup>

The rules of interpretation of the VCLT, critical to interpret tax treaties, are laid down in articles 31, 32 and 33.

##### 3.1.1 Article 31 VCLT

Pursuant to article 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.”<sup>112</sup> It follows, that double taxation conventions must be interpreted in accordance with their object and purpose: the avoidance of double taxation.

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<sup>108</sup> LANG, Article 3 paragraphe 2, m.no. 47; FSC Judgment of 4 April 2006, 2A.416/2005, para 3.3.1

<sup>109</sup> VOGEL/RUST, Klaus Vogel on Double Taxation Conventions, Introduction m.no. 68.

<sup>110</sup> Art. 2(1)(a) VCLT.

<sup>111</sup> OBERSON, Droit fiscal international, p. 36 and commentators mentioned therein.

<sup>112</sup> Art. 31(1) VCLT.

Article 31(2) VCLT states that the ‘context’ mentioned in article 31(1) includes, not only the text of a treaty but also the preambles and annexes thereof. Article 31(4) provides that “a special meaning shall be given to a term if its established that the parties so intended.”

There is no consensus on what is the ‘ordinary meaning’ of a term. Commentators have for instance proposed that the ordinary meaning of the term ‘beneficial ownership’ may well be that which it has in common law<sup>113</sup> – the system in which the origins of beneficial ownership can be traced to<sup>114</sup> – but also its meaning in the OECD Commentary<sup>115</sup> or its meaning in ‘international tax language’.<sup>116</sup>

### 3.1.2 Article 32 VCLT

Article 32 VCLT allows the recourse to supplementary means of interpretation. These include preparatory works as well as the circumstances of a treaty’s conclusion. The use of the preposition ‘including’ clarifies that the enumeration of article 32 VCLT is non-exclusive.<sup>117</sup> However, supplementary means of interpretation can only be taken into account “to confirm the meaning resulting from the application of article 31 or to determine the meaning when the interpretation according to article 31: leaves the meaning ambiguous or obscure; or leads to a result which is manifestly absurd or unreasonable.”<sup>118</sup> Despite the wording of the provision, historical interpretation is not subsidiary.<sup>119</sup> Indeed, the intentions of the parties, relevant under article 31(4) CVLT, may be revealed by a historical interpretation.<sup>120</sup>

### 3.2 Article 3(2) OECD MC

Article 3(2) is the provision of the OECD MC which covers the interpretation of double taxation conventions. Article 3(2) is considered a specific rule (*lex specialis*) to the VCLT.<sup>121</sup> The article provides that:

As regards the application of the Convention at any time by a Contracting State, *any term not defined therein shall, unless the context otherwise requires, have the meaning*

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<sup>113</sup> DU TOIT, Beneficial Ownership of Royalties in Bilateral Tax Treaties, p. 197.

<sup>114</sup> See *supra* 2.4.2.

<sup>115</sup> DANON, Switzerland’s direct and international taxation of private express trusts, p. 332; see *infra* 3.2.

<sup>116</sup> VOGEL/RUST, Klaus Vogel on Double Taxation Conventions, Introduction para. 86. Modifier mauvaise édition.

<sup>117</sup> OESTERHELT, Auslegung von Doppelbesteuerungsabkommen, p. 377.

<sup>118</sup> Art. 32(a) and (b) VCLT.

<sup>119</sup> LANG, Article 3 paragraphe 2, m.no. 51.

<sup>120</sup> *Ibid.*

<sup>121</sup> *Ibid.*, m.no. 47.

*that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.*<sup>122</sup>

The OECD Commentary<sup>123</sup> clarifies that if, pursuant to article 3(2) OECD MC, domestic law is applicable to a treaty, the relevant legislation is the one at the time of the treaty's application, and not at the time of the treaty's adoption. This an example of an ambulatory approach.

Article 3(2) OECD MC restricts interpretation under domestic law when the context otherwise requires. Most commentators argue for a broad meaning and suggest considering the object and purpose of the treaty. According, to the OECD, 'context' in article 3(2) OECD Model does not have the same meaning as 'context' in the VCLT.<sup>124</sup> Commentators agree that the context as understood in article 3(2) incorporates both the OECD MC and the OECD commentary.

The debate on a domestic or international autonomous meaning of beneficial ownership, owed to article 3(2) OECD Model, is covered hereafter in section 4.1.

### 3.3 OECD Commentary

According to the OECD:

The worldwide recognition of the provisions of the Model Convention and their incorporation into a majority of bilateral conventions have helped make the Commentaries on the provisions of the Model Convention *a widely-accepted guide to the interpretation and application of the provisions of existing bilateral conventions*. This has facilitated the interpretation and the enforcement of these bilateral conventions along common lines. As the network of tax conventions continues to expand, the importance of such a generally accepted guide becomes all the greater [emphasis added].<sup>125</sup>

Commentators overwhelmingly agree that the OECD Model and OECD Commentary can be deemed relevant under the VCLT. According to Vogel, Baumgartner and du Toit, the OECD Model and the OECD Commentary are descriptive of the 'ordinary meaning' mentioned under article 31(1) of the VCLT. Ault, Lang, Rust and Vogel<sup>126</sup> agree that if OECD member states

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<sup>122</sup> Art. 3(2) OECD MC.

<sup>123</sup> OECD Commentary 2003, para. 11 *ad art.* 3.

<sup>124</sup> OECD Commentary, para. 13.1 *ad art.* 3.

<sup>125</sup> OECD MC 2014, Introduction, para. 15.

<sup>126</sup> AULT, OECD Commentaries in the Interpretation of Tax Treaties, p. 146 et seq.; LANG, Article 3 paragraphe 2, m.no. 54; VOGEL/RUST, Klaus Vogel on Double Taxation Conventions, Introduction, m.no. 101.



conclude a treaty on the basis of the OECD Model, the provisions of the double taxation convention should be presumed to have the meaning of the same provisions in the Model.

## 4 NATURE AND MEANING OF BENEFICIAL OWNERSHIP

To define beneficial ownership first requires determining where the definition should be found. There is no consensus on the question and national courts have held different opinions. Most authors consider beneficial ownership to have an autonomous treaty meaning. This position was also followed by the Court of Appeal in the *Indofood* case.<sup>127</sup>

As beneficial ownership is not defined in the OECD MC, and seldom in double taxation conventions, article 3(2) of the Model is usually applicable. It is commonly accepted that defining beneficial ownership meets this contextual requirement. Given that the context requires, where must that meaning be found? Two contenders have been proposed: a domestic law meaning and an international meaning.

The OECD's Glossary of Tax Terms defines the beneficial owner as "a person who enjoys the real benefits of ownership, even though the title to the property is in another name"<sup>128</sup> further specifying that the concept is "often important in tax treaties, as a resident of a tax treaty partner may be denied the benefits of certain reduced withholding tax rates if the beneficial owner of the dividends etc is resident of a third country."<sup>129</sup> Numerous commentators have proposed their definition of beneficial ownership,<sup>130</sup> to cite them here would, however, go beyond the reasonable scope of this contribution.

### 4.1 Domestic Law Meaning of Beneficial Ownership

Article 3(2) OECD MC provides that terms not defined in a treaty are to be defined according to the domestic law of the state applying the treaty, 'unless the context otherwise requires'. There has been a debate on whether the meaning of beneficial ownership should be found in domestic law or whether it had an autonomous treaty meaning. Commentators favouring a domestic law meaning of the concept, have suggested that in common law jurisdictions the concept is 'well-known'.<sup>131</sup> It has also been argued that the verb 'requires' in article 3(2) of the OECD Model is a 'word of force', making it difficult to apply an autonomous treaty meaning.<sup>132</sup>

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<sup>127</sup> See *infra* 7.2.

<sup>128</sup> OECD, Glossary of Tax Terms.

<sup>129</sup> *Ibid.*

<sup>130</sup> For an overview see MEINDL-RINGLER, *Beneficial Ownership*, p. 77 et seq.

<sup>131</sup> DU TOIT, *Beneficial Ownership of Royalties*, p. 173.

<sup>132</sup> MEINDL-RINGLER, *Beneficial Ownership*, p. 295.

Most commentators, however, agree that beneficial ownership has an autonomous treaty meaning.<sup>133</sup> Under this conception, the context of article 3(2) OECD MC requires that the concept is defined under VCLT rules. It follows that the source state should avoid construing beneficial ownership according to its domestic law, partly because most contracting states do not have a definition of beneficial ownership in their legislation. Moreover, the tax relief provided by articles 10, 11 and 12 is contingent on the recipient of the income being the beneficial owner thereof; if a treaty definition is given to beneficial ownership, the risk of divergence, and thus of double taxation, is avoided,<sup>134</sup> whereas domestic law application increases that risk.<sup>135</sup>

In the United Kingdom, the ‘international fiscal meaning’ of beneficial ownership has been recognised by the Court of Appeal,<sup>136</sup> there is, however, no consensus on the question amongst OECD member states.<sup>137</sup>

Before 2003 the OECD’s position was unclear. According to Meindl-Ringler,<sup>138</sup> the OECD has generally favoured autonomous treaty definitions. This would be backed by the fact that the OECD Commentary, for instance, provides with respect to the definition of ‘interest’ that “in the Model Convention reference to domestic law should as far as possible be avoided.”<sup>139</sup> However, no similar remark had been made on beneficial ownership in the Commentary.<sup>140</sup> As of 2014, the OECD Commentary does state that beneficial ownership:

[...] was intended to be interpreted in [the] context [of paid to... a resident] 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).<sup>141</sup>

The 2011 Discussion Draft suggested an amendment to the previously quoted paragraph which would have provided that:

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<sup>133</sup> DANON, La notion de bénéficiaire effectif, p. 40; DANON/DINH, La clause du bénéficiaire effectif, m.no. 97; OBERSON, Bénéficiaire effectif, p. 220; MEINDL-RINGLER, Beneficial Ownership, p. 295.

<sup>134</sup> DANON/DINH, La clause du bénéficiaire effectif, m.no. 97.

<sup>135</sup> OBERSON, Bénéficiaire effectif, p. 220; OLIVER et al., Beneficial Ownership, p. 323.

<sup>136</sup> See *infra* 7.2.2.

<sup>137</sup> DANON/DINH, La clause du bénéficiaire effectif, m.no. 98.

<sup>138</sup> MEINDL-RINGLER, Beneficial Ownership, p. 296.

<sup>139</sup> OECD Commentary 2014, para. 21 *ad* art. 11.

<sup>140</sup> MEINDL-RINGLER, Beneficial Ownership, p. 296.

<sup>141</sup> OECD Commentary 2014, para. 12.1 *ad* art. 10, and para. 9.1 *ad* art. 11.

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.<sup>142</sup>

The Revised Draft of 2012 abandoned this amendment,<sup>143</sup> which was described as incoherent. Indeed, the qualification of beneficial ownership as an autonomous treaty concept, commands that the subject matter must be exclusively determined under articles 31 and 32 CVLT.<sup>144</sup>

## 4.2 Ultimate Beneficial Owner and Beneficial Owner

Ultimate beneficial ownership and beneficial ownership should not be confused. Since 2014, the OECD Commentary states that, in the context of article 10, 11 and 12, beneficial ownership does not have the meaning that it has been given in other instruments.<sup>145</sup> The Commentary refers here, *inter alia*, to the Financial Action Task Force’s documentation, which defines the beneficial owner, in the context of money laundering, as the natural person who ultimately owns a legal person. For a tax treaty purpose beneficial ownership has nothing to do with this definition. Indeed, interpreting beneficial ownership according to economic reality does not involve a look through approach, *i.e.* full transparency. The distinction between beneficial owner and ‘ultimate’ beneficial owner is critical when apprehending a group of companies and holding structures. According to Danon and Dinh, within a group, the criterion of economic control should not lead to ignore intermediary entities in sole consideration of the ultimate shareholder.<sup>146</sup>

## 4.3 Implied Beneficial Ownership

Before the 2014 modifications, some states already considered the beneficial owner clause to be implied or implicit in treaty law. Under this conception, passive income attribution rules of tax treaties, even when adopted before 1977, were considered subject to the clause even if not expressly mentioned in the text of the treaty.<sup>147</sup> This opinion was backed by the fact that according to the OECD Commentary, the term beneficial owner only clarifies the meaning of

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<sup>142</sup> 2011 Discussion Draft, p. 3.

<sup>143</sup> 2012 Revised Draft, p. 14.

<sup>144</sup> DANON/DINH, *La clause du bénéficiaire effectif*, m.no. 99.

<sup>145</sup> OECD Commentary 2014, para. 12.6 *ad* art. 10, para. 10.4 *ad* art. 11 and para. 4.5 *ad* art. 12.

<sup>146</sup> DANON/DINH, *La clause du bénéficiaire effectif*, m.no. 120.

<sup>147</sup> *Ibid.*, m.no. 87.

the words ‘paid... to a resident.’<sup>148</sup> Both France<sup>149</sup> and Switzerland<sup>150</sup> have privileged this approach.

This position has been criticized<sup>151</sup> as the language ‘paid... to a resident’ only deals with the personal attribution of income required by a tax treaty (not to be confused with the concept of residency<sup>152</sup>). Danon has further argued that the implicit beneficial ownership criterion should be construed under article 1 OECD MC<sup>153</sup> (which deals with ‘persons covered’ by the treaty) and fulfils the principle of the relative effect of double taxation conventions in treaty abuse.<sup>154</sup>

De Broe and von Frenckell suggest that the cumulative application of the implied anti-abuse rule is contradicted by article 31(1) of the VCLT, a provision which establishes the principle of the primacy of textual interpretation. Both commentators consider that since the text of the treaty reflects first and foremost the intention of the parties, the intentions of the contracting states should not be concretised beyond the text of the treaty. Accordingly, it is fitting to conclude that the implicit anti-abuse rule is of subsidiary nature and may not be applied to a situation in which the contracting states have elected to apply a specific anti-abuse measure.<sup>155</sup>

#### 4.4 Inherent Anti-Abuse Principle

Commentators<sup>156</sup> have held that double taxation conventions contain an inherent anti-abuse principle, which they derive from article 26 and 31 VCLT. There is however no consensus on the question.<sup>157</sup> The *pacta sunt servanda* principle, expressed by articles 26 and 31 VCLT, provides that “treaties are required to be complied with in accordance with the principle of good faith”, and thus should be understood as preventing abuse of treaties, the latter being deemed contrary to the VCLT.<sup>158</sup>

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<sup>148</sup> OECD Commentary 2014, para. 12 *ad* art. 10; OECD Commentary 2003, para. 12.1 *ad* art. 10.

<sup>149</sup> Conseil d’État, 13 October 1999, case no. 191191, *Ministre de l’Économie, des Finances et de l’Industrie v. SA Diebold Courtage*.

<sup>150</sup> CRC du 3 mars 2005 (SRK 2003-139), para. 3.d

<sup>151</sup> DANON/DINH, La clause du bénéficiaire effectif, m.no. 89.

<sup>152</sup> Art. 4(1) OECD MC.

<sup>153</sup> DANON/DINH, La clause du bénéficiaire effectif, m.no. 89.

<sup>154</sup> DANON, Le concept de bénéficiaire effectif, p. 40.

<sup>155</sup> DE BROE/VON FRENCKELL, La notion de « bénéficiaire effectif », p. 287.

<sup>156</sup> DANON, Cession transfrontalière de droits de participations, p. 136 et seq.; WARD, Abuse of Tax Treaties, p. 180; dissenting: GANI, RDAF 2006 II 239, p. 254.

<sup>157</sup> DANON/DINH, La clause du bénéficiaire effectif, m.no. 144.

<sup>158</sup> WARD, Abuse of Tax Treaties, p. 178.

As of 2003, the OECD recognises an inherent anti-abuse principle in the form of the guiding principle:

A guiding principle is that 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.<sup>159</sup>

This guiding principle has been considered to be the origin of the PPT rule, which will be covered hereafter under section 8.3.

Beneficial ownership and the inherent anti-abuse principle, if recognised, pose a problem of delimitation. Indeed, whether beneficial ownership or the anti-abuse principle, or both, should apply to certain situations is not entirely clear. Commentators disagree on whether the approach should be cumulative or subordinate.<sup>160</sup>

Under the cumulative approach, the inherent anti-abuse principle is applicable concurrently with specific anti-abuse rules, such as the beneficial ownership test. Accordingly, this leads to a two-step process: if the application of the SAAR must be ruled out, the anti-abuse principle is then relevant to analyse the situation.<sup>161</sup>

The subordinate approach gives the inherent anti-abuse principle a subsidiary nature. As such, when a specific anti-abuse rule is applicable, such as the beneficial ownership test, it should be considered that only that specific rule is relevant to cover the facts it is relevant for; in other words, if a subject matter falls under the scope of beneficial ownership, it may not be apprehended through the inherent anti-abuse principle.<sup>162</sup> Moreover, Ward has argued that it is not possible to imply that the parties to a tax treaty intended the application of the inherent anti-abuse if they have provided for a GAAR in the double taxation convention.<sup>163</sup> The subordinate approach relies on a literal interpretation of tax treaties, as provided by article 31(1) VCLT.<sup>164</sup>

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<sup>159</sup> OECD Commentary 2003, para. 9.5. *ad art.* 1.

<sup>160</sup> DANON, *La réserve non écrite de l'abus*, m.no. 156.

<sup>161</sup> *Ibid.*, m.no. 152.

<sup>162</sup> *Ibid.*, m.no. 153.

<sup>163</sup> WARD, *Abuse of Tax Treaties*, p. 184; dissenting: OECD Commentary 2003, para. 9.6. *ad art.* 1.

<sup>164</sup> DANON, *La réserve non écrite de l'abus*, m.no. 157.

#### 4.5 Beneficial owner and *Bénéficiaire effectif*

As both French and English are authentic languages of the OECD MC, as well as official languages of the OECD, comparing the terminology in both versions of the Model seems adequate. Some authors<sup>165</sup> have argued that the French terminology, '*bénéficiaire effectif*' better demonstrates the purpose of the concept under the OECD's vision. '*Bénéficiaire effectif*' has been translated to 'real beneficiary' or 'effective beneficiary',<sup>166</sup> the former, although not literal, being, in my opinion, a better capture of the meaning.

Moreover, '*bénéficiaire effectif*', unlike the English term 'beneficial owner', does not imply ownership, which is interesting given how problematic the reference to ownership has been in interpreting the concept, especially outside of common law jurisdictions; the concerned courts being unfamiliar with beneficial ownership. Furthermore, the 'idea of effectiveness'<sup>167</sup> renders the literal interpretation of the Model's wording much easier as it conveys the notion of effectiveness in the enjoyment of passive incomes. However, other authors have argued that '*bénéficiaire effectif*' is not a good translation of English.<sup>168</sup>

Interestingly, Canada, a bilingual common law jurisdiction, has found different translations of beneficial ownership. In the *Prévost* case, the Tax Court of Canada mentioned that although 'beneficial owner' corresponded to *bénéficiaire effectif* in the French language versions of tax treaties signed by Canada, Canadian domestic legislation used '*propriété effective*' (effective or real ownership), '*propriétaire effectif*' (effective or real owner), '*personne ayant la propriété effective*' (person having the effective or real ownership) in its French versions. Furthermore, when dealing with trusts, Canadian legislation translated 'beneficial ownership' to '*droit de bénéficiaire*' (beneficiary right).<sup>169</sup>

As evidenced by the difficulties, even for bilingual common law jurisdiction,<sup>170</sup> in finding an adequate and single translation to a term such as 'beneficial ownership' and with a meaning arduous to convey, the expression seems unfit for usage in an international tax treaty model. Indeed, tax treaties, although numerous in English, are not always provided in an authentic version in that sole language. Furthermore, the courts from whom interpretation is expected are

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<sup>165</sup> PISTONE, Beneficial Ownership as Anti-Abuse Provision, p. 177.

<sup>166</sup> KEMMEREN, Klaus Vogel on Double Taxation Conventions, Preface to Articles 10 to 12, m.no. 24.

<sup>167</sup> PISTONE, Beneficial Ownership as Anti-Abuse Provision, p. 177.

<sup>168</sup> VANN, Beneficial Ownership, p. 288, footnote 46.

<sup>169</sup> The translations in brackets are my own.

<sup>170</sup> Excluding Quebec, all the provinces and territories of Canada follow common law.

not necessarily anglophone and perhaps even more importantly, often belong to other legal traditions. Lastly, the expression beneficial ownership has without doubt origins in common law<sup>171</sup> and seems to be very firmly largely anchored as such in Anglo-Saxon legal minds, which has arguably led common law courts to construe beneficial ownership accordingly.<sup>172</sup>

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<sup>171</sup> See *supra* 2.4.2.

<sup>172</sup> See *infra* 7.1.1.3.



## 5 BENEFICIAL OWNERSHIP IN SWISS CASE LAW

### 5.1 The Swiss Withholding Tax Regime

The Swiss Federal Constitution provides that “the Confederation may levy a withholding tax<sup>173</sup> on income from moveable capital assets, on lottery winnings and on insurance benefits.”<sup>174</sup> This withholding tax and its regulation are implemented in the Federal Act on Withholding Tax of 13 October 1965<sup>175</sup> (hereafter WHTA) and in the Ordinance on Withholding Tax of 19 December 1966.<sup>176</sup>

The Swiss withholding tax is considered to be ‘special income tax’<sup>177</sup> by commentators.<sup>178</sup> The mechanism of the withholding tax is designed to serve two alternative purposes:

For Swiss residents who correctly inform tax authorities on their gross income, it aims to guarantee that income tax is paid and prevents tax evasion.<sup>179</sup> Indeed, the levy of the withholding tax deters taxpayers from omitting taxed revenues on their tax sheet as failing to inform the tax authorities prevents a subsequent refund of the withholding tax, thus functioning as an incentive.<sup>180</sup>

The other purpose of the Swiss withholding tax solely concerns non-resident recipients and is purely fiscal.<sup>181</sup> Individuals not residing in Switzerland when the tax was due are normally not granted a refund of the withholding tax.<sup>182</sup> However, under certain conditions, the tax may be fully or partially refunded to foreign residents under the benefit of a double tax convention signed between the beneficiary’s state of residence and Switzerland (i.e. the state of source).<sup>183</sup> Indeed, under the Swiss Constitution, treaty law supersedes domestic law (i.e. the WHTA). Legal persons and partnerships are entitled to a refund if they were incorporated in Switzerland

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<sup>173</sup> Verrechnungsteuer [de]; impôt anticipé [fr]; imposta preventiva [it].

<sup>174</sup> Art. 132(2) FC.

<sup>175</sup> RS 642.21.

<sup>176</sup> RS 642.211.

<sup>177</sup> Spezialeinkommensteuer [de]; impôt spécial sur le revenu [fr].

<sup>178</sup> BLUMENSTEIN/LOCHER, *System des schweizerischen Steuerrechts*, p. 234; HÖHN/WALDBURGER, *Steuerrecht*, § 21, m.no. 2.

<sup>179</sup> FSC Judgment of 29 October 1992, ATF 118 Ib 317 para. 2.

<sup>180</sup> OBERSON, *Droit fiscal suisse*, p. 309.

<sup>181</sup> FSC Judgment of 5 May 2015, ATF 141 II 447, para. 2.2.

<sup>182</sup> Art. 22(1) WHTA.

<sup>183</sup> BAUER-BALMELLI/REICH, *VStG-Kommentar, Vorbemerkungen*, m.no. 71.

at the date of payment<sup>184</sup> and may also be entitled to a full or partial refund of the withholding tax on the basis of a double taxation convention.<sup>185</sup>

## 5.2 The X Holding ApS Case

The two main issues reviewed by the Swiss Federal Supreme Court in this case<sup>186</sup> were whether a Danish holding company was entitled to a refund of the Swiss withholding tax on dividends and whether an anti-abuse rule was applicable despite the Denmark-Switzerland double taxation convention not expressly providing for such a rule.

X Holding ApS (hereafter X ApS), a Danish holding company acquired all the shares of W SA in December 1999. X ApS was wholly owned by a company resident of Guernsey (Y Ltd.), itself controlled by a corporation resident of Bermuda (A Ltd.).<sup>187</sup> B., the only shareholder and general manager of A Ltd. was a resident of Bermuda. On 30 November 2000, W SA distributed dividends to X ApS. The Swiss withholding tax was levied on the amount.<sup>188</sup>

Subsequently, X ApS distributed a dividend to Y Ltd. and filed for a withholding tax refund. The Swiss Federal Tax Administration denied the refund,<sup>189</sup> holding that X ApS had no real activity in Denmark and was only incorporated to benefit from the Switzerland-Denmark double taxation convention of 1973.<sup>190</sup> Indeed, at the time the tax treaty in question stipulated that the withholding tax rate in the state of source was 0 percent.<sup>191</sup> The Federal Commission for Appeals in Tax Matters adopted a substance over form point of view and rejected X ApS' appeal and upheld the Swiss Federal Tax Administration's decision.<sup>192</sup>

### 5.2.1.1 Particularities of the Switzerland-Denmark DTC

At the time of the case and until the amendment of 22 November 2010,<sup>193</sup> article 10(1) of the Switzerland-Denmark tax treaty provided that “dividends paid by a company which is a resident of a contracting State to a resident of another contracting State *shall be taxable only* in that

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<sup>184</sup> Art. 24(2) WHTA.

<sup>185</sup> JAUSSE et al., *Rückerstattung der Verrechnungssteuer*, p. 651.

<sup>186</sup> FSC Judgment of 28 November 2005, 2A.239/2005 = RDAF 2006 II 239 = StR 2006 2017.

<sup>187</sup> FSC Judgment of 28 November 2005, 2A.239/2005, para. A.

<sup>188</sup> Ibid.

<sup>189</sup> Ibid., para. B.

<sup>190</sup> Ibid.

<sup>191</sup> REARDON-KOFMEL, *The judicial concept of tax avoidance in Switzerland*, p. 196.

<sup>192</sup> FSC Judgment of 28 November 2005, 2A.239/2005, para. B.

<sup>193</sup> RO 2010 5939.

other State (i.e the state of residence) [emphasis added]”.<sup>194</sup> This provision was different from the OECD Model which does not attribute an exclusive taxing right on dividends to the state of residence of the beneficiary.<sup>195</sup> Furthermore, this full relief was provided for in no other tax treaty ratified by Switzerland, which may have induced taxpayers to hold shares of a Swiss company through a Danish holding company for pure tax purposes.<sup>196</sup>

#### 5.2.1.2 Court’s Decision and Critical Remarks

The Federal Supreme Court ruled that “in cases of abuse of double taxation conventions, treaty benefits may be denied even in the absence of a conventionally adopted, express anti-abuse provisions.”<sup>197</sup> The Court further held that when the tax treaty is properly interpreted and pursuant to articles 26 and 31 of the VCLT, an inherent anti-abuse principle is apparent. More specifically, the FSC considered that the inherent anti-abuse principle is embodied in the principle of good faith.

However, the court, mistook paragraph 9.4 to article 1 of the 2003 OECD Commentary<sup>198</sup> as an expression of the international recognition of a prohibition of treaty abuse. Indeed, this section of the OECD Commentary is arguably an example of a provision that contracting states may wish to adopt; the Swiss and Danish authorities did not, however, include such a provision in the tax treaty. Some authors argued that the guiding principle<sup>199</sup> should have been the basis of the FSC’s reasoning.<sup>200</sup> Danon has further argued that the guiding principle codifies a general principle of prohibition of abuse of rights in tax treaties.<sup>201</sup>

Moreover, the court considered that the OECD Commentaries were valid interpretation tools for double taxation conventions, even if adopted after the tax treaty’s entry into force. Commentators generally disagreed with the use of the 2003 OECD Commentary by the court as article 10 of the double taxation convention in question and article 10 OECD MC did not correspond.<sup>202</sup> De Broe and von Frenckell<sup>203</sup> have argued that the court used the OECD

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<sup>194</sup> REARDON-KOFMEL, *The judicial concept of tax avoidance in Switzerland*, p. 197.

<sup>195</sup> FSC Judgment of 28 November 2005, 2A.239/2005, para. 3.1.

<sup>196</sup> Ibid.

<sup>197</sup> REARDON-KOFMEL, *The judicial concept of tax avoidance in Switzerland*, p. 195.

<sup>198</sup> Look-through approach.

<sup>199</sup> OECD Commentary 2003, para 9.5 *ad art.* 1.

<sup>200</sup> REARDON-KOFMEL, *The judicial concept of tax avoidance in Switzerland*, p. 240 et seq.

<sup>201</sup> DANON, *Cession transfrontalière de droits de participations*, p. 120.

<sup>202</sup> REARDON-KOFMEL, *The judicial concept of tax avoidance in Switzerland*, p. 202.

<sup>203</sup> DE BROE/VON FRENCKELL, *La notion de « bénéficiaire effectif » et la question de l’abus de convention*, p. 295.

Commentary without realising that Switzerland had expressed an observation indicating that the country did not share the view, expressed under paragraph 7, according to which the purpose of double taxation conventions is to prevent tax avoidance and evasion.<sup>204</sup>

The court considered that beneficial ownership, which was not denied to X ApS, did not preclude the application of the inherent anti-abuse principle.<sup>205</sup> On the basis of the look-through approach, absent from the double taxation convention at stake, the FSC assessed X ApS's financial statements and arrived at the conclusion that the company had no substance as it lacked employees and offices in Denmark. The court further held that there were no solid business reasons for the company's creation other than benefiting from a withholding tax relief.

### 5.3 Beneficial Ownership in Switzerland

The Federal Supreme Court (hereafter FSC) is the supreme judicial authority of Switzerland.<sup>206</sup> Lacking a statutory definition of 'beneficial ownership', Swiss law relies on the FSC's case law to construe the concept.

#### 5.3.1 The TRS Case

In this case<sup>207</sup> the FSC had to determine how to interpret beneficial ownership in a situation where Swiss equity dividends were hedged in derivatives transactions.

##### 5.3.1.1 Facts

A Danish bank entered into total return swap (hereafter TRS) agreements over Swiss equities with other banks, acting as counterparties, located in the United Kingdom, the United States, Germany and France.<sup>208</sup> The conditions of the swap agreement were the following: the Danish bank would pay any appreciation of the shares and the dividends, corresponding to the duration of the term of the swaps, to its counterparties, who in return would pay any depreciation of the shares, as well as a market interest rate (LIBOR) plus a margin to the bank.<sup>209</sup>

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<sup>204</sup> OECD Commentary 2003, paragraph 27.9 *ad art.* 1.

<sup>205</sup> FSC Judgment of 28 November 2005, 2A.239/2005, para. 3.5.3.

<sup>206</sup> Art. 188(1) FC.

<sup>207</sup> Federal Supreme Court Judgment of 5 May 2015, ATF 141 II 447.

<sup>208</sup> FAC Judgment of 7 March 2012, A-6537/2010, para. K.

<sup>209</sup> *Ibid.*, para. 6.1 and 6.2.1

To hedge its risk, the bank bought the underlying shares to the TRS from third party brokers; the swap agreement did not stipulate that the bank had to do so, nonetheless the bank was fully hedged.<sup>210</sup> Upon dividend distribution, the bank made its payments to the counterparties and applied for a withholding tax refund under articles 10 and 26(2) of the Switzerland-Denmark DTC, which provided for an exemption in the state of source.<sup>211</sup> Unlike dividends, the bank's TRS payments were not subject to a Swiss withholding tax.<sup>212</sup> The bank sold the underlying securities upon the TRS's maturity.

The tax authorities denied the withholding tax refund,<sup>213</sup> arguing that the shares were systematically bought before and sold after dividend distribution dates, and that the transactions' purpose was to transfer dividends to undisclosed counterparties net of the Swiss withholding tax. Furthermore, the tax authorities claimed that the transactions were constitutive to treaty abuse as they were unusually important and solely driven by fiscal motives.<sup>214</sup>

#### 5.3.1.2 Federal Administrative Court's Decision

The FAC held that "the concept of beneficial ownership is merely a condition of entitlement like, say, the concept of residence, rather than a singular abuse clause"<sup>215</sup> and cited the FSC's case law to conclude that "[o]nly once all the conditions of entitlement under a DTC are met (including beneficial ownership) does the question of potential abuse of the convention arise."<sup>216</sup> Consequently, the court considered that the duration of the TRS and the 'subjective motive' of tax avoidance were irrelevant to the case.<sup>217</sup>

The court followed the FSC's conclusions of the *X Holding ApS* case and held that the Switzerland-Denmark double taxation convention is subject to an inherent anti-abuse principle.<sup>218</sup>

Commentators have argued that if the FAC had ruled that tax avoidance prevention was relevant to interpret the concept of beneficial ownership, it would have had to investigate whether

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<sup>210</sup> DESAX/BUSENHART, Total Return Swap, p. 557.

<sup>211</sup> RO 2010 5939, the DTC has since been amended (2010) and now provides for a 15 percent withholding tax.

<sup>212</sup> DESAX/BUSENHART, Total Return Swap, p. 557.

<sup>213</sup> FAC Judgment of 7 March 2012, A-6537/2010, para. F and I.

<sup>214</sup> Ibid., para. I.

<sup>215</sup> Ibid., para. 3.4.3, unofficial translation by Walder Wyss AG.

<sup>216</sup> Ibid.

<sup>217</sup> WEIDMANN, Swiss Swaps case, p. 623.

<sup>218</sup> FAC Judgment of 7 March 2012, A-6537/2010, para. 7.1.

legitimate commercial reasons explained why the bank had entered into the TRS, if the transaction were solely a means of evading withholding taxes and establish the normal market conditions for entering into comparable agreements.<sup>219</sup>

The court adopted a narrow interpretation of beneficial ownership,<sup>220</sup> and considered that:

Regardless of whether it received the dividends, the complainant was obliged to pay the counterparty the amounts equivalent to the dividends. At the same time, the complainant was free to decide, independently of the swap contracts, whether to buy the shares in question and to receive the corresponding dividends. *The lack of interdependence shows that the complainant did indeed have the power to decide how to use the dividends it received. The complainant therefore was under no de facto obligation to pass on the dividends.* It was free to dispose of them as it wished and to use them for other purposes instead.<sup>221</sup>

The court thus found that the bank had no obligation, legal or factual, to use the dividends to pay its counterparties, finding no interdependence in the transactions.<sup>222</sup> Moreover, the FAC ruled out treaty abuse on the grounds that the bank was effectively headquartered in Denmark and engaged in genuine activity.<sup>223</sup> The court decided in favour of the bank, ruling that it was the beneficial owner of the dividends.<sup>224</sup>

### 5.3.1.3 Federal Supreme Court's Decision and Critical Remarks

On 5 May 2015, the FSC reversed the FAC's judgment and denied the Danish bank's refund claim. Like the FAC, the court found that the beneficial ownership criterion was indeed implicit in the Switzerland-Denmark DTC,<sup>225</sup> thus confirming the 2006 *X Holding ApS* decision.<sup>226</sup>

The court considered that establishing the purpose of beneficial ownership, i.e. whether it is designed to prevent abuse (broad interpretation) or not, was not necessary in the present case.<sup>227</sup>

The FSC ruled that in the context of dividend payments, the key criterion to identify the beneficial owner is whether the person can fully dispose of the dividends, i.e. fully use and

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<sup>219</sup> WEIDMANN, Swiss Swaps case, p. 623.

<sup>220</sup> Ibid., p. 622.

<sup>221</sup> FAC Judgment of 7 March 2012, A-6537/2010, para. 6.2.1, unofficial translation by Walder Wyss AG.

<sup>222</sup> Ibid., para. 6.2.1.

<sup>223</sup> Ibid., para. 7.2.

<sup>224</sup> Ibid., para. 8.1.

<sup>225</sup> FSC Judgment of 5 May 2015, ATF 141 II 447, para. 4 et seq.; as of 2010 beneficial ownership is expressly mentioned in art. 10(2) of the Switzerland-Denmark DTC, see *supra* footnote 211.

<sup>226</sup> See *supra* 5.2.

<sup>227</sup> FSC Judgment of 5 May 2015, ATF 141 II 447, para. 4.5.

benefit, without legal, contractual or factual limitations.<sup>228</sup> According to Weidmann, the FSC assumed that beneficial ownership of dividends is distinct from beneficial ownership of shares.<sup>229</sup>

The court held that “the German term [*Nutzungsberechtigter*] emphasises that beneficial ownership is not to be understood in a narrow technical or legalistic sense, but rather taking into account the economic circumstances”<sup>230</sup> and that “this [reasoning] applies therefore for any restrictions of the entitlement. Although an obligation limiting full use generally results from legal documents, it may also be based on facts or circumstances from which it appears that the recipient does not enjoy the full power to dispose and full beneficial ownership.”<sup>231</sup> A limitation of control can thus result from legal obligations that restrict the right to enjoy dividends or from restrictions resulting from facts and circumstances.

The court somewhat addressed the purpose of beneficial ownership, finding that “it is designed to prevent a person or company with only limited powers [from] being interposed as an intermediary in order to benefit from the benefits of the double taxation convention”<sup>232</sup> and that “it is irrelevant whether the interposition of an intermediary in another state actually results in a tax benefit.”<sup>233</sup> This excerpt has proven to be critical; Swiss courts have denied beneficial ownership to taxpayers despite there being no apparent fiscal gain.<sup>234</sup>

The court considered that the receipt of dividends, from an economic perspective, was linked with the contractual obligation to pay the counterparties to the swap, to the extent that a de facto obligation to transfer dividends could be assumed. Consequently, there was interdependence between the reception of dividends by the bank and the payments made to the counterparties. Indeed, the shares were systematically purchased before dividend maturity, to pass on dividends net of Swiss withholding tax to the counterparties outside of the contracting states (i.e. Denmark and Switzerland). The bank itself admitted that the counterparties were residents in states whose

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<sup>228</sup> FSC Judgment of 5 May 2015, ATF 141 II 447, para. 5.2.; BAUMGARTNER/FRICK, Swiss supreme court decisions on denial of withholding tax refund, p. 2.

<sup>229</sup> WEIDMANN, Swiss Swaps case, p. 625.

<sup>230</sup> FSC Judgment of 5 May 2015, ATF 141 II 447, para. 5.2.1.; inofficial translation by Walder Wyss AG.

<sup>231</sup> *Ibid.*

<sup>232</sup> *Ibid.*

<sup>233</sup> *Ibid.*

<sup>234</sup> See e.g. FSC Judgment of 27 November 2015, 2C\_752/2014 para. 4.1.

tax treaties with Switzerland provided for a less advantageous residual withholding tax of 15 percent.<sup>235</sup>

Several questions were raised by the FSC's judgment. The first one is whether beneficial ownership could be regarded as implicit in the Switzerland-Denmark double taxation convention. The court mentioned that most Swiss commentators<sup>236</sup> agreed with the implicit nature of beneficial ownership in tax treaties<sup>237</sup> and considered that the criterion was implicitly present in the treaty at stake.<sup>238</sup> The court based its reasoning on the 2009 amending Protocol to the Switzerland-Denmark double taxation convention of 1973,<sup>239</sup> which, *inter alia*, introduced the term 'beneficial owner' in the treaty. However, the withholding tax refund claims of the Danish bank were anterior to the conclusion and entry into force of the Protocol. Furthermore, the double taxation convention of 1973, was adopted before the introduction of beneficial ownership in the OECD MC. To remedy with this incoherence, the court argued that the Protocol was a 'mere clarification' of the treaty, but not a real change or new criterion. This view is coherent with the OECD Commentary of 2014.<sup>240</sup>

In my opinion, this reasoning is contradictory if the introduction of beneficial ownership in 1977 is considered to have been a way to prevent a specific form of abuse, i.e. treaty shopping. Indeed, if the concept is of such importance, it cannot be asserted that it is a mere clarification of 'paid to', especially not in a treaty predating the introduction of the notion in the OECD Model. Moreover, the FSC interpreted a 1973 tax treaty under the OECD Commentary of 2014, without explaining why the interpretation of an earlier treaty with a later OECD Commentary was possible.<sup>241</sup> Some commentators have argued that beneficial ownership should only be considered in the Switzerland-Denmark double taxation convention if the case at stake occurs after the entry into force of the amendment of article 10.<sup>242</sup> Based on the Swiss government's message which accompanied the Protocol of 2009, Gani considers that the introduction in the treaty of an express anti-abuse rule which provides that the tax relief is contingent on being the beneficial owner, was an admittance of a pre-existing loophole.<sup>243</sup> Indeed, if, as the FSC

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<sup>235</sup> *Ibid.* 6.4.2.

<sup>236</sup> e.g. DANON, *Le concept de bénéficiaire effectif*, p. 40; dissenting: GANI, RDAF 2006 II 239, p. 254.

<sup>237</sup> See *supra* 4.3.

<sup>238</sup> FSC Judgment of 5 May 2015, ATF 141 II 447, para. 4.1 et seq.

<sup>239</sup> RO 2010 5939.

<sup>240</sup> See *supra* 2.3.5.

<sup>241</sup> See *supra* 3.3.

<sup>242</sup> WEIDMANN, *Swiss Swaps case*, p. 627.

<sup>243</sup> GANI, RDAF 2017 II 104, pp. 108-109.



interprets it, the beneficial owner criterion was implicit in the treaty, it was unnecessary to amend the treaty to expressly introduce it. In any case, the government's message should have expressly mentioned that although the concept was formally introduced by the Protocol, it did not constitute a new criterion.<sup>244</sup>

The second, and most important issue in the case is the alleged interdependence between the receipt of dividends by the Danish bank and the passing on of the dividends to swap counterparties under the TRS agreement. Indeed, the interdependence between both transactions was the primary reason for the FSC's conclusion that the bank was not the beneficial owner of the dividends.

The definition of beneficial ownership employed by the court was first suggested by Baumgartner.<sup>245</sup> The court explained this commentator's view as follows:

[B]eneficial ownership is to be affirmed if the recipient of the relevant income is able not only to make very limited decisions but, as a minimum, is able to make at least certain decisions independently. This power of decision must be denied to a person when the said person must pass on the earnings on the basis of contractual obligations entered into before the date of payment or of [f]actual restrictions. The existence of [a] [f]actual restriction is to be assumed when both of the following characteristics have been cumulatively fulfilled. *On the one hand, obtaining of income must depend on this obligation to pass on these earnings, on the other hand, the obligation to pass an income must depend on this income being obtained.*<sup>246</sup>

Under this conception there are two cumulative criteria for the existence of a factual limitation: The first dependency is that the realisation of the income depends on the duty to forward this income upon the obligation to transfer the income. The second dependency is that the duty to forward the income depends on the realisation of the income.<sup>247</sup>

It follows, that a factual restriction can be presumed if there is an interdependence between the reception of dividends and the obligation to pass on the dividends. The FSC considers that “[i]n relation to the scope of the passing on, the following rule is applied: The greater the dependence between income and obligation to pass it on, the weaker the beneficial ownership.”<sup>248</sup>

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<sup>244</sup> Ibid., p. 109.

<sup>245</sup> BAUMGARTNER, Das Konzept des beneficial owner.

<sup>246</sup> FSC Judgment of 5 May 2015, ATF 141 II 447, para. 5.2.2, unofficial translation by Walder Wyss AG.

<sup>247</sup> BAUMGARTNER/FRICK, Swiss supreme court decisions on denial of withholding tax refund, p. 2.

<sup>248</sup> FSC Judgment of 5 May 2015, ATF 141 II 447, para. 5.2.4, unofficial translation by Walder Wyss AG.

Consequently, the court stated that the recipient passing on the dividend in full or being obliged to do so evidenced a lack of ‘power of disposal’. However, the court disagreed with authors<sup>249</sup> according to whom beneficial ownership could be ascertained if a recipient does not transfer the totality of the received income to a non-resident party, namely arguing that this was even more so when the difference was a small percentage attributable to remuneration or compensation for forwarding the income.<sup>250</sup> This point of view has had some support amongst commentators.<sup>251</sup>

The court concluded its decision by comparing the situation of the Danish bank to a stepping-stone arrangement. Indeed, under the swap agreements, 100 percent of the distributed dividends, i.e. net of withholding tax, were to be passed on to the counterparties. Moreover, the passed-on dividends were deductible expenses for the bank. The FSC thus considers that beneficial ownership should not only be denied to agents, nominees and conduit companies but also when a transaction somewhat resembles a stepping-stone arrangement.<sup>252</sup> This argument has been criticised.<sup>253</sup>

### 5.3.2 Federal Administrative Court’s Case Law

The Federal Administrative Court (hereafter FAC) is the judicial authority to which decisions of the Swiss Federal Tax Authority in matters of withholding tax can be appealed.<sup>254</sup> The decisions of the FAC can, as previously mentioned, be appealed to the FSC. However, three judgments<sup>255</sup> on beneficial ownership were not appealed by the taxpayers, thus entering into force, and, as of today<sup>256</sup> another three Federal Administrative Court judgments<sup>257</sup> also relating to beneficial ownership are still pending appeal before the Federal Supreme Court. Since the landmark decision of 5 May 2015, in which its reasoning was reversed,<sup>258</sup> the FAC has thoroughly followed the FSC’s understanding of Baumgartner’s interdependence theory and

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<sup>249</sup> DANON, *Le concept de bénéficiaire effectif*, p. 46; BAUMGARTNER, *Das Konzept des beneficial owner*, p. 142 et seq.

<sup>250</sup> FSC Judgment of 5 May 2015, ATF 141 II 447, para. 5.2.4, unofficial translation by Walder Wyss AG.

<sup>251</sup> DE BROE/VON FRENCKELL, *La notion de « bénéficiaire effectif » et la question de l’abus de convention*, p. 273.

<sup>252</sup> WEIDMANN, *Swiss Swaps case*, p. 633.

<sup>253</sup> *Ibid.*, pp. 634-635.

<sup>254</sup> Art. 42 WHTA.

<sup>255</sup> FAC Judgment of 26 May 2016, A-1245/2011; FAC Judgment of 7 July 2016, A-1103/2011 and FAC Judgment of 31 August 2016, A-5692/2015.

<sup>256</sup> 31 December 2017.

<sup>257</sup> FAC decision of 20 December 2016, A-1426/2011; FAC decision of 31 January 2017, A-2122/2016 and FAC decision of 25 September 2017, A-3061/2015.

<sup>258</sup> See *supra* 5.3.1.2.

applied it to a series of cases involving financial instruments which were suspended in expectation of the *Total Return Swap* and *SMI Index Futures* decisions.

#### 5.4 Conclusion: Beneficial Ownership in Switzerland

Since the 2015 landmark *Total Return Swap* decision, Switzerland has followed a broad substance oriented approach of beneficial ownership. This case law has since been confirmed in several judgments.<sup>259</sup> These decisions assess beneficial ownership through economic control, focusing on the criterion of interdependence between the income and the obligation to transfer the income to a non-resident, whether this obligation is a legal one or simply observed from facts, i.e. circumstances. This conception of beneficial ownership does not incorporate a subjective element, such as the intention of the taxpayer or his motives in entering an arrangement, and is thus purely objective. Consequently, a distinction is made in the FSC's case law between beneficial ownership and the general prohibition of abuse, the latter including both an objective and subjective element.<sup>260</sup>

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<sup>259</sup> See, inter alia, FSC Judgment of 5 May 2015, 2C\_895/2012, FSC Judgment of 2 October 2015, 2C\_383/2013, FSC Judgment of 22 November 2015, 2C\_752/2014 and FSC Judgment of 5 April 2017, 2C\_964/2016.

<sup>260</sup> DANON/SALOMÉ, *The BEPS Multilateral Instrument*, p. 215, citing e.g. FAC Judgment of 26 August 2016, A-2902/2014, para. 4.3.3, partially confirmed by the FSC Judgment of 5 April 2017, 2C\_964/2016.

## 6 BENEFICIAL OWNERSHIP IN THE EUROPEAN UNION

Beneficial ownership was added as a criterion in two EU directives: the EU Interest and Royalties Directive and the now repealed Savings Directive.<sup>261</sup> Most authors argue for an autonomous EU law meaning of beneficial ownership in the Interest and Royalties Directive.<sup>262</sup> However, it has been argued that beneficial ownership as defined in the directive could help assess beneficial ownership in a treaty context.<sup>263</sup> Indeed, primary and secondary (such as directives) EU law qualify as international law and thus fall under the scope of article 31(3)(c) VCLT and could, therefore, be applied in treaty context unless the context requires otherwise.<sup>264</sup>

There are currently<sup>265</sup> seven Danish cases<sup>266</sup> on beneficial ownership pending before the European Court of Justice (hereafter ECJ). The numerous preliminary questions submitted to the ECJ include questions on whether beneficial ownership as provided for in the Interest and Royalty Directive should be interpreted according to the article 11 OECD MC and the OECD Commentary, and if yes which version (1977 or more recent).

### 6.1 Interest and Royalty Directive

This directive exempts royalties and interest payments of source taxes between parent companies in the EU, under the condition that the recipient is the ‘beneficial owner’ of the income.<sup>267</sup> Article 1(4) indicates that the company qualifies as the beneficial owner “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.” Article 1(5) provides for the treatment of a permanent establishment as the beneficial owner of interest or royalties, which is contingent on the permanent establishment being subject to tax on the income it claims beneficial ownership of. Beneficial ownership as understood in this directive is a term of EU law.<sup>268</sup>

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<sup>261</sup> Directive 2003/48/EC.

<sup>262</sup> MEINDL-RINGLER, *Beneficial Ownership*, p. 300.

<sup>263</sup> AVELLA, *Using EU Law To Interpret Undefined Tax Treaty Terms*, pp. 113-121.

<sup>264</sup> Art. 3(2) OECD MC.

<sup>265</sup> 31 December 2017.

<sup>266</sup> Case C-115/16, Case C-116/16, Case C-117/16, Case C-118/16, Case C-119/16, Case C-299/16 and Case C-682/16.

<sup>267</sup> Art. 1(1) Interest and Royalties Directive.

<sup>268</sup> MEINDL-RINGLER, *Beneficial Ownership*, p. 300.

## 6.2 Savings Directive

The Savings Directive has been repealed by a new directive<sup>269</sup> which covers many of the aspects previously dealt with by the Savings Directive, but no longer contains a definition of beneficial ownership.

## 6.3 Savings Agreement

In the context of the Bilateral Agreements II, Switzerland and the EU have ratified an agreement on the taxation of savings<sup>270</sup> (hereafter Savings Agreement), which entered into force on 1 July 2005. Following a Protocol adopted on 27 May 2015, the Agreement was renamed and almost completely amended,<sup>271</sup> to cover the automatic exchange of information according to the OECD standard and to continue the exemption of withholding taxes on dividend, interest and royalty cross-border payments between affiliated companies.<sup>272</sup>

In its previous versions, the Agreement implemented, inter alia, a retention<sup>273</sup> (i.e. withholding tax) on interest payments outbound from Switzerland to residents of a EU member state, provided that they qualified as ‘beneficial owners’. The term ‘beneficial owner’ was used in several provisions of the Agreement.<sup>274</sup> The Treaty was authenticated in 19 languages,<sup>275</sup> the French terminology that was employed matched the OECD’s (i.e. *bénéficiaire effectif*), the German and Italian versions also corresponded to the translations of the term ‘beneficial owner’ that have been used in double taxation conventions ratified by OECD member states.<sup>276</sup>

Under the previous version of the Agreement, the beneficial owner of the interest was the individual who received or secured an interest payment for his own benefit.<sup>277</sup> Pursuant to article 4(1) of the Agreement, the individual did not qualify as the beneficial owner if he acted as a paying agent,<sup>278</sup> or acted on behalf of a legal person, investment fund or similar body for common investments in securities,<sup>279</sup> or acted on behalf of another individual who was the

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<sup>269</sup> Directive 2014/107/EU amending Directive 2011/16/EU.

<sup>270</sup> RS 0.641.926.81.

<sup>271</sup> RO 2016 5003.

<sup>272</sup> BLUMENSTEIN/LOCHER, *System des schweizerischen Steuerrechts*, p. 240.

<sup>273</sup> Art. 1(1) Savings Agreement, version of 1<sup>st</sup> July 2013.

<sup>274</sup> Art. 1(1); art. 2(2); art. 2(4); art. 3(2); art. 4(1); art. 4(2); art. 9(1).

<sup>275</sup> Art. 22 Savings Agreement, version of 1<sup>st</sup> July 2013.

<sup>276</sup> *Nutzungsberechtigter* [de]; *beneficiario effettivo* [it].

<sup>277</sup> Art. 4 Savings Agreement, version of 1<sup>st</sup> July 2013.

<sup>278</sup> Art. 4(1)(a) Savings Agreement, version of 1<sup>st</sup> July 2013.

<sup>279</sup> Art. 4(1)(b) Savings Agreement, version of 1<sup>st</sup> July 2013.

beneficial owner and who disclosed their identity and state of residence to the paying agent.<sup>280</sup> The definition of ‘beneficial ownership’ was considered specific to the agreement and not necessarily applicable to the definition of the term as found in double taxation conventions.<sup>281</sup>

Moreover, article 15 of the Savings Agreement, which dealt with intercompany dividends, interest and royalties – thus granting Switzerland measures equivalent to those found in the EU directives – did not expressly require the parent company to be the beneficial owner of the outbound income. This provision did not stop more favourable provisions in double taxation conventions binding Switzerland and a EU member state from being applicable.<sup>282</sup>

Whether ‘beneficial ownership’, as understood in the Agreement, was to be applied to this provision was controversial. Based on teleological interpretation some commentators<sup>283</sup> supported that beneficial ownership was applicable to article 15 because the concept was suitable to prevent ‘directive shopping’. Others disagreed,<sup>284</sup> arguing that the wording of article 15 did not include the term ‘beneficial owner’ and that considering it to be implicit is contrary to article 31(1) VCLT, which provides for the interpretation of treaties in good faith.<sup>285</sup>

This issue remains of importance, as contrary to all the provisions that explicitly mentioned beneficial ownership, article 15 has not been repealed by the Protocol of 27 May 2015, but simply renumbered (article 9). Under the new treaty, entered into force 1<sup>st</sup> January 2017, Switzerland no longer proceeds to a treaty based retention on outbound interests. Article 9(3) of the amended agreement still provides that tax treaties between a EU member state and Switzerland are applicable if they are more favourable.

Although it can be argued that there is no room for an implicit ‘beneficial ownership’ condition in the treaty since the term no longer appears explicitly in other provisions of the amended agreement, it must be considered that the Savings Agreement implements EU law in Switzerland-EU relations. Consequently, it cannot be excluded that the European Court of Justice (hereafter ECJ) may find an implicit beneficial ownership condition in the revised Agreement. Although the decisions of the ECJ are not binding for Switzerland, Swiss courts

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<sup>280</sup> Art. 4(1)(c) Savings Agreement, version of 1 July 2013.

<sup>281</sup> OBERSON/HULL, *Switzerland in International Tax Law*, p. 302.

<sup>282</sup> Art. 15(3) Savings Agreement, version of 1 July 2013.

<sup>283</sup> DANON/GLAUSER, *Article 15 of the Swiss-EU Savings Agreement*, p. 516.

<sup>284</sup> BAUMGARTNER, *Das Konzept des beneficial owner*, pp. 283-284.

<sup>285</sup> See *supra* 3.1.1.

must take into consideration the ECJ's case law on matters relating to the Savings Agreement.<sup>286</sup>

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<sup>286</sup> OBERSON, droit fiscal international, p. 31.

## 7 BENEFICIAL OWNERSHIP IN SELECTED JURISDICTIONS

Canada, the United Kingdom, Spain, France and Italy have all had landmark cases relating to beneficial ownership. These jurisdictions are all OECD members, yet they have interpreted and construed the concept in various ways with different outcomes.

### 7.1 Canada

In 2007, the Canadian Federal Court of Appeal ruled<sup>287</sup> that a domestic general anti-avoidance rule was inapplicable to a treaty shopping case.<sup>288</sup> The court also denied the existence of an inherent anti-abuse principle.<sup>289</sup> The loss of this case prompted the Canadian tax authorities to change their strategy and challenge treaty shopping arrangements involving passive income by considering that the recipient of the payment was not the beneficial owner.<sup>290</sup> This strategy was first employed in the *Prévost* case.

#### 7.1.1 The Prévost Case

This case<sup>291</sup> was of major importance internationally as it was the first common law decision to directly address beneficial ownership in a tax treaty context. Indeed, the previous *Indofood* decision in the United Kingdom was not an actual tax treaty case but a contract case in which tax law had implications.<sup>292</sup>

##### 7.1.1.1 Facts

The issue, in this case, was whether Prévost Holding BV (hereafter PHBV), a holding company resident of the Netherlands was the beneficial owner of dividends paid by its wholly owned subsidiary Prévost Car Inc., incorporated in Quebec, Canada. The Minister of National Revenue (hereafter Minister) argued that the shareholders of PHBV, Volvo (a resident of Sweden) and Henlys (a resident of the United Kingdom), were the beneficial owners of the dividends, i.e. that PHBV was not the beneficial owner of the dividends, which meant that article 10(2) of the Canada-Netherlands tax treaty was not applicable.

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<sup>287</sup> *MIL (Investments) SA v. The Queen*.

<sup>288</sup> ARNOLD, *Beneficial Ownership*, p. 39.

<sup>289</sup> DANON, *La réserve non écrite de l'abus*, m.no. 148.

<sup>290</sup> *Ibid.*, pp. 39-40.

<sup>291</sup> *Prévost Car Inc. v. The Queen*, 2008 T.C.C. 231.

<sup>292</sup> See *infra* section 7.2.



The identity of the beneficial owner was critical: Canadian domestic law<sup>293</sup> provided that companies distributing dividends overseas were required to withhold and remit 25 percent of the amounts paid.<sup>294</sup> The reduced tax rates in the Canadian tax treaties with Sweden and the United Kingdom, applicable if the shareholders were considered beneficial owners,<sup>295</sup> were, respectively, 15 and 10 percent. However, under article 10(2) of the Canada-Netherlands double taxation convention, the withholding tax rate was set at 5 percent, a substantial difference, which probably explains why PHBV was incorporated in the Netherlands by its shareholders (the appellants claimed that the Netherlands was chosen as a compromise between Sweden and the United Kingdom, and that tax considerations were present but secondary).<sup>296</sup>

Both shareholders of PHBV had signed a shareholders' agreement, which provided, amongst other things, that at least 80 percent of the profits of Prévost, PHBV and any possible subsidiaries were to be distributed to the shareholders.<sup>297</sup> The distribution of profits was subject to the structure having sufficient financial resources to operate unless the shareholders agreed otherwise.<sup>298</sup> PHBV was not a party to this agreement.<sup>299</sup>

Furthermore, PHBV had no employees, its only assets were the shares of Prévost Car, and its office in the Netherlands was in the office of a management company affiliated with the holding company's bank;<sup>300</sup> in other words, PHBV had no substance.

#### 7.1.1.2 Court's Decision

The Tax Court began by comparing the Canada-Netherlands tax treaty to the OECD Model and essentially observed that article 10 of the treaty was almost identical to the wording of the 1997 version of the OECD Model.<sup>301</sup> The various translations of beneficial ownership found in the French versions of Canadian domestic legislation were also mentioned but not relevant as '*bénéficiaire effectif*' was used in the concerned tax treaties.<sup>302</sup>

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<sup>293</sup> Subsection 215(1) of the Canadian Income Tax Act.

<sup>294</sup> *Prévost Car Inc. v. The Queen*, para. 2.

<sup>295</sup> ARNOLD, *Beneficial Ownership*, p. 40.

<sup>296</sup> *Prévost Car Inc. v. The Queen*, para. 9.

<sup>297</sup> *Ibid.*, para. 12.

<sup>298</sup> *Ibid.*

<sup>299</sup> ARNOLD, *Beneficial Ownership*, p. 41.

<sup>300</sup> *Ibid.*

<sup>301</sup> *Prévost Car Inc. v. The Queen*, para. 29.

<sup>302</sup> *Prévost Car Inc. v. The Queen*, para. 30 and 62; see *supra* 4.5.

A definition of ‘beneficial owner’ was given by the judge:

[...] *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 enjoy and assumes all the attribute of ownership [emphasis added].* 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 [...].<sup>303</sup>

However, the court also found that certain conduit companies were barred from beneficial ownership. Indeed, the decision mentions that a holding company is the beneficial owner of dividends paid to it unless there is strong evidence of tax avoidance or treaty abuse.<sup>304</sup> The court also held that:

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. When corporate entities are concerned, *one does not pierce the corporate veil unless the corporation is a conduit for another person and has absolutely no discretion as to the use or application of 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.*<sup>305</sup>

Consequently, the court ruled in favour of the taxpayer, deciding that PHBV was the beneficial owner of the dividends paid by Prévost Car Inc.,<sup>306</sup> as it owned the Prévost shares and there was no evidence that PHBV acted as a conduit,<sup>307</sup> an agent or a nominee for Volvo and Henlys.<sup>308</sup>

The Minister appealed the Tax Court’s decision, arguing that ‘beneficial owner’ should “mean the person who can, in fact, *ultimately benefit from the dividend* [emphasis added]”.<sup>309</sup> The decision was upheld<sup>310</sup> by the Federal Court of Appeal because no support for the Minister’s argument could be found in OECD documentation (the 1997 and 2003 OECD Commentaries on article 10 and the Conduit Companies Report of 1987).<sup>311</sup>

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<sup>303</sup> *Prévost Car Inc. v. The Queen*, para. 100.

<sup>304</sup> *Ibid.*, para. 57.

<sup>305</sup> *Ibid.*, para. 100.

<sup>306</sup> *Ibid.*, para. 110.

<sup>307</sup> *Ibid.*, para. 102.

<sup>308</sup> *Ibid.*, para. 100.

<sup>309</sup> ARNOLD, *Beneficial Ownership*, p. 42.

<sup>310</sup> *Prévost Car Inc. v. The Queen*, 2009, FCA 57 2 F.C.R. 65.

<sup>311</sup> MEINDL-RINGLER, *Beneficial Ownership*, p. 228.

### 7.1.1.3 Critical remarks

The outcome and reasoning of the court in the *Prévost* case have been subject to much debate. The court deviated from the *Indofood* case and preferred a legal rather than economic approach in interpreting the term ‘beneficial owner’.<sup>312</sup> Indeed, as the shareholders’ agreement did not bind the Dutch holding company, which meant that there was no predetermined or automated cash flow, the court did not consider PHBV to be a conduit company.<sup>313</sup> Only legal circumstances were considered to assess beneficial ownership.

Although the Dutch holding company lacked substance, the court correctly asserted that beneficial ownership was not dependent on substance requirements.<sup>314</sup> Furthermore, the court held that “an intermediary holding company should as a matter of principle, be regarded as the beneficial owner of the income it receives.”<sup>315</sup> This consideration is essential as not all holding companies are illegitimate nor are they systematically conduit companies.

However, the court did somewhat insist on the attributes of ownership,<sup>316</sup> an understanding of beneficial ownership which is not exactly that of the OECD material. Some commentators argue that beneficial ownership was perceived as an attribution-of-income rule by the court.<sup>317</sup> The Court, in accordance with previous Canadian case law,<sup>318</sup> and unlike other jurisdictions,<sup>319</sup> did not consider the application of a GAAR.<sup>320</sup>

Despite the Canadian Supreme Court having previously held<sup>321</sup> that the ‘beneficial owner’ was the person who could ‘ultimately’ exercise the rights of ownership in the property, the court did not strip away the corporate veil, i.e. consider the shareholders of a company to be the beneficial owners of corporate assets.<sup>322</sup> This is important as beneficial ownership should not be assimilated to ‘ultimate’ ownership.<sup>323</sup>

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<sup>312</sup> DE BROE/VON FRENCKELL, La notion de « bénéficiaire effectif » et la question de l’abus de convention, p. 279; MEINDL-RINGLER, Beneficial Ownership, p. 228.

<sup>313</sup> KEMMEREN, Klaus Vogel on Double Taxation Conventions, Preface to Articles 10 to 12, m.no. 55.

<sup>314</sup> DANON, Source versus Residence, p. 105.

<sup>315</sup> Ibid.

<sup>316</sup> *Prévost Car Inc. v. The Queen*, para. 105.

<sup>317</sup> MARTÍN JIMÉNEZ, Beneficial Ownership, p. 48.

<sup>318</sup> *MIL (Investments) SA v. The Queen*.

<sup>319</sup> see e.g. *infra* 7.4.1.

<sup>320</sup> DANON/STORCKMEIJER, Le concept de bénéficiaire effectif et les structures de relais directs, p. 111.

<sup>321</sup> *Covert v. Nova Scotia (Minister of Finance)*.

<sup>322</sup> *Prévost Car Inc. v. The Queen*, para. 100.

<sup>323</sup> See *supra* 4.1.

Commentators do not agree on whether the *Prévost* case is an example of giving beneficial ownership an international meaning based on the context of the treaty or a domestic meaning; the court did not clearly address the question.<sup>324</sup> Indeed, the judge mentioned that article 3(2) of the tax treaty required him “to look to a domestic solution in interpreting beneficial owner” but further stated that the OECD Commentary of 1977 on article 10(2) was also relevant.<sup>325</sup> Kemmeren argues that the extensive reference by the judge to OECD documentation, which based the decision, despite Canadian and Dutch law also being referred to, shows that the court gave beneficial ownership an international meaning.<sup>326</sup> However, Arnold argues that article 3(2) of the Netherlands-Canada double taxation convention led the court to consider the meaning of beneficial ownership under Canadian laws, and that even though article 10 OECD MC, Dutch law, and the *Indofood* case were also considered, the “decision was fundamentally based on the meaning under Canadian law.”<sup>327</sup> This author considers the application of domestic law unsurprising as Canadian courts are more familiar with it.<sup>328</sup> Some authors consider that the court seems to have been strongly influenced by the Dutch perspective, according to experts, that PHBV was the beneficial owner of the dividends.<sup>329</sup> Finally, the Federal Court of Appeal in its decision upholding the Tax Court’s judgment considers that the OECD material was the basis for the lower courts findings.

The *Prévost* case is undoubtedly amongst the most important decisions on beneficial ownership. In my opinion this is imputable to two reasons: the case was the first<sup>330</sup> common law judgment to address the meaning of beneficial ownership and it was also the first major decision to rely on international tax expert witnesses.<sup>331</sup>

Policy-wise, the *Prévost* case is unusual. In 1993, before the decision, the Canada-Netherlands tax treaty was amended, reducing the source taxation on dividends from 10 to 5 percent. Arnold argues that the Canadian authorities had to be aware that the lowered rate, compared to other European countries, provided by the treaty would encourage investors to use Dutch holding companies for investments in Canadian companies.<sup>332</sup> Despite all this, no limitation-of-benefits

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<sup>324</sup> MEINDL-RINGLER, *Beneficial Ownership*, p. 228.

<sup>325</sup> *Prévost Car Inc. v. The Queen*, para. 95.

<sup>326</sup> KEMMEREN, Klaus Vogel on Double Taxation Conventions, Preface to Articles 10 to 12, m.no. 56.

<sup>327</sup> ARNOLD, *Beneficial Ownership*, p. 42.

<sup>328</sup> *Ibid.*

<sup>329</sup> DE BROE/VON FRENCKELL, La notion de « bénéficiaire effectif » et la question de l’abus de convention, p. 279.

<sup>330</sup> See *supra* 7.1.1 and *infra* 7.2.

<sup>331</sup> *Prévost Car Inc. v. The Queen*, para. 41-59.

<sup>332</sup> ARNOLD, *Beneficial Ownership*, p. 43.

rule or anti-treaty shopping provision was included in the amended treaty. The author concludes that the result of the *Prévost* case is thus coherent from a policy point of view.<sup>333</sup> Furthermore, Canada, unlike other countries,<sup>334</sup> did not amend the concerned treaty after the decision. Moreover, the tax treaty between Sweden (where Volvo was resident) and Canada was amended in 2003,<sup>335</sup> after the *Prévost* decision, and the source tax levied on dividends reduced from 10 to 5 percent, which demonstrates that the Canadian government chose this treaty policy in full awareness of the applicable case law.

There is a consensus that Canadian case law sets a very low threshold for beneficial ownership in tax treaty practice.<sup>336</sup> Indeed, only agents, nominees and conduit companies are denied beneficial ownership. Moreover, holding companies are only considered conduits if they have “absolutely no discretion as to the use of the received funds.”<sup>337</sup>

The *Prévost* precedent was confirmed in the *Velcro* case,<sup>338</sup> in which the tax authorities chose not to appeal the decision.<sup>339</sup>

## 7.2 United Kingdom: The Indofood Case

This decision<sup>340</sup> of the English Court of Appeal initiated a new phase in the discussion of the meaning of beneficial ownership.<sup>341</sup> Indeed, the case was the first judgment on beneficial ownership, as understood in tax treaties, in the United Kingdom. Although the court analysed, inter alia, the OECD Commentary, the case was not a tax dispute but commercial litigation.

It must be noted that the *Indofood* case is quite extraordinary. Firstly, the issue was a civil law matter,<sup>342</sup> Indonesia being a civil law jurisdiction; secondly, the judges and counsel had no expertise in tax law and finally the issue at stake before the English court was the treatment of

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<sup>333</sup> Ibid.

<sup>334</sup> e.g. Switzerland amended treaties in which exemptions were provided for portfolio dividends (back to a 15 percent tax rate).

<sup>335</sup> ARNOLD, *Beneficial Ownership*, p. 43.

<sup>336</sup> KEMMEREN, *Klaus Vogel on Double Taxation Conventions*, Preface to Articles 10 to 12, m.no. 56; ARNOLD, *Beneficial Ownership*, p. 49.

<sup>337</sup> ARNOLD, *Beneficial Ownership*, p. 42, see also p. 49.

<sup>338</sup> *Velcro Canada Inc. v. The Queen*.

<sup>339</sup> KEMMEREN, *Klaus Vogel on Double Taxation Conventions*, Preface to Articles 10 to 12, m.no. 57.

<sup>340</sup> *Indofood International Finance Ltd. v. JP Morgan Chase Bank NA, London Branch*, [2006] EWCA Civ 158, 8 ITLR 653 et seq. (2 March 2006) (hereafter *Indofood*).

<sup>341</sup> BAKER, *Indofood*, p. 27.

<sup>342</sup> Ibid.

a subsidiary under Indonesian law. Moreover, under English law, foreign law is a matter of fact and not law, and thus has a probative nature.<sup>343</sup>

### 7.2.1 Facts

Indofood, an Indonesian company, wanted to raise a sizeable loan which would be syndicated amongst lenders in the United Kingdom. Indonesian domestic law provided for a 20 percent withholding tax at the time, however, this tax was reduced to 10 percent under the Indonesia-Mauritius tax treaty of 1996. Indofood incorporated a wholly-owned subsidiary in Mauritius. This subsidiary had the sole purpose of granting a loan to its parent company, Indofood. The Mauritian entity then borrowed money from lenders and in turn lent the borrowed amounts to Indofood. The net interest rates<sup>344</sup> on the loans and the borrowed amounts were identical between both entities and the British lenders.

According to the Court of Appeal, the loan documentation prevented the Mauritian subsidiary from doing anything with the interest it received from Indofood. Moreover, evidence submitted to the court indicated that the subsidiary was ignored for income flows; the payments went directly from Indofood to the trustee and collecting agent of the lenders, JP Morgan.

Indonesia terminated its double taxation convention with Mauritius, effective 1<sup>st</sup> January 2005. As a result, the applicable withholding tax rate to the interest payments from Indofood to its Mauritian subsidiary would revert to 20 percent.<sup>345</sup> At this time, market conditions were advantageous for Indofood to terminate the loan agreement, to take a new loan with lower interest.<sup>346</sup>

The loan agreement stipulated that Indofood could end the agreement (i.e. repay the loan early) if disadvantageous changes to the Indonesian or Mauritian tax laws occurred unless ‘such an obligation’ (i.e. additional taxes) could be avoided by taking ‘reasonable measures’.<sup>347</sup> Indofood, keen to reimburse its loan early argued that there were no possible reasonable measures. Conversely, JP Morgan, acting as trustee for the syndicated lenders, believed that a reasonable alternative arrangement was possible in the form of the incorporation of a Dutch

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<sup>343</sup> MEINDL-RINGLER, *Beneficial Ownership*, p. 114, footnote 488.

<sup>344</sup> A gross-up was provided by the parent company to account for the 10 percent withholding tax.

<sup>345</sup> *Indofood*, para. 3.

<sup>346</sup> *Ibid.*

<sup>347</sup> *Ibid.*, para. 2.

subsidiary by Indofood, which could obtain treaty benefits under the Netherlands-Indonesia double taxation convention.

The parties had agreed to submit disputes to English courts. The presented issue was whether the interposition of a subsidiary in the Netherlands, taking the role of the Mauritian subsidiary, would be entitled to treaty benefits under the applicable tax treaty. The question was specifically whether the Netherland resident subsidiary would be the beneficial owner of the received interest.

### 7.2.2 Court's Decision

The High Court Chancery Division found that Newco, the envisaged Netherlands subsidiary, would qualify as the beneficial owner of the interest. This decision was appealed and reversed by the Court of Appeal. The parties did not appeal the judgment before the House of Lords.

The Court of Appeal found that “the term “beneficial owner” is to be given an international fiscal meaning not derived from the domestic laws of contracting states.”<sup>348</sup> The court reached this conclusion by referring to the Conduit Companies Report, the OECD Commentary, a Commentary by Philip Baker and guidance provided by Indonesian tax authorities. The judge further held that “the concept of beneficial ownership is incompatible with that of the formal owner who does not have “*the full privilege to directly benefit from the income*” and added that the emphasised quote was found in a circular letter of the Indonesian tax authorities.<sup>349</sup> Baker has commented that it is not entirely clear what the quote from the circular means, but argues that “there is a clear emphasis on the beneficial owner having rights to enjoy the benefit of the income.”<sup>350</sup>

The court then considered the facts of the case and concluded that the proposed Dutch subsidiary would not be the beneficial owner of the interest. Indeed, the parent company had taken the habit of bypassing its Mauritian subsidiary and paid its interest directly to the lenders. Moreover, Indofood had given a payment guarantee to the lenders.<sup>351</sup> Furthermore, the subsidiary would have been obligated to make interest payments on precise days; Newco would have been bound to pay what it received from its parent company, to the principal paying agent

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<sup>348</sup> Ibid., para. 42.

<sup>349</sup> Ibid.

<sup>350</sup> BAKER, Indofood, p. 32.

<sup>351</sup> Indofood, para. 9.

(JP Morgan). As such Newco did not directly benefit from the income.<sup>352</sup> The Court of Appeal added that “the meaning to be given to the phrase ‘beneficial owner’ is plainly not to be limited by so technical and legal approach. Regard is to be had to the substance of the matter.”<sup>353</sup>

Furthermore, the fact that the Indonesian tax authorities had never contested that the Mauritian subsidiary was the beneficial owner of the interest was not decisive as it did not necessarily follow that an Indonesian tax court would have reached the same conclusion.<sup>354</sup>

### 7.2.3 Critical Remarks

The judgment clearly states that the term ‘beneficial owner’ has an international fiscal meaning and not one found in the domestic law of states bound by the double taxation convention. Baker argues that this shows that the judgment is relevant to situations beyond Indonesian law. This author does, however, concede that the decision concluded more specifically that under Indonesian law beneficial ownership would have an international fiscal meaning.<sup>355</sup> Moreover, countries with a definition of beneficial ownership in their legislation could interpret article 3(2) OECD MC as the basis for a domestic law meaning of beneficial ownership. Nonetheless, most commentators agree that the court did in fact give beneficial ownership an international fiscal meaning.<sup>356</sup>

The Court of Appeal decided that beneficial ownership had an international fiscal meaning, but it did not address the question of how the meaning of the term should be found. A hint is however given, as the court resorted to OECD material and publications by commentators, as well as Indonesian tax documentation, although the latter merely confirmed the former.<sup>357</sup>

The judgment has been criticised because of the importance the court placed on the obligation to forward interest payments.<sup>358</sup> Moreover, that the subsidiary is required “to have full privilege

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<sup>352</sup> MEINDL-RINGLER, *Beneficial Ownership*, p. 115.

<sup>353</sup> *Indofood*, para. 44.

<sup>354</sup> *Ibid.*, para. 72.

<sup>355</sup> BAKER, *Indofood*, p. 31.

<sup>356</sup> BAKER, *Indofood*, p. 27; MEINDL-RINGLER, *Beneficial Ownership*, p. 111 et seq.; DANON, *Source versus Residence*, p. 101.

<sup>357</sup> *Indofood*, para. 42.

<sup>358</sup> MEINDL-RINGLER, *Beneficial Ownership*, p. 115.



to directly benefit from the income” is controversial. Indeed, establishing when one has full privilege of an income proves difficult.<sup>359</sup>

De Broe and von Frenckell regret that the court used OECD material which was posterior to the Netherlands-Indonesia tax treaty, arguing in favour of a static interpretation of the OECD Commentary.<sup>360</sup> They also argue that the structure, both pre-existent and envisaged by the lenders, was fictitious as the taxpayers themselves did not respect the consequences of the arrangement, i.e. the Mauritius subsidiary was bypassed for the sake of interest payments. According to both commentators, such fictitious arrangements should not entitle to treaty benefits;<sup>361</sup> it follows that, under this conception, the Court of Appeal should not have even considered the application of a double taxation convention.

When considering the *Indofood* case, the realisation that the facts at stake were atypical is essential. It is arguable that the Court of Appeal would have held different conclusions had the situation been different. The sole function of the subsidiary was to receive and pay interest; according to the court there was nothing it could do with the interest but forward it. Moreover, the subsidiary had no way of raising funds, to pay the interest, other than the ones it received from its parent. Baker has argued that had the facts been less extreme the Court of Appeal might have concluded otherwise than it did.<sup>362</sup>

### 7.3 Spain: The Real Madrid Cases

As most civil law jurisdictions, Spain does not have a statutory definition of beneficial ownership.<sup>363</sup> Spanish courts have followed other jurisdictions and considered beneficial ownership to be a broad anti-abuse rule.<sup>364</sup>

#### 7.3.1 Facts

The *Real Madrid* cases<sup>365</sup> refer to several judgments in which the *Audiencia Nacional* (hereafter AN) had to deal with structures used by a Spanish football club. The structures involved

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<sup>359</sup> Ibid., and commentators mentioned therein.

<sup>360</sup> DE BROE/VON FRENCKELL, La notion de « bénéficiaire effectif » et la question de l’abus de convention, p. 278.

<sup>361</sup> Ibid.

<sup>362</sup> BAKER, *Indofood*, p. 32.

<sup>363</sup> MARTÍN JIMÉNEZ, *Beneficial Ownership*, p. 36.

<sup>364</sup> Ibid., p. 40.

<sup>365</sup> AN Judgments of 18 July 2006, JUR/2006/204307, JUR/2007/8915 and JUR/2007/16549; AN Judgment of 10 November 2006, JUR/2006/284679; AN Judgment of 13 November 2006, JUR/2006/284618; AN Judgment of 20 July 2006, JUR/2007/16526 and AN Judgment of 26 March 2007, JUR/2007/101877.

Hungarian companies and the payment of royalties for image rights on some of the club's players. The Hungarian companies, recipients of the royalties, would then proceed to transfer the received income to companies in the Netherlands and Cyprus.<sup>366</sup>

More precisely, a Hungarian company would only keep between 2 and 0.5 percent of the paid royalties, and would almost immediately, within a day after reception of the payments, transfer the rest of the income. Furthermore, there were no invoices between the Hungarian companies and the Dutch and Cypriot companies, yet the payments were still executed. Finally, the contracts between the Hungarian company, the club and the companies resident of the Netherlands and Cyprus were not dated coherently, nor did the amounts stated in the contracts systematically match those that were paid.<sup>367</sup>

The Hungarian resident companies were key to the structure; the double taxation convention between Spain and Hungary was one of only two Spanish tax treaties which provided for a full exemption of royalties in the state of source.<sup>368</sup>

The issue at stake was whether the Hungarian company receiving royalties, which it then forwarded, could be considered to be the 'beneficial owner' of said royalties under article 12 of the Hungary-Spain double taxation convention of 1984.

### 7.3.2 Court's Decision

In its judgments the AN held that the main purpose of the concept of 'beneficial owner' is to prevent treaty shopping.<sup>369</sup> Furthermore, the court considers beneficial ownership to be a clause providing for a large anti-treaty shopping effect. The meaning and consequence of beneficial ownership were deemed to correspond to a Spanish domestic statutory general anti-abuse clause.<sup>370</sup> Consequently, the court concluded that the beneficial ownership requirement allowed the source state to ignore article 12 (royalties) of the Hungary-Spain tax treaty of 1984 in a situation where avoidance was present, without a domestic law procedure being necessary.<sup>371</sup>

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<sup>366</sup> MARTÍN JIMÉNEZ, *Beneficial Ownership: Decisions by Spanish Courts*, p. 128.

<sup>367</sup> *Ibid.*, p. 129.

<sup>368</sup> MARTÍN JIMÉNEZ, *Beneficial Ownership*, p. 38.

<sup>369</sup> MARTÍN JIMÉNEZ, *Beneficial Ownership: Decisions by Spanish Courts*, p. 130.

<sup>370</sup> At the time of the cases, art. 24 of the *Ley General Tributaria* of 1963.

<sup>371</sup> MARTÍN JIMÉNEZ, *Beneficial Ownership: Decisions by Spanish Courts*, p. 130.

The AN further considered that the term ‘beneficial owner’ has an international autonomous meaning. The court excluded that beneficial ownership could have a domestic law meaning by using article 3(2) OECD MC, which provides for such an exception when ‘the context otherwise requires’.<sup>372</sup> Martín Jiménez argues that the court held that ‘beneficial ownership’ has an international autonomous meaning by mistake. Indeed, the AN followed the evolution of the concept in the OECD Model, the Commentaries and the Conduit Companies Report. However, in doing so, the court considered that the 2003 modifications of articles 10, 11, and 12 OECD MC and Commentary confirmed “the clear goal of the concept of beneficial ownership, i.e., its function as a wide anti-treaty shopping device aimed at tackling any form of treaty shopping.”<sup>373</sup> Martín Jiménez, although disagreeing with this understanding of beneficial ownership, does not contest the result of the decisions.<sup>374</sup> Kemmeren has argued that the AN was not mistaken<sup>375</sup> as the OECD 2012 Discussion Draft suggest that beneficial ownership was introduced to prevent some forms of tax avoidance that the term ‘recipient’ could not prevent.<sup>376</sup>

In essence, the court held that after the 2003 amendments, an economic interpretation is sufficient to determine the ‘real owner’ of an income;<sup>377</sup> the AN thus disregarded legal ownership of the asset generating the income and focused on the relation between the recipient (i.e. the Hungarian companies) and the income. Martín Jiménez considers that the court goes so far as to assimilate ‘beneficial ownership’ to a ‘business purpose test’.<sup>378</sup> Under this conception beneficial ownership requires a business rationale for having an entity between the payer of the income and the final recipient; the goal of reducing withholding taxes is not considered a business rationale.<sup>379</sup>

The court did not analyse the legal power of the Hungarian conduits on the received income. It was simply assumed that the immediate transfer of the amounts to the Dutch and Cypriot companies showed that there was no control on the income.<sup>380</sup>

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<sup>372</sup> Ibid.

<sup>373</sup> Ibid.

<sup>374</sup> Ibid., p. 136.

<sup>375</sup> KEMMEREN, Klaus Vogel on Double Taxation Conventions, Preface to Articles 10 to 12, m.no. 107.

<sup>376</sup> Ibid., m.no. 21; see also *supra* 2.3 et seq.

<sup>377</sup> MARTÍN JIMÉNEZ, Beneficial Ownership: Decisions by Spanish Courts, p. 130.

<sup>378</sup> Ibid., pp. 130-131.

<sup>379</sup> Ibid., p. 131.

<sup>380</sup> Ibid.

### 7.3.3 Critical Remarks

There is no doubt that the Hungarian entities were conduit companies, and as such the outcome of the *Real Madrid* cases is not problematic. However, the reasoning of the court and the arguments of the tax authorities are not correct. Numerous tax authorities have used beneficial ownership as a way of countering treaty abuse when GAARs were not applicable (e.g. in the *Prévost* case); this was not necessary in the present cases. Indeed, the authorities and the court could have considered the Hungarian conduits to be nominees or agents, which would have sufficed to deny treaty benefits.<sup>381</sup> Spanish courts seem to have followed other jurisdictions in considering beneficial ownership to be a broad anti-avoidance rule.

Furthermore, the court based its reasoning on OECD publications, or rather their modifications, which were posterior to the Spain-Hungary double taxation convention of 1984 (i.e. the 2003 OECD Commentary and the Conduit Companies Report of 1987).<sup>382</sup> The fact that the AN did not explain why this documentation was relevant to the case, although this position has been defended by commentators, is arguably regrettable.

### 7.3.4 Other Spanish Case Law

In more recent cases, Spanish courts refused to apply the Parent-Subsidiary Directive to a Dutch holding company, arguing that it lacked a valid economic reason (although it had substance), but considered the Spain-Netherlands double taxation convention to be applicable to dividends paid by the Spanish subsidiary.<sup>383</sup> These decisions did not address beneficial ownership, as the treaty in question did not contain such a clause. It follows that Spanish courts do not consider beneficial ownership to be implicit to tax treaties. Arguing that the court would not have applied the treaty if it had not considered that the income was attributable to the holding company, Martín Jiménez notes that this is an occurrence of beneficial ownership being interpreted more narrowly than a domestic anti-abuse rule.<sup>384</sup>

## 7.4 France

Two landmark decisions regarding beneficial ownership were issued by France's supreme administrative court, the Conseil d'État: the *Diebold Courtage* case and the *Bank of Scotland*

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<sup>381</sup> Ibid., p. 136.

<sup>382</sup> Ibid., p. 131.

<sup>383</sup> MARTÍN JIMÉNEZ, Beneficial Ownership, footnote 19, p. 40.

<sup>384</sup> Ibid.

case. Although undefined, the concept of beneficial ownership appears in French tax treaties as well as in some domestic provisions on international taxation.<sup>385</sup>

#### 7.4.1 The Diebold Case

The *Diebold* case<sup>386</sup> was the first important French decision on beneficial ownership.<sup>387</sup> Although its importance has since been limited, it was among the first decisions to recognise the implicit nature of beneficial ownership.

##### 7.4.1.1 Facts

Diebold Courtage SA (hereafter Diebold) was a French company active in computer equipment rental. To operate its business, Diebold bought equipment and simultaneously sold it to Equilease CV, a Dutch partnership. In turn, Equilease CV rented the equipment to Diebold, which then sub-rented it to its French clients and paid rent to Equilease CV.<sup>388</sup> The Dutch company had entered into a service contract with a related Swiss company. The contract caused approximately 68 percent of the royalties, paid by Diebold to Equilease, to be transferred to the Swiss company.<sup>389</sup>

The double taxation convention of 1973 between the Netherlands and France provided for an exemption on royalties in the state of source, whereas French law provided for a 33.33 percent withholding tax on royalties paid to non-residents. The treaty, as it was ratified before 1977, did not include a beneficial ownership test.<sup>390</sup>

The tax authorities argued that the treaty had to be put aside for two reasons: first, Equilease CV could not be regarded as a resident of the Netherlands under the treaty because it was a transparent entity (partnership) according to Dutch law and thus not subject to tax.<sup>391</sup> Subsidiarily, the authorities claimed that the Swiss company was, in fact, the beneficial owner of the royalties.<sup>392</sup>

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<sup>385</sup> GOUTHÈRE, *Beneficial Ownership*, p. 218.

<sup>386</sup> Conseil d'État, 13 October 1999, case no. 191191, *Ministre de l'Économie, des Finances et de l'Industrie v. SA Diebold Courtage*.

<sup>387</sup> GUTMANN, *Beneficial Ownership without Specific Provision*, p. 161.

<sup>388</sup> *Ibid.*, pp. 161-162.

<sup>389</sup> *Ibid.*, p. 162.

<sup>390</sup> *Ibid.*

<sup>391</sup> GOUTHÈRE, *Beneficial Ownership*, p. 219.

<sup>392</sup> GUTMANN, *Beneficial Ownership without Specific Provision*, p. 162.

The issue the Conseil d'État had to rule on was whether the France-Netherlands tax treaty could be ignored (and thus a 33.33 percent tax levied on the royalty payments), on the basis that Equilease was not the beneficial owner of the royalties, even though no provision in the treaty mentioned beneficial ownership.<sup>393</sup>

#### 7.4.1.2 Court's Decision

The court agreed with the tax authorities that a double taxation convention is not applicable if the recipient of the royalty payment is not the beneficial owner thereof, regardless of the treaty not mentioning such a requirement.<sup>394</sup>

However, the Conseil d'État ruled in favour of the taxpayer because the tax authorities failed to demonstrate that the amounts transferred to the Swiss company (approximately 68% of the royalties) were excessive in consideration of the services provided. The transactions being at arm's length, the payments were insufficient in proving that the Swiss company was the beneficial owner of the royalties.<sup>395</sup> The tax authorities also lost on the main issue, as the partners of the CV were Dutch residents, and as such eligible to treaty benefits.<sup>396</sup>

#### 7.4.1.3 Critical Remarks

The arm's length criterion does not seem relevant in interpreting beneficial ownership.<sup>397</sup> Indeed, although services may be rendered in relation to royalties and interest, albeit rarely, the situation is not conceivable with dividends.

Unlike other decisions (e.g. *Indofood*<sup>398</sup> and *Prévost*<sup>399</sup>), the *Diebold* case does not address the definition of beneficial ownership.<sup>400</sup> Furthermore, the case is criticisable insofar as the court seems to have, before the OECD, considered that beneficial ownership only clarifies 'paid to'.<sup>401</sup>

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<sup>393</sup> Ibid.

<sup>394</sup> Ibid.

<sup>395</sup> Ibid.

<sup>396</sup> GOUTHÈRE, *Beneficial Ownership*, p. 219.

<sup>397</sup> KEMMEREN, Klaus Vogel on Double Taxation Conventions, Preface to Articles 10 to 12, m.no. 76.

<sup>398</sup> See *supra* 7.2.

<sup>399</sup> See *supra* 7.1.1.

<sup>400</sup> MEINDL-RINGLER, *Beneficial Ownership*, p. 232.

<sup>401</sup> KEMMEREN, Klaus Vogel on Double Taxation Conventions, Preface to Articles 10 to 12, m.no. 17.

Although the court considered that beneficial ownership was a general condition of application of tax treaties, even when not explicitly provided for, the actual impact of the *Diebold* case was later somewhat diminished. Indeed, the Conseil d'État gave an opinion to the French government, wherein it confirmed the applicability of the beneficial ownership test whenever France is the state of source, regardless of there being no reference to beneficial ownership in the treaty.<sup>402</sup> However, the court specified that the *Diebold* doctrine only applied to situations where the concerned treaty was ratified before the introduction of beneficial ownership the OECD Model.<sup>403</sup>

In situations involving a treaty signed after 1977, but not containing a beneficial ownership provision, the *Diebold* case law is not relevant, and the concept not considered implicit to the treaty. The Conseil d'État has based this position on treaty interpretation, namely articles 31 and 32 VCLT;<sup>404</sup> if a treaty is signed after 1977 but contains no beneficial ownership provision, it cannot be argued in good faith that the contracting states wanted such a rule, nor is it compatible with contextual interpretation.<sup>405</sup> Commentators have observed that the limited scope of the *Diebold* case is due to the court favouring static interpretation of double taxation conventions.<sup>406</sup>

#### 7.4.2 The Bank of Scotland Case

The Conseil d'État had the opportunity to further analyse beneficial ownership in the *Bank of Scotland* case.<sup>407</sup> Following this case, French courts have tended to combine the beneficial ownership test with the domestic abuse of law principle.<sup>408</sup>

##### 7.4.2.1 Facts

The Bank of Scotland, a United Kingdom resident, bought a three-year-long usufruct on non-voting shares issued by the French subsidiary of an American pharmaceutical company.<sup>409</sup> The

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<sup>402</sup> GOUTHÈRE, *Beneficial Ownership*, p. 219.

<sup>403</sup> GUTMANN, *Beneficial Ownership without Specific Provision*, pp. 163-164.

<sup>404</sup> See *supra* 3.1.

<sup>405</sup> GOUTHÈRE, *Beneficial Ownership*, p. 220.

<sup>406</sup> GUTMANN, *Beneficial Ownership without Specific Provision*, p. 164.

<sup>407</sup> Conseil d'État, 29 December 2006, case no. 283314, *Ministre de l'Économie, des Finances et de l'Industrie v. Société Bank of Scotland*.

<sup>408</sup> GOUTHÈRE, *Beneficial Ownership*, p. 217.

<sup>409</sup> GUTMANN, *Beneficial Ownership as Anti-Abuse Provision*, p. 167.

acquisition was financed by one payment and allowed the bank to receive dividends from the French subsidiary over a three-year period. The American parent company had predetermined and guaranteed the amounts to be paid. Furthermore, the France-UK double taxation convention of 1968 provided for a withholding tax rate of 15 percent whereas the French domestic rate was 25 percent. As a result, the Bank of Scotland was eligible to claim a refundable tax credit (*avoir fiscal*) to the French authorities. However, the sum of dividends, to be distributed by the French subsidiary, and refundable *avoir fiscal* was greater than what the bank had paid to acquire the usufruct on the shares of the French subsidiary.<sup>410</sup>

The French tax authorities considered that the transaction was a form of treaty shopping and thus refused to apply the France-UK tax treaty, i.e. apply a lower withholding tax rate on dividends and refund the *avoir fiscal*.<sup>411</sup>

The Cour Administrative d'Appel de Paris ruled, on appeal, that the usufruct agreement between the American company and the British bank was not a loan agreement and that the tax authorities had failed to demonstrate the existence of 'fraud to the law'.<sup>412</sup>

#### 7.4.2.2 Court's Decision

The Conseil d'État reversed the lower court's decision and held that the sale of the usufruct was a disguised loan agreement between the bank and the American parent company, wherein the French subsidiary reimbursed the loan through dividend payments and *avoir fiscal* refunds. According to the court, the sole purpose of the transaction was to abusively benefit from the France-UK treaty, as the France-US treaty would not have entitled the American company to an *avoir fiscal* refund.<sup>413</sup>

The main reason for the court's decision was that the Bank of Scotland had too many guarantees and thus bore no shareholder risk. Indeed, the usufruct agreement provided that an indemnity would be paid to the bank if dividends were not distributed by the French subsidiary, another indemnity was included in the event of the tax authorities refusing the *avoir fiscal* refund.

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<sup>410</sup> Ibid., pp. 167-168

<sup>411</sup> Ibid., p. 168.

<sup>412</sup> Ibid.

<sup>413</sup> Ibid.



Moreover, the bank could sell its shares back to the American company if the quarterly results of the French subsidiary were below a predetermined threshold.<sup>414</sup>

Furthermore, the court considered that the American parent was the beneficial owner of the dividends and consequently that the British bank was not entitled to treaty benefits (i.e. partial refund of the withholding tax).<sup>415</sup>

### 7.4.2.3 Critical Remarks

Article 9 of the double taxation convention between the United Kingdom and France, provided for a beneficial ownership test under its section 6, which dealt with the reduction of withholding tax. However, section 7 of the same article, wherein the conditions for the refund of the *avoir fiscal* were listed, did not provide for a beneficial ownership test. Commentators have consequently argued that the judgment is “unsatisfactory from a legal perspective”<sup>416</sup> as the court, by way of literal interpretation, should not have ruled that the treaty provided for a beneficial ownership test in the present case.<sup>417</sup> Such reasoning would have had no consequence on the result of the decision, as the Conseil d’État had already held, in the *Diebold* case,<sup>418</sup> that the beneficial ownership test applies to a treaty even when not expressly provided for therein.<sup>419</sup> The decision can be explained by the court’s intent on avoiding to set aside a tax treaty on the grounds of a domestic general anti-avoidance doctrine.<sup>420</sup>

The Conseil d’État has a broad interpretation of beneficial ownership. Indeed, the Bank of Scotland was neither a nominee nor an agent and could thus not be excluded under the general understanding of beneficial ownership in the existing OECD material. Moreover, the court never denied that the bank had full right of use and enjoyment on the dividends it received, nor was an obligation to further transfer them found. Gutmann argues that under the Discussion Draft of 2011, the bank qualified as beneficial owner.<sup>421</sup>

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<sup>414</sup> Ibid.

<sup>415</sup> Ibid.

<sup>416</sup> Ibid., p. 169

<sup>417</sup> Ibid., p. 169.

<sup>418</sup> See *supra* 7.4.1.2.

<sup>419</sup> GUTMANN, Beneficial Ownership as Anti-Abuse Provision, p. 169.

<sup>420</sup> Ibid., p. 171.

<sup>421</sup> Ibid.

It can be argued that the beneficial ownership test was a consequence of the ‘abuse of law’ analysis conducted by the Conseil d’État.<sup>422</sup> In other words, the court distorted the meaning of beneficial ownership because it wanted “to apply the French general anti-avoidance theory without formally departing from the treaty rule.”<sup>423</sup>

Some commentators have argued that the *Bank of Scotland* case is not relevant in understanding beneficial ownership because the decision only dealt with the “appropriate qualification of a so-called usufruct contract [into a loan agreement]”.<sup>424</sup>

The *Bank of Scotland* case is important as it follows from it that, from a French point of view, beneficial ownership is not only applicable to cases of payment forwarding to third parties but also where ‘fraud of the law’ is found.<sup>425</sup> In my opinion, linking beneficial ownership to ‘abuse of law’ would imply that the former has a subjective nature. Indeed, ‘abuse of law’ is the consequence of a party’s fraudulent intentions, and thus necessarily embodies a subjective aspect. Moreover, the wide interpretation of beneficial ownership by French courts is problematic as it ignores that beneficial ownership should be construed as a specific anti-abuse rule.

## 7.5 Italy: Supreme Court Decision no. 27113

On 28 December 2016, the Italian Supreme Court issued a decision clarifying the concept of beneficial ownership in a case of dividend payments between an Italian subsidiary and its French parent. The case presents the particularity of dealing with a holding company’s substance and the relevance thereof to establish beneficial ownership.

### 7.5.1 Facts

An Italian subsidiary distributed dividend to its parent, a French holding company, itself owned by an American company. The French company filed for a refund of the withholding tax as provided by the France-Italy tax treaty and Italian domestic law. Under the applicable double taxation convention, the reduced tax rate was set at 5 percent. There were two conditions to

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<sup>422</sup> GOUTHIERE, *Beneficial Ownership*, p. 220.

<sup>423</sup> GUTMANN, *Beneficial Ownership as Anti-Abuse Provision*, p. 172.

<sup>424</sup> DE BROE/VON FRENCKELL, *La notion de « bénéficiaire effectif » et la question de l’abus de convention*, p. 276, own translation.

<sup>425</sup> MEINDL-RINGLER, *Beneficial Ownership*, p. 235.

apply for the tax relief: beneficial ownership of the dividends and residence in the other contracting state (i.e. France).

The tax authorities rejected the claim of the French company, arguing that it was a conduit solely established to enjoy treaty benefits and transferring the dividends to its American parent. The company appealed and won against the tax authorities before a tax court. The tax authorities appealed to an appellate court which reversed the decision in their favour. The French company then appealed to the Supreme Court.<sup>426</sup>

### 7.5.2 Court's Decision

The Supreme Court held that beneficial ownership ensures that treaty reliefs are only granted to a company with full legal and economic control on the dividends, and which is the final recipient thereof. The court consequently ruled that treaty benefits, under the substance over form approach, should be denied to entities lacking substance that are interposed solely for tax reasons. The court further held that the beneficial ownership requirement is a specific anti-abuse provision, comparable to other domestic and EU anti-avoidance rules.<sup>427</sup> The court did not address whether a general anti-abuse rule was applicable.

Moreover, the Supreme Court considered that for pure holding companies (i.e. primarily owning and managing subsidiary shares), the lack of economic substance does not necessarily indicate lack of beneficial ownership. Rather, the court considered that the beneficial ownership of pure holding companies must be assessed under two exclusive factors:<sup>428</sup> first, the recipient must be the legal owner of the income. Secondly, the recipient must be independent; the independence of the holding company depends on whether it can retain the dividends received without being obligated to forward them to another entity. Accordingly, the court held that the French company was the beneficial owner of the dividends.

The court seems to follow a narrow approach to beneficial ownership, close to the one provided for in the OECD Commentary 2014, which it mentions in its judgment. Indeed, the court's analysis focuses on the company's control of the dividend, irrespective of the former's substance. The decision is interesting insofar as it deals with a holding company with no substance without considering the entity to be a conduit. In doing so, the Supreme Court follows

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<sup>426</sup> EY, Italian Supreme Court issues important guidance on beneficial ownership, p. 2.

<sup>427</sup> Ibid., pp. 2-3.

<sup>428</sup> SCHIAVELLO/FASOLINO, Beneficial ownership in Italy.

the Conduit Companies Report of 1987, which recognised that “the fact that [the] main function [of a company] is to hold assets or rights is not itself sufficient to categorise it as a mere intermediary [i.e. conduit].”<sup>429</sup> The court’s reasoning is comparable to the Tax Court of Canada’s in the *Prévost* case, where corporate substance was ignored, and legal ownership considered foremost.

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<sup>429</sup> OECD, Conduit Companies Report of 1987, p. 8

## 8 BENEFICIAL OWNERSHIP AND THE PRINCIPAL PURPOSE TEST

### 8.1 BEPS Action 6

The BEPS Project consists of 15 actions designed to address base erosion and profit shifting (hereafter BEPS). Action 6,<sup>430</sup> which is one of the four BEPS minimum standards,<sup>431</sup> deals with treaty abuse which includes treaty shopping.<sup>432</sup> The main proposition of Action 6 is to introduce anti-abuse provisions in tax treaties.

One of these provisions is the LOB rule which is designed to address treaty shopping. Under the LOB rule, the granting of treaty benefits to entities is contingent on the entities meeting certain conditions (legal nature of the entity, ownership, general activities) which ensure that the relation between the entity and its state of residence is not merely formal.

### 8.2 The MLI

The MLI is a complex international instrument; its purpose is to offer a fast track, compared to bilateral double taxation convention negotiations, to the implementation of BEPS treaty measures.<sup>433</sup> The advantage of such an instrument is that it dissuades states from adopting unilateral measures which would be contrary to the coordinated approach taken by the OECD.<sup>434</sup> However, bilateral treaties and amending protocols may still be used to implement BEPS treaty measures.<sup>435</sup> The MLI has not yet entered into force.<sup>436</sup>

Pursuant to a distinction already made in BEPS Action 6, the MLI is divided into minimum standards, rules that must be adopted if signing the MLI, and optional provisions, which includes both opt-in and opt-out provisions.<sup>437</sup>

The first minimum standard to be included in the contracting states' tax treaties, through ratification of the MLI or amendment of double taxation conventions, is a preamble, which specifies that the treaty is set on elimination double taxation, non-taxation, and reduced taxation through tax avoidance. "Treaty shopping aimed at obtaining reliefs" is also mentioned amongst

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<sup>430</sup> OECD, Action 6 Final Report.

<sup>431</sup> Together with Action 5, 13 and 14.

<sup>432</sup> OECD, Action 6 Final Report, p. 9.

<sup>433</sup> DANON/SALOMÉ, The BEPS Multilateral Instrument, p. 199.

<sup>434</sup> KLEIST, Multilateral Instrument, p. 824.

<sup>435</sup> DANON/SALOMÉ, The BEPS Multilateral Instrument, p. 199.

<sup>436</sup> 31 December 2017.

<sup>437</sup> DANON, Treaty Abuse in the Post-BEPS World, p. 39.

the goals of the treaty.<sup>438</sup> According to the OECD, this preamble, although not a provision, should be relevant when interpreting the MLI because it qualifies as ‘context’ under article 31(2) VCLT. Some authors have however argued that the treaty’s object cannot supersede a clear substantive provision.<sup>439</sup> Danon further argues that the primary objective of tax treaties will nonetheless remain the avoidance of double taxation.<sup>440</sup>

The second minimum standard is a substantive treaty anti-avoidance rule. States will be free to choose between the PPT rule or a LOB rule (thus opting out of the PPT rule).<sup>441</sup> Opting out of the PPT rule is only possible if the contracting state amends its LOB rule to deal with conduit company arrangements. This can be done by either adopting an ad hoc PPT rule which only applies to conduits, introducing a specific domestic anti-abuse rule or through judicial precedent.<sup>442</sup>

The recommendations of the MLI are a set of specific anti-abuse rules,<sup>443</sup> each designed for a form of treaty abuse. As they are not part of the minimum standard these rules may be opted out of.<sup>444</sup> A savings clause has also been included in the MLI.<sup>445</sup>

### 8.3 The PPT Rule

A GAAR is also introduced in the OECD Model<sup>446</sup> and the MLI<sup>447</sup> to deal with other forms of treaty abuse, including treaty shopping situations not addressed by the LOB rule. This GAAR is called the principal purpose test (hereafter PPT) and focuses on the principal purposes of arrangements or transactions (i.e. the rationale thereof). The PPT rule is a minimal standard of BEPS Action 6. Article 7(1) MLI provides the following PPT rule:

Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement 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 purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established

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<sup>438</sup> OECD Commentary 2017, para. 75 *ad* art. 6(1) MLI.

<sup>439</sup> DE BROE, Tax treaty and EU law aspects of the LOB and PPT, pp. 203-204.

<sup>440</sup> DANON, Treaty Abuse in the Post-BEPS World, pp. 39-40

<sup>441</sup> Art. 7(15)(a) MLI.

<sup>442</sup> DANON, Treaty Abuse in the Post-BEPS World, p. 40.

<sup>443</sup> Articles 8, 9 and 10 MLI.

<sup>444</sup> DANON, Treaty Abuse in the Post-BEPS World, p. 40.

<sup>445</sup> Art. 11 MLI.

<sup>446</sup> Art. 29(9) OECD MC 2017.

<sup>447</sup> Art. 7(1) MLI.

that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement.<sup>448</sup>

According to the OECD, the PPT rule is a codification of the ‘guiding principle’.<sup>449</sup> The guiding principle was introduced in the OECD Commentary in 2003 to deal with treaty abuse. However, the wording of the guiding principle<sup>450</sup> is not identical to the PPT rule.<sup>451</sup> The differences are twofold: first, the PPT rule applies regardless of other treaty provisions; and second, the PPT is applicable “unless it is established that granting that benefit in these circumstances would be in accordance with the object of the relevant provisions of the Covered Tax Agreement.”<sup>452</sup> Commentators have argued that the PPT rule is controversial because it reverses the burden of proof on the taxpayer.<sup>453</sup>

#### 8.4 Beneficial Ownership and the PPT

Action 6, while addressing conduit structures with the PPT rule (or anti-conduit mechanisms producing similar results) does not refer to the beneficial ownership concept. Commentators argue that the relation between beneficial ownership and the PPT rule varies depending on the meaning given to the former. Indeed, to summarise, beneficial ownership may be construed in a substance over form approach or in a formal and legal way. It follows that beneficial ownership will not interact in the same way with the PPT rule depending on how it is construed.

The 2014 OECD Commentary reduced the scope of beneficial ownership; arguably the concept no longer covers conduit companies. Furthermore, the Action 6 report does not consider beneficial ownership to apprehend conduit arrangements. Moreover, according to the report, conduit structures should be dealt with either by the PPT rule or with a specific anti-conduit rule.<sup>454</sup> This interpretation is confirmed by the 2017 amendment to the OECD Commentary, which mentions that the PPT rule applies to “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.”<sup>455</sup>

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<sup>448</sup> Art. 7(1) MLI.

<sup>449</sup> DANON, Treaty Abuse in the Post-BEPS World, p. 37.

<sup>450</sup> OECD Commentary 2014, para. 9.5 *ad art.* 1.

<sup>451</sup> DANON, Treaty Abuse in the Post-BEPS World, para. 3.3.1.; OECD Commentary 2017, para. 187 *ad art.* 29.

<sup>452</sup> Art. 7(1) MLI.

<sup>453</sup> DE BROE, Tax treaty and EU law aspects of the LOB and PPT, p. 206; DANON, Treaty Abuse in the Post-BEPS World, p. 42.

<sup>454</sup> DANON/SALOMÉ, The BEPS Multilateral Instrument, p. 239.

<sup>455</sup> OECD Commentary 2017, para. 175 *ad art.* 29.

However, several jurisdictions have retained a broad and objective meaning of beneficial ownership. Generally, the situation is somewhat attributable to the fact that relevant beneficial ownership case law predates the 2014 amendment to the Commentary and thus did not take into account the narrowing of the beneficial ownership scope. However, some jurisdictions, like Switzerland, have given a broad and objective meaning to beneficial ownership in judgments despite the 2014 update.

Notwithstanding chronological considerations, broadly construed beneficial ownership can be conflicting with the PPT rule. Indeed, under this conception of beneficial ownership, the concept applies to most conduit arrangements.<sup>456</sup> Thus, in a case involving a conduit company, beneficial ownership is a specific treaty abuse provision whereas the PPT rule is a GAAR, therefore, under the *lex specialis derogat legi generali* doctrine, the beneficial ownership test supersedes the PPT rule.

However, the PPT rule applies “[n]otwithstanding any provisions in the Covered Tax Agreement”, which seems to indicate that both the GAAR, i.e. the PPT rule, and a SAAR would be applicable cumulatively.

Danon and Salomé suggest that in these situations, the application of the beneficial ownership test would not always have the same consequences as the PPT rule.<sup>457</sup> In Switzerland, for instance, the FSC’s case law does not take into consideration the taxpayer’s intentions when assessing beneficial ownership; in other words, the FSC does not give beneficial ownership a subjective meaning.<sup>458</sup> It follows that contrary to the PPT rule, which takes into account the purpose and business rationale of transactions, the beneficial ownership test, under certain judicial interpretation (i.e. broad and objective meaning of beneficial ownership), would lead to denying treaty benefits where the application of the PPT rule would have dictated that they be granted.<sup>459</sup> The findings of the authors are confirmed by an example provided by the OECD in the 2017 amendment to the Commentary.<sup>460</sup> It is interesting to note that said example has been borrowed from the Technical Explanation of the US-UK double taxation convention,

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<sup>456</sup> DANON/SALOMÉ, The BEPS Multilateral Instrument, p. 240.

<sup>457</sup> Ibid.

<sup>458</sup> See *supra* 5.3.1.3.

<sup>459</sup> DANON/SALOMÉ, The BEPS Multilateral Instrument, p. 218.

<sup>460</sup> OECD Commentary 2017, para. 187 *ad* art. 29, Example E.



which was published in 2001, which explains the application of the anti-conduit rule<sup>461</sup> provided for in the treaty.<sup>462</sup>

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<sup>461</sup> Art. 3(1)(n).

<sup>462</sup> US Department of Treasury, Technical Explanation to the US-UK DTC, p. 130.

## 9 CONCLUSION

### 9.1 Beneficial Ownership Case Law

As seen throughout this contribution, beneficial ownership has been interpreted and construed in diverse ways in different jurisdictions. Two trends appear in the case law reviewed herein: a substance reasoning has been adopted in countries like France and Switzerland; other countries, such as Canada and to some extent Italy, have taken a more narrow, formal and legal interpretation, which is arguably more in line with the OECD Commentary 2014. Arguably, the case law of some countries, needs to be adjusted in consideration of the Commentary.

### 9.2 OECD Evolution

Historically, the OECD has shown to be inconsistent in how it interprets beneficial ownership; the documentation is at times contradictory, and it remains difficult to construe the concept accordingly.

The term was initially, in 1977, meant to ensure agents and nominees would not benefit from tax reliefs. The Conduit Companies Report considered an extension of the concept to income recipients who had functions similar to agents and nominees, e.g. a conduit company with narrow powers on its income. The 2003 Commentary focused on a meaning of beneficial ownership which is not narrow or technical; recipients with narrow powers over their income did not meet the beneficial ownership requirements.

As of 2014, the concept has been narrowed (compared to the 2003 Commentary). Indeed, the OECD uses beneficial ownership as a narrow anti-avoidance provision meant for certain conduit arrangements. Under the current conception of the term, beneficial ownership is to be denied to the recipient if he is bound by a legal obligation dependent on the receipt of income subject to treaty relief. This legal obligation may be assessed on legal and factual evidence. Agents and nominees continue to be barred from treaty benefits. Finally, beneficial ownership is considered to have an autonomous meaning, which excludes domestic law.

### 9.3 Renaming the Term ‘Beneficial Owner’

Several remedies to beneficial ownership have been suggested. Some argue that the term ‘owner’, construed under article 31(1) VCLT, is confusing as it implies that legal ownership is

a requirement of beneficial ownership, which is not the case.<sup>463</sup> Consequently, a renaming of the term ‘beneficial owner’ has been suggested, with the preferred replacement term being ‘effective beneficiary’.<sup>464</sup>

This new term would have three advantages. First, the word ‘owner’ would no longer appear, second, the new term would be closer to its translation in French, the other authentic language of the OECD MC, and third, the term would not be wrongly assimilated to beneficial ownership as understood in trust law.

I find this proposition interesting. However, its implementation would be extremely complex. Indeed, double taxation conventions would have to be amended one by one as the use of an instrument of magnitude comparable to the MLI is not foreseeable for a simple lexical update. Furthermore, if this suggestion were adopted, the interpretation of older treaties with the language ‘beneficial owner’ would certainly be controversial and the overall situation no better.

#### 9.4 Necessity of Beneficial Ownership

The necessity, whether initial<sup>465</sup> or actual,<sup>466</sup> of beneficial ownership, has been mentioned by several commentators.

Whether beneficial ownership has become redundant because of the implementation of BEPS Action 6 in the MLI is an interesting premise. If beneficial ownership is construed as a specific anti-abuse rule dealing with the exclusion of conduit companies from treaty benefits, then the answer is probably affirmative. Indeed, the MLI provides for a PPT rule perfectly capable of addressing conduit arrangements. Moreover, the countries which have not opted for the PPT rule, in favour of the LOB rule, are in return expected to adopt anti-conduit rules.

Strictly speaking, the application of a PPT rule renders beneficial ownership unnecessary for the purpose of dealing with conduits. The lack of consideration for beneficial ownership in BEPS Action 6 indicates that the OECD shares this position. However, the concept does retain some utility in dealing with agents and nominees, as well as some trustees; more so given that

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<sup>463</sup> KEMMEREN, Klaus Vogel on Double Taxation Conventions, Preface to Articles 10 to 12, m.no. 173.

<sup>464</sup> Ibid., m.no. 173 and 174 ; at m.no. 176 Kemmeren suggest a system where a chain of persons, reporting only their spread on the received income, would be beneficial owners, or rather effective beneficiaries.

<sup>465</sup> AVERY JONES, The Beneficial Ownership Concept Was Never Necessary in the Model, p. 333.

<sup>466</sup> MEINDL-RINGLER, Beneficial Ownership, p. 379 et seq.

Action 6 does not specifically address their situation. Moreover, the LOB rule is not designed for nominees and agents, and its application to trusts raises several issues.<sup>467</sup>

However, beneficial ownership conserves some utility for two reasons, first the concept, although somewhat outdated and inefficient when compared to newer anti-abuse provisions, does remain the most common anti-treaty shopping rule. Many treaties still largely rely on the beneficial ownership test to avoid treaty shopping and will continue to do so despite the MLI's upcoming entry into force. Indeed, numerous double taxation conventions will remain unaffected by the instrument.

The initial necessity of beneficial ownership may also be challenged. Specific anti-conduit rules have existed for a long time in double taxation conventions.<sup>468</sup> These provisions dismiss the application of articles 10, 11 and 12, if the considered situation qualifies as a conduit arrangement, the latter being usually defined in the provision.

## 9.5 Tax Treaty Policy

Furthermore, one might consider that the risk of treaty shopping can be reduced through policy. Indeed, countries with a wide network of double taxation conventions may somewhat avoid treaty shopping when the withholding tax rates stipulated in the treaties are identical (e.g. 15 percent on dividends as provided by the OECD MC for non-qualified shareholding). Indeed, the incentive of a taxpayer to claim benefits under the wrong tax treaty disappears if a more favourable tax rate is not provided for and that his state of residence has signed a tax treaty with the state of source.

Moreover, there seems to be a trend in some jurisdictions to amend double taxation conventions which previously provided for an exemption on dividends, interests or royalties. Switzerland, for instance, renegotiated a tax treaty which provided for exemptions on dividends from portfolio shares;<sup>469</sup> in fact, the *Total Return Swaps* landmark decision dealt with an exemption provision on dividends which had already been amended at the time of the judgment.

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<sup>467</sup> MEINDL-RINGLER, *Beneficial Ownership*, p. 381.

<sup>468</sup> See e.g. Art. 3(1)(n) of the US-UK DTC for a more recent example, article 25b of the Switzerland-Russia DTC.

<sup>469</sup> See Amending Protocol to the Switzerland-Denmark DTC (RO 2010 5939).

## 9.6 OECD Definition of Beneficial Ownership

For the foreseeable future, beneficial ownership will probably remain present in the OECD MC and a number of tax treaties. If the OECD does not intend to fully abandon the concept, it would be opportune to insert a definition of the term ‘beneficial owner’ under article 3(1) OECD MC. A Model definition was already suggested in 2012 by commentators,<sup>470</sup> in response to the 2011 Discussion Draft, but was regrettably not envisaged by the OECD. There would undoubtedly be difficulties in reaching a consensus on a definition amongst member states, but if successful the process could amount to a true clarification.

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<sup>470</sup> IBFD Research Staff, Clarification of the Meaning of “Beneficial Owner”.