OECD MODEL TAX CONVENTION: REVISED PROPOSALS CONCERNING THE MEANING OF "BENEFICIAL OWNER" IN ARTICLES 10, 11 AND 12

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REVISED PROPOSALS CONCERNING THE MEANING OF BENEFICIAL OWNER IN ARTICLES 10, 11 AND 12 OF THE OECD MODEL TAX CONVENTION

Revised public discussion draft

On 29 April 2011, the OECD released a public discussion draft entitled "Clarification of the meaning of 'beneficial owner' in the OECD Model Tax Convention".[1]

In light of the comments received[2] on that first discussion draft, the OECD Committee on Fiscal Affairs, through its Working Party 1 on Tax Conventions and Related Questions, made a number of changes to the proposals released in April 2011.

This revised discussion draft includes the revised proposals that the Working Party has drafted. Since the changes originally proposed were almost identical for Articles 10, 11 and 12, this revised discussion draft focuses on the proposals made with respect to Article 10. This draft includes a summary of the comments received and an explanation of the changes made with respect to each relevant paragraph of the Commentary on that Article (as well as a new proposal for a clarifying change to the wording of paragraph 2 of Articles 10 and 11 that addresses a triangular case that was raised in some of the comments received). The Annex includes a consolidated version of the revised proposals for Articles 10, 11 and 12 where changes made to the proposals included in the first discussion draft are underlined.

The Committee on Fiscal Affairs invites comments on this discussion draft **before 15 December 2012**. These additional comments, which should focus on drafting issues rather than on the substance of the proposals, will be reviewed at the February 2013 meeting of Working Party 1.

Comments on this revised discussion draft should be sent electronically (in Word format) by email to taxtreaties@oecd.org and should be addressed to:

Tax Treaties, Transfer Pricing and Financial Transactions Division
OECD/CTPA

Unless otherwise requested at the time of submission, comments submitted in response to this invitation will be posted on the OECD website.

This document is a discussion draft released for the purpose of inviting comments from interested parties. It does not necessarily reflect the final views of the OECD and its member countries.

1. http://www.oecd.org/tax/taxtreaties/47643872.pdf.

2. These comments are available at: http://www.oecd.org/tax/taxtreaties/publiccommentsreceivedonthediscussiondraftonthemeaningofbeneficialownerintheoecdmodeltaxconvention.htm.

REVISED PROPOSALS CONCERNING THE MEANING OF BENEFICIAL OWNER IN ARTICLES 10, 11 AND 12 OF THE OECD MODEL TAX CONVENTION

A. Paragraph 12 of the Commentary on Article 10

Proposal included in the first discussion draft (changes to the existing Commentary appear in ***bold italics*** for additions and ~~strikethrough~~ for deletions)	***Revised proposal***
12. The requirement of beneficial owner 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~~ ***paid direct to*** a resident of a State with which the State of source had concluded a convention. [*the rest of the paragraph has been moved to new paragraph 12.1*]	*[No changes]*

Summary of the comments received on the paragraph and explanations of the changes made

1. No comments were received on paragraph 12 and no additional changes are proposed to that paragraph.

B. Paragraph 12.1 of the Commentary on Article 10

Proposal included in the first discussion draft (changes to the existing Commentary appear in ***bold italics*** for additions and ~~strikethrough~~ for deletions)	***Revised proposal (changes are <u>underlined</u>)***
12.1 Since the term "beneficial owner" was added to address potential difficulties arising from the use of the words "paid to …a resident" in paragraph 1, it was intended to be interpreted in this context and not to refer to any technical meaning that it could have had under the domestic law of a specific country (in fact, when it was added to the paragraph, the term did not have a precise meaning in the law of many countries). The term "beneficial owner" is ***therefore*** not used in a narrow technical sense ***(such as the***	***12.1 Since the term "beneficial owner" was added to address potential difficulties arising from the use of the words "paid to … a resident" in paragraph 1, it was intended to be interpreted in this context and not to refer to any technical meaning that it could have had under the domestic law of a specific country (in fact, when it was added to the paragraph, the term did not have a precise meaning in the law of many countries).*** The term "beneficial owner" is ***therefore*** not used in a narrow technical sense ***(such as the***

meaning that it has under the trust law of many common law countries[1]), rather, it should be understood in its context***, in particular in relation to the words "paid … to a resident",*** and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance. ***This does not mean, however, that the domestic law meaning of "beneficial owner" is automatically irrelevant for the interpretation of that term in the context of the Article: that domestic law meaning is applicable to the extent that it is consistent with the general guidance included in this Commentary.***	***meaning that it has under the trust law of many common law countries[1])***, rather, it should be understood in its context***, in particular in relation to the words "paid … to a resident",*** and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance. ***~~This does not mean, however, that the domestic law meaning of "beneficial owner" is automatically irrelevant for the interpretation of that term in the context of the Article: that domestic law meaning is applicable to the extent that it is consistent with the general guidance included in this Commentary.~~***
_____	_____
[Footnote to paragraph 12.1] ***1. 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 (or the trust, if recognised as a separate taxpayer), could constitute the beneficial owners of such income for the purposes of Article 10 notwithstanding that the relevant trust law might distinguish between legal and beneficial ownership***.	*[Footnote to paragraph 12.1]* ***1. 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 (or the trust, if recognised as a separate taxpayer), could constitute the beneficial owners of such income for the purposes of Article 10 even if they are not the beneficial owners under the relevant trust law~~ notwithstanding that the relevant trust law might distinguish between legal and beneficial ownership~~.***

Summary of the comments received on the paragraph and explanations of the changes made

(i) Issue of autonomous treaty meaning versus domestic law meaning

2. A number of comments supported the suggestion that "beneficial owner" should have an autonomous treaty meaning. A few commentators, however, disagreed. Also, one commentator suggested clarifying the meaning of "beneficial owner" in the wording of the articles themselves because there was "not enough evidence that autonomous meaning is required."

3. Whilst the majority of comments supported the conclusion that an autonomous meaning should be given to the term "beneficial owner", a number of commentators objected to the last sentence of the paragraph dealing with the domestic law meaning of that term. It was noted that this sentence appeared to contradict the conclusion that an autonomous meaning should be preferred; it was also suggested that the sentence could be read as allowing a taxpayer to choose between the domestic law interpretation and the guidance of the OECD Commentary.

4. Based on the guidance in existing paragraph 12 and the majority of the comments received on this issue, the Working Party concluded that the interpretation reflected in the proposed paragraph was the correct one but that the last sentence of the paragraph was potentially confusing and should therefore be deleted.

(ii) Footnote dealing with trusts

5. A number of comments were received with respect to the footnote to paragraph 12.1 and, more generally, to the application of the "beneficial owner" concept in the case of trusts.

6. The inclusion of the footnote was supported by a number of commentators. Some of these commentators, however, expressed the view that it was difficult to reconcile the conclusion of the footnote with the concept of "full right to use and enjoy the income" in proposed paragraph 12.4 since a trustee does not have full rights with respect to the trust income.

7. A few commentators expressed disappointment that the discussion draft did not include more clarification with respect to trusts and encouraged the OECD to do so. A few commentators also expressed the view that the footnote was not clear and suggested various changes.

8. Given that the comments generally supported the interpretation put forward in the footnote, the Working Party decided to leave the footnote unchanged except for a clarifying change made to the last part of that footnote. It also concluded that a general examination of the treaty issues related to trusts was beyond the scope of the work on clarifying the concept of beneficial owner. As regards the difficulty of reconciling the footnote with the concept of "full right to use and enjoy the income" in paragraph 12.4, the Working Party concluded that the issue should be dealt with through amendments to paragraph 12.4 (see below).

C. Paragraph 12.2 of the Commentary on Article 10

Proposal included in the first discussion draft (changes to the existing Commentary appear in ***bold italics*** for additions and ~~strikethrough~~ for deletions)	***Revised proposal***
12.~~1~~***2*** Where an item of income is ~~received by~~***paid to*** a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption merely on account of the status of the ~~immediate~~ ***direct*** recipient of the income as a resident of the other Contracting State. The ~~immediate~~ ***direct*** recipient of the income in this situation qualifies as a resident but no potential double taxation arises as a consequence of that status since the recipient is not treated as the owner of the income for tax purposes in the State of residence. [*the rest of the paragraph has been moved to new paragraph 12.3*]	*[No changes]*

Summary of the comments received on the paragraph and explanations of the changes made

9. One commentator asked for clarification as to the reasons for the changes to this paragraph, asking what would happen if the direct recipient and beneficial owner are in two different States. The Working Party decided to address that particular issue through changes to paragraph 2 of Articles 10 and 11, as explained under paragraph 12.7 (see below). As regards the reasons for the changes made to paragraph 12.2, these are minor drafting improvements which are not intended to affect the meaning of the paragraph.

D. Paragraph 12.3 of the Commentary on Article 10

Proposal included in the first discussion draft (changes to the existing Commentary appear in ***bold italics*** for additions and ~~strikethrough~~ for deletions)	***Revised proposal***
12.3 It would be equally inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency 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"[1] 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. _____ *[Footnote to paragraph 12.3]* 1. Reproduced at page R(6)-1 of Volume II of the ***full-length*** ~~loose-leaf~~ version of the OECD Model Tax Convention.	*[No changes]*

Summary of the comments received on the paragraph and explanations of the changes made

10. No comments were received on paragraph 12.3 and no additional changes are proposed to that paragraph.

E. Paragraph 12.4 of the Commentary on Article 10

Proposal included in the first discussion draft (changes to the existing Commentary appear in ***bold italics*** for additions and ~~strikethrough~~ for deletions)	***Revised proposal (changes are underlined)***
12.4 In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the recipient of the dividend is not the "beneficial owner" because that recipient does not have the full right to use and enjoy the dividend that it receives and this dividend is not its own; the powers of that recipient over that dividend are indeed constrained in that the recipient is obliged (because of a contractual, fiduciary or other duty) to pass the payment received to another person. The recipient of a dividend is the "beneficial owner" of that dividend	***12.4 In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the recipient of the dividend is not the "beneficial owner" because that recipient's right to use and enjoy the dividend is constrained ~~that recipient does not have the full right to use and enjoy the dividend that it receives and this dividend is not its own; the powers of that recipient over that dividend are indeed constrained in that the recipient is obliged (because of a contractual, fiduciary or other duty) to pass the payment received to another person. The recipient of a dividend is the~~***

where he has the full right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass the payment received to another person. Such an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the full right to use and enjoy the dividend; also, the use and enjoyment of a dividend must be distinguished from the legal ownership, as well as the use and enjoyment, of the shares on which the dividend is paid.	***~~"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 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 recipient clearly does not have the ~~full~~ right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person. This type of obligation must be related to the payment received; it would therefore not include contractual or legal obligations unrelated to the payment received even if those obligations could effectively result in the recipient using the payment received to satisfy those obligations. Examples of such unrelated obligations are those unrelated obligations that the recipient may have as a debtor or as a party to financial transactions or typical distribution obligations of pension schemes and of collective investment vehicles entitled to treaty benefits under the principles of paragraphs 6.8 to 6.34 of the Commentary on Article 1. Where the recipient of a dividend does have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person, the recipient is the "beneficial owner" of that dividend. It should also be noted that Article 10 refers to the beneficial owner of a dividend as opposed to the owner of the shares, which may be different in some cases. ~~;also, the use and enjoyment of a dividend must be distinguished from the legal ownership, as well as the use and enjoyment, of the shares on which the dividend is paid.~~***

Summary of the comments received on the paragraph and explanations of the changes made

11. Most of the comments received on the discussion draft dealt with paragraph 12.4. The vast majority of the commentators either objected to that paragraph or thought that it was unclear.

12. Many of these comments were specifically addressed at the phrase "full right to use and enjoy the dividend" in the first sentence. A number of commentators argued that the phrase was overly broad and could catch a number of legitimate situations. The comments suggested a number of situations in which that phrase could have unintended effects, including in the case of:

- The use of the income received to meet other costs, such as interest that the recipient has to pay to a creditor.
- The activities of banks or, more generally, any type of financial institution.
- The use of holding companies.
- Entities, such as a unit trust, that are required to distribute their income.

- Payments of interest or dividends under "plain vanilla" securities or hybrids such as convertible debentures.
- A creditor who obtains a court order that "freezes the income of the debtor".
- An individual who is obliged to make alimony payments to his former spouse.
- The payment of a dividend by a subsidiary to its parent.
- The situation of trusts.
- The use of a special purpose vehicle in securitisation arrangements or to ring-fence commercial risks.
- Situations where a debtor pledges shares or loan notes and the resulting income to its bank as security for a loan.
- Joint venture arrangements that require distributions.
- Hedging in the financial services industry [*see also the specific comments related to typical financial transactions below*].
- Various financial products (*e.g.* repos and credit derivatives, including credit default swaps).

13. The following specific concerns were expressed in relation to typical financial transactions, collective investment vehicles and holding companies:

- A number of commentators from the finance industry expressed concerns about the uncertainty related to the impact of the proposed Commentary on a number of typical financial transactions. It was noted that the uncertainty would be particularly problematic for withholding agents who do not have full knowledge of the treaty claimant's facts and circumstances. It was suggested that a financial institution should be considered to be the beneficial owner where "no other party has the ability to constrain the rights of that financial institution and where the financial institution is taking risk and is actively hedging/managing/trading that risk as part of its normal business activities". A similar suggestion was that financial institutions acting in the ordinary course of their business should in principle be considered beneficial owners, absent contrary evidence.
- A number of commentators asked for confirmation that the guidance already provided in existing paragraph 6.14 of the Commentary on Article 1 concerning collective investment funds would not be affected by the proposed changes. One commentator expressly referred to the need to clarify the situation of multi-tiered fund structures (one commentator suggested, however, that existing paragraph 6.14, which deals with the issue of beneficial owner in relation to collective investment vehicles, wrongly focuses on the power of the fund managers over investment of funds whereas the concept of beneficial owner should relate to the power over the income received).
- A number of commentators similarly expressed concerns that the use of holding companies might be affected by the proposed changes. One commentator suggested "clarifying that also mere holding companies can be the beneficial owner and that beneficial ownership does not depend on physical substance (having an office or employees)." Another commentator suggested that "specific guidance is needed to harmonize how jurisdictions apply the concept of "beneficial owner" to holding companies … we believe in principle that a holding company should be treated as the beneficial owner of income unless demonstrated that it is serving as a conduit company merely for tax motivated reasons as described in the 1987 Report and suggested in both the current Commentary and the Discussion Draft."

– One related concern was expressed by some commentators about the "dividend sweeping" policies that some corporate groups implement: "[t]he treasury function at many multinational enterprises typically has a goal of optimizing cash management and to utilize cash balances in subsidiary companies efficiently and effectively. One strategy is to 'sweep' dividends received by lower tier companies to higher tier entities where the cash can then be used for multiple purposes, such as reinvestment within the group of companies or the payment of onward dividends to ultimate shareholders."

14. The comments included a number of suggestions as to how to address the perceived problems with paragraph 12.4. For example,

– One commentator suggested that the phrase "and this dividend is not its own" in the first sentence did not add guidance and should be removed.

– One set of comments suggested a different approach to that proposed in paragraph 12.4: "[i]n terms of principles, it is recommended that the Commentaries distinguish two cases in relation to beneficial ownership. First, if the country of residence of the person to whom the income is paid does not attribute it to that person, that person will not be the beneficial owner of the income. Secondly, if the country of residence does attribute the income to that person, that person will not be treated as the beneficial owner of the income in only a very limited number of situations. … The crucial point should be that a person is not the beneficial owner of income to which the person is legally entitled and to whom the income is attributed for tax purposes if the person has no control over its application due to a legally enforceable obligation to pass the income on to another person."

– Another suggestion was that the test should be whether the recipient of the income is entitled to the income as a matter of law and is not legally or contractually obliged to pay the amount to other persons except in limited cases where "the recipient is under some commercial or economic compulsion to pay the above amounts to other persons; and it is necessary to treat the recipient as not being the "beneficial owner" of the interest in order to prevent 'treaty shopping'."

– According to another commentator "the beneficial owner under articles 10, 11 and 12 of the OECD Model should refer to 'the person who legally, economically or factually has the power to control the attribution of the income'."

– A more basic suggestion was that "the drafting of the Commentary in paragraph 12.4 be amended to make it clear that its application is limited only to agents, nominees, fiduciaries and bare trustees."

– One commentator suggested simply dropping the word "full" because "full right vs. right may lead some tax authorities to unduly restrict the scope of the BO notion to an entity having full ownership vs. partial ownership (e.g., usufruct)."

– One commentator suggested that, in order to remove some uncertainty, the paragraph should be redrafted to clarify that either "the exclusion from beneficial ownership is limited specifically to agents, nominees and conduit companies acting as a fiduciary or administrator" or "that the test of beneficial ownership may apply more broadly than only to agents, nominees and conduit companies acting as a fiduciary or administrator."

– A commentator suggested that the paragraph be drafted in the positive form to avoid putting the burden on the taxpayer to establish that it is the beneficial owner, arguing that "[i]t is not uncommon for tax authorities in Asia to require objective evidence to support a treaty claim, which would be practically impossible where it is necessary to 'prove a negative'."

- It was suggested that the reference to "payment" should be clarified: "To clarify what constitutes a payment in this context, the Commentary might usefully include examples which demonstrate the necessary connection required for there to be a particular amount 'passed on', including for example, where the nature of the amount received changes before it is paid. For example, a payment under a Transfer Pricing Agreement (because a function that contributed to the receipt of the relevant amount is based in another location) should not be considered as changing the beneficial owner."
- According to one commentator "... an income recipient has full right to use and enjoy income unless another party has real and actual control (legal or contractual) over how that particular item of income is used. In particular, we suggest inclusion of wording to the effect that equivalent payments under derivatives will not generally mean the payer does not have full use and enjoyment of any income earned on any underlying hedges suggested."
- Two commentators proposed different redrafts of the paragraph; the first of these redrafts focussed on the concept of a recipient acting "for and on behalf of" (agent, nominee) or "on behalf of" (conduit company) a third party whilst the second suggested that the recipient of a payment is the beneficial owner "where he receives the dividend unconstrained by a contractual or legal obligation to pass the entire payment received to another person immediately and in the same legal form".

15. One commentator remarked that the words "unconstrained by a contractual or legal obligation", used in the second sentence, were different from the words "constrained in that the recipient is obliged (because of a contractual, fiduciary or other duty)" in the preceding sentence and asked that the same formulation be used for the sake of clarity. In redrafting the paragraph, the Working Party has therefore tried to use the same terminology as far as possible.

16. A number of commentators expressed additional concerns about the first part of the last sentence of the paragraph (which reads "Such an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the full right to use and enjoy the dividend ..."). Some commentators argued that this part of the paragraph would have the effect of introducing an "economic ownership" test. It was also suggested that this part of the last sentence contradicted the guidance in the preceding part of the paragraph. Some commentators indicated that this part of the paragraph would add uncertainty even in non-abusive cases; one commentator suggested that "countries which are concerned about fact patterns that suggest a streaming of income through a treaty claimant should combat these situations using their general anti-avoidance principles or treaty provisions specifically directed at the problem". One commentator also noted an ambiguity reflected in the statement and asked that it should be clarified whether the sentence meant that "in ascertaining the extent of the legal obligations of a recipient to pass on a payment, regard may be had to both the legal documents and the surrounding facts and circumstances, including the conduct of the parties" which would be similar to what is provided in paragraph 1.53 of the Transfer Pricing Guidelines, or whether it meant that "a taxation authority may conclude that an obligation in substance exists, even where there is no contractual or legal agreement to that effect".

17. In light of all these comments, the Working Party recognized that the drafting of paragraph 12.4 could give rise to significant uncertainty and that the paragraph needed to better identify the kind of obligations that would mean that the recipient of a dividend would not be considered to be the beneficial owner of that dividend. After extensive discussions, it agreed on the proposed redraft included in the box at the beginning of this section.

18. As regards the last part of the paragraph (which reads "**...** also, the use and enjoyment of a dividend must be distinguished from the legal ownership, as well as the use and enjoyment, of the shares

on which the dividend is paid"), one commentator suggested that it be deleted because, according to that commentator, a "... taxpayer cannot assign the 'fruits' of property (e.g., interest on a debt-claim) separately from the ownership of the 'tree' or underlying property (e.g. the debt-claim itself)" in that commentator's country. As noted by another commentator, however, the issue of "assignment of income … should not be confused with the beneficial ownership discussion… The issue here, however, is whether the assignment is recognized for tax purposes, rather than any question related to a person's receipt of income on behalf of someone else." Another commentator, who expressed support for the statement distinguishing the beneficial ownership of the income from the beneficial ownership of the underlying asset, suggested that the problem of attribution rules could be dealt with separately in the Commentary: "it would be appropriate for the Commentary to refer to this problem and possibly to suggest that, where, under a deemed attribution rule, the recipient is taxed on an item of income arising in the source state, the contracting states may deem this person to be the beneficial owner, even if, in this particular instance, this person does not hold any ownership attribute over the income received."

19. Given these views, the Working Party concluded that the distinction made in the last part of paragraph 12.4 (which is repeated in paragraph 12.6; see below) was an appropriate one. It did agree, however, that the distinction could be better formulated and decided to redraft the last sentence accordingly**.**

F. Paragraph 12.5 of the Commentary on Article 10

Proposal included in the first discussion draft (changes to the existing Commentary appear in ***bold italics*** for additions and ~~strikethrough~~ for deletions)	***Revised proposal (changes are underlined)***
12.5 The fact that the recipient of a dividend is considered to be the beneficial owner of that dividend does not mean, however, that the limitation of tax provided for by paragraph 2 must automatically be granted. This limitation of tax should not be granted in cases of abuse of this provision (see also paragraphs 17 and 22 below). As explained in the section on "Improper use of the Convention" in the Commentary on Article 1, there are many ways of addressing conduit company and, more generally, treaty shopping situations. These include specific treaty anti-abuse provisions, general anti-abuse rules and substance-over-form or economic substance approaches. Whilst the concept of "beneficial owner" deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass the dividend to someone else), it does not deal with other cases of treaty shopping and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases.	***12.5 The fact that the recipient of a dividend is considered to be the beneficial owner of that dividend does not mean, however, that the limitation of tax provided for by paragraph 2 must automatically be granted. This limitation of tax should not be granted in cases of abuse of this provision (see also paragraphs 17 and 22 below). As explained in the section on "Improper use of the Convention" in the Commentary on Article 1, there are many ways of addressing conduit company and, more generally, treaty shopping situations. These include specific ~~treaty~~ anti-abuse provisions in treaties, general anti-abuse rules and substance-over-form or economic substance approaches. Whilst the concept of "beneficial owner" deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on the dividend to someone else), it does not deal with other cases of treaty shopping and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases.***

Summary of the comments received on the paragraph and explanations of the changes made

20. Some commentators suggested that the concept of beneficial owner should not be used as an anti-avoidance rule or should not be referred to as an anti-avoidance rule. One of these commentators suggested that "[t]he inclusion of a discussion on anti-avoidance mechanisms within the sections of the Commentary discussing 'beneficial ownership' is unnecessary and may be misinterpreted by tax authorities as a requirement to apply additional anti-avoidance testing as part of the determination of 'beneficial ownership'". These and other comments seemed to object to the conclusion that a beneficial owner might not be entitled to treaty benefits under other anti-abuse rules. One of these commentators suggested that "[m]ultiple layers of anti-abuse provisions may render a treaty inoperable and will not achieve the goal of a treaty to encourage international business and trade." The Working Party, however, strongly disagreed with the view that a beneficial owner should be immune from the application of other anti-abuse rules, a view that would be inconsistent with the guidance already included in paragraphs 7 to 26.1 of the Commentary on Article 1.

21. A few commentators expressed concerns that the suggestion that the beneficial owner concept was a form of anti-abuse rule might lead some countries to take the view that treaty benefits should not be granted to the beneficial owner who is not the recipient of the income. One of these commentators suggested that the Commentary should "clarify the application of the right treaty to the beneficial owner (similar to the treatment of partnerships). Otherwise, the mere anti-abuse approach of this clause may lead to double taxation". The Working Party considered that this issue was already dealt with in paragraph 12.2 (renumbered as paragraph 12.7; see below) and that the proposed clarification to be made to paragraph 2 of Articles 10 and 11 will confirm the treaty entitlement of the beneficial owner who is not the recipient of a payment (subject to the possible application of other anti-abuse rules).

22. The comments included a few proposals dealing more generally with anti-abuse rules that could be relevant in a situation involving the question of whether a person is a beneficial owner. These included:

- The suggestion that the application of other anti-abuse rules in case involving the question of beneficial ownership should be "of a subsidiary nature and cannot be used to test a segment of the fact pattern that is already covered by the beneficial ownership requirement. ... [T]he elements of the fact pattern that relate to the manner in which the income arising in the source state is transferred to the residence state should exclusively be tested in light of the beneficial ownership requirement. The guiding principle [of paragraph 9.5 of the Commentary on Article 1], on the other hand, may be used to test other elements of the fact pattern, such as the circumstances surrounding the transfer of shares to a company residing in the residence state."

- The suggestion that "harmonization of anti-abuse principles should be considered … since the requirement for the recipient to be the 'beneficial owner' does not in itself constitute the sole ground for ensuring access to a double tax treaty…. other anti-avoidance or limitation of benefit provisions (i.e. generic ones) could be invoked by the national tax authorities for disallowing access to a double tax treaty."

- The suggestion that "if the proposed changes … are to be interpreted as a change, … the proposed changes to paragraph 12.4 (as well as to paragraphs 10.2 and 4.3) of the Commentary should not be implemented and … specific anti-abuse provisions could be included in tax treaties based on the preferences of the treaty partners."

23. The Working Party did not consider it necessary to address these suggestions, which relate more to the application of other anti-abuse rules than to the interpretation of the concept of "beneficial owner". Based on the preceding, the Working Party concluded that, apart from two minor clarifying changes, paragraph 12.5 should not be modified.

G. Paragraph 12.6 of the Commentary on Article 10

Proposal included in the first discussion draft (changes to the existing Commentary appear in ***bold italics*** for additions and ~~strikethrough~~ for deletions)	***Revised proposal (changes are <u>underlined</u>)***
12.6 The above explanations concerning the meaning of "beneficial owner" make it clear that the meaning given to this term in the context of the Article must be distinguished from the different meaning that has been given to that term in the context of other instruments[1] that concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of "beneficial owner" cannot be applied in the context of the Article. Indeed, that meaning, which refers to natural persons (i.e. individuals), cannot be reconciled with the express wording of subparagraph 2 a), which refers to the situation where a company is the beneficial owner of a dividend. Since, in the context of Article 10, the term beneficial owner is intended to address difficulties arising from the use of the word "paid" in relation to dividends, it would be inappropriate to consider a meaning developed in order to refer to the individuals who exercise "ultimate effective control over a legal person or arrangement".[2]	***12.6 The above explanations concerning the meaning of "beneficial owner" make it clear that the meaning given to this term in the context of the Article must be distinguished from the different meaning that has been given to that term in the context of other instruments[1] that concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of "beneficial owner" cannot be applied in the context of the Article. Indeed, that meaning, which refers to natural persons (i.e. individuals), cannot be reconciled with the express wording of subparagraph 2 a), which refers to the situation where a company is the beneficial owner of a dividend. ~~Since, i~~In the context of Article 10, the term <u>"beneficial owner"</u> is intended to address difficulties arising from the use of the word<u>s</u> "paid <u>to</u>" in relation to dividends<u>, rather than difficulties related to the ownership of the shares of the company paying these dividends. For that reason, it would be inappropriate, in the context of that Article,</u> to consider a meaning developed in order to refer to the individuals who exercise "ultimate effective control over a legal person or arrangement."[2]***
[Footnotes to paragraph 12.6] 1. ***See, for example, the Glossary to the Financial Action Task Force's Forty Recommendations (http://www.fatf-gafi.org/glossary/0,3414,en_32250379_32236930_35433764_1_1_1_1,00.html#34276864)) which sets forth in detail the international anti-money laundering standard and which includes the following definition of beneficial owner: "the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement." Similarly, the 2001 report of the OECD Steering Group on Corporate Governance,***	*[Footnotes to paragraph 12.6]* 1. ***See, for example, <u>Financial Action Task Force,</u> <u>International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation – The FATF Recommendations</u> <u>(OECD-FATF, Paris, 2012),</u> ~~the Glossary to the Financial Action Task Force's Forty Recommendations (http://www.fatf-gafi.org/glossary/0,3414,en_32250379_32236930_35433764_1_1_1_1,00.html#34276864)~~ which sets forth in detail the international anti-money laundering standard and which includes the following definition of beneficial owner <u>(at page 109)</u>: "the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement." Similarly, the 2001 report of the OECD Steering Group on Corporate Governance,***

"Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes", http://publications.oecd.org/acrobatebook/2101131E.PDF, at page 14, defines beneficial owner as follows: *In this Report, "beneficial owner" refers to ultimate beneficial owner or interest by a natural person. In some situations, uncovering the beneficial owner may involve piercing through various intermediary entities and/or individuals until the true owner who is a natural person is found. With respect to corporations, ownership is held by shareholders or members. In partnerships, interests are held by general and limited partners. In trusts and foundations, beneficial owner refers to beneficiaries, which may also include the settlor or founder.* *2. Glossary to the Financial Action Task Force's Forty Recommendations (http://www.fatf-gafi.org/glossary/0,3414,en_32250379_32236930_35433764_1_1_1_1,00.html#34276864).*	*"Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes" (OECD, Paris, 2001), ~~http://publications.oecd.org/acrobatebook/2101131E.PDF, at page 14~~, defines beneficial ownership as follows (at page 14):* *In this Report, "beneficial ownership" refers to ultimate beneficial ownership or interest by a natural person. In some situations, uncovering the beneficial owner may involve piercing through various intermediary entities and/or individuals until the true owner who is a natural person is found. With respect to corporations, ownership is held by shareholders or members. In partnerships, interests are held by general and limited partners. In trusts and foundations, beneficial ownership refers to beneficiaries, which may also include the settlor or founder.* *2. See the Financial Action Task Force's definition quoted in the previous note. ~~Glossary to the Financial Action Task Force's Forty Recommendations (http://www.fatf-gafi.org/glossary/0,3414,en_32250379_32236930_35433764_1_1_1_1,00.html#34276864).~~*

Summary of the comments received on the paragraph and explanations of the changes made

24. Whilst one commentator welcomed the distinction proposed in paragraph 12.6, another commentator suggested that notwithstanding that statement, "in practice the OECD's definition will be highly influential in shaping the definitions used at both the national level and in the context of legislation such as the EU's 3rd Anti-Money Laundering Directive." That commentator concluded that it "would welcome progress towards a more general and universal definition of the term 'beneficial owner'."

25. One commentator expressed the view that the last sentence was difficult to follow and should be reworded.

26. The Working Party concluded that it would be very difficult to find a single, universal meaning of the term "beneficial owner" irrespective of the context in which it was used. It therefore agreed to maintain the distinction reflected in the paragraph. The Working Party, however, agreed with the comment concerning the drafting of the last sentence of the paragraph and decided to redraft that sentence in order to clarify its meaning. It also decided to modify the footnotes in order to refer to the published versions of the reports mentioned therein.

H. Paragraph 12.7 of the Commentary on Article 10

Proposal included in the first discussion draft (changes to the existing Commentary appear in ***bold italics*** for additions and ~~strikethrough~~ for deletions)	***Revised proposal (changes are <u>underlined</u>)***
	<u>Change to the preamble of paragraph 2 of Article 10:</u> <u>2. However, ~~such~~ dividends ***paid by a company which is a resident of a Contracting State*** may also be taxed in ***that State*** ~~the Contracting State of which the company paying the dividends is a resident~~ and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed: ...</u> *<u>Change to paragraph 12.2 (now 12.7) of the Commentary on Article 10:</u>*
12.~~7~~2 Subject to other conditions imposed by the Article, the limitation of tax in the State of source remains available when an intermediary, such as an agent or nominee located in a Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State (the text of the Model was amended in 1995 to clarify this point, which has been the consistent position of all Member countries). States which wish to make this more explicit are free to do so during bilateral negotiations.	12.~~7~~2 Subject to other conditions imposed by the Article, the limitation of tax in the State of source remains available when an intermediary, such as an agent or nominee located in a Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State (the text of the Model was amended in 1995 ***<u>and in [year of next update]</u>*** to clarify this point, which has been the consistent position of all ~~M~~***<u>m</u>***ember countries). <u>~~States which wish to make this more explicit are free to do so during bilateral negotiations.~~</u>

Summary of the comments received on the paragraph and explanations of the changes made

27. A few comments were received on paragraph 12.7 even though no changes to the existing text of that paragraph (currently paragraph 12.2) were proposed in the discussion draft.

28. Another commentator suggested that the meaning of "limitation of tax" was uncertain. The Working Party considers that the context of Article 10 makes it clear that the "limitation of tax" referred to the limitation on source taxation resulting from paragraph 2 of Article 10.

29. A few commentators raised the issue of how the Article applies where the direct recipient and beneficial owner are in two different States. One commentator suggested that "if the recipient is not considered the beneficial owner of a dividend, it should in our view be made more explicit in the Commentary which party is the beneficial owner."

30. The Working Party agreed that the issue raised in these last comments needed to be addressed. A literal interpretation of the words "such dividends" in the preamble of paragraph 2 of Article 10 could lead to the conclusion that these dividends must be dividends that are paid direct to a resident of a Contracting State, which would be problematic where the direct recipient and the beneficial owner of the dividends are

residents of two different States. Whilst existing paragraph 12.2 of the Commentary clearly indicates that such an interpretation should be rejected, it suggests that some States may wish to adopt a clearer wording in their bilateral treaties. The Working Party decided that, in order to remove any doubt, such clearer wording should be included in the Article itself. At the same time, it decided to clarify in the Commentary that this issue was dealt with through two different changes to the wording of the Article since the 1995 change that is already referred to in paragraph 12.2 only addressed the issue where the direct recipient and the beneficial owner of the dividends are both residents of the same State.

I. Other comments on the discussion draft

1. Addition of examples

31. A number of commentators expressed the wish for more clarity through the addition of examples. Specific situations with respect to which examples were requested included: joint venture agreements that included provisions for automatic payments to the joint venture members; repos or payment equivalents under swap transactions entered into by investment banks; special purpose finance vehicles which borrow from banks or other entities and on-lend internally to other group members and, more generally, financing, hedging and derivative arrangements. After discussion, the Working Party decided not to change the existing approach which focuses on general principles and concluded that the addition of obvious examples would not be very useful whilst the addition of examples dealing with more difficult cases would need to be extremely fact-specific and would raise additional questions concerning similar but not identical situations. It was also agreed that the new changes made to paragraph 12.4 (see above) should provide some comfort with respect to some of the situations identified in the comments.

2. Other comments

32. The following comments did not appear to relate to any specific parts of the proposed Commentary changes; no changes are proposed to deal with these comments.

- Two commentators suggested clarifying that the concept of beneficial owner does not apply with respect to other Articles such as Article 13.

- One commentator proposed that the rates of withholding tax should be harmonised.

- In relation to the uncertainty that would arise from the proposed guidance on beneficial owner, one commentator expressed concerns about the strict liability imposed under the TRACE project. A somewhat similar concern was expressed by another commentator who suggested that "[i]t might be advisable to stipulate the level of diligence that should be incumbent on the disbursing institution when applying limitations on the rate of withholding tax or exemptions."

- One commentator made the following comment in relation to payments under transfer pricing requirements: "[i]t is assumed, but the Discussion Draft should make clear, that payments under transfer pricing requirements do not affect beneficial ownership."

- It was also suggested to add a reference to the "Double Taxation Conventions and the Use of Conduit Companies" report "in further discussion papers or the commentary to the model treaty to clarify certain concepts." [The Working Party noted that the report on the Use of Conduit companies was already referred to in existing paragraph 12.1 and that reference would be kept.]

- A few commentators suggested adding a specific definition of "beneficial owner" either to the Article or the Commentary.

- Two commentators requested “the OECD to explicitly make clear that the proposed changes solely are a clarification and not in any way a change”. In this respect, another commentator expressed the wish that “[h]opefully, tax administrators and courts faced with the issue for earlier years will recognize the changes as a ‘clarification’ and will have no hesitancy in relying on the new language in resolving pending issues.” [The Working Party considers that the changes are indeed a mere clarification of the existing guidance.]

- Two commentators suggested that the concept of beneficial owner should be applied differently with respect to dividends, interest and royalties. [Whilst the Working Party considered that relevant facts and circumstances might be different in the cases of dividends, interest and royalties, it considered that the same principles should apply, a view that is already reflected in the existing guidance.]

- For one commentator “[t]he problems intended to be addressed by the beneficial ownership concept are only one set of issues raised by the attribution of income to a person. This topic has a much wider import than the beneficial ownership question alone”.

- One commentator suggested “introducing instruments for assessment of the real powers of an entity over the incomes received based on the level of competence and responsibility of the individuals administrating the assets which have produced the incomes received by this entity”.

ANNEX

REVISED PROPOSALS CONCERNING THE MEANING OF BENEFICIAL OWNER IN ARTICLES 10, 11 AND 12 OF THE OECD MODEL TAX CONVENTION

*[Additions to the existing text of the Commentary appear in **bold italics** whilst deletions appear in ~~strikethrough~~; changes made to the proposals included in the April 2011 discussion draft are underlined]*

Article 10

1. Replace the first part of paragraph 2 of Article 10 of the OECD Model Tax Convention by the following:

> 2. However, ~~such~~ dividends ***paid by a company which is a resident of a Contracting State*** may also be taxed in ***that State*** ~~the Contracting State of which the company paying the dividends is a resident~~ and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed: ...

Article 11

2. Replace paragraph 2 of Article 11 by the following:

> 2. However, ~~such~~ interest ***arising in a Contracting State*** may also be taxed in ***that State*** ~~the Contracting State in which it arises~~ and according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10 per cent of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation

Commentary on Article 10 (Dividends)

3. Replace paragraphs 12 to 12.2 of the Commentary on Article 10 by the following:

> 12. The requirement of beneficial owner 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~~ ***paid direct to*** a resident of a State with which the State of source had concluded a convention. [*the rest of the paragraph has been moved to new paragraph 12.1*]
>
> ***12.1 Since the term "beneficial owner" was added to address potential difficulties arising from the use of the words "paid to … a resident" in paragraph 1, it was intended to be interpreted in this context and not to refer to any technical meaning that it could have had under the domestic***

law of a specific country (in fact, when it was added to the paragraph, the term did not have a precise meaning in the law of many countries). The term "beneficial owner" is ***therefore*** not used in a narrow technical sense ***(such as the meaning that it has under the trust law of many common law countries[1])***, rather, it should be understood in its context***, in particular in relation to the words "paid … to a resident",*** and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance. ***~~This does not mean, however, that the domestic law meaning of "beneficial owner" is automatically irrelevant for the interpretation of that term in the context of the Article: that domestic law meaning is applicable to the extent that it is consistent with the general guidance included in this Commentary.~~***

[Footnote to paragraph 12.1]

1. 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 (or the trust, if recognised as a separate taxpayer), could constitute the beneficial owners of such income for the purposes of Article 10 even if they are not the beneficial owners under the relevant trust law ~~notwithstanding that the relevant trust law might distinguish between legal and beneficial ownership~~.

12.~~1~~***2*** Where an item of income is ~~received by~~***paid to*** a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption merely on account of the status of the ~~immediate~~ ***direct*** recipient of the income as a resident of the other Contracting State. The ~~immediate~~ ***direct*** recipient of the income in this situation qualifies as a resident but no potential double taxation arises as a consequence of that status since the recipient is not treated as the owner of the income for tax purposes in the State of residence. [*the rest of the paragraph has been moved to new paragraph 12.3*]

12.3 It would be equally inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency 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"[1] 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.

[Footnote to paragraph 12.3]

1. Reproduced at page R(6)-1 of Volume II of the ***full-length*** ~~loose-leaf~~ version of the OECD Model Tax Convention.

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

recipient clearly does not have the ~~full~~ right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person. This type of obligation must be related to the payment received; it would therefore not include contractual or legal obligations unrelated to the payment received even if those obligations could effectively result in the recipient using the payment received to satisfy those obligations. Examples of such unrelated obligations are those unrelated obligations that the recipient may have as a debtor or as a party to financial transactions or typical distribution obligations of pension schemes and of collective investment vehicles entitled to treaty benefits under the principles of paragraphs 6.8 to 6.34 of the Commentary on Article 1. Where the recipient of a dividend does have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person, the recipient is the "beneficial owner" of that dividend. It should also be noted that Article 10 refers to the beneficial owner of a dividend as opposed to the owner of the shares, which may be different in some cases. ~~;also, the use and enjoyment of a dividend must be distinguished from the legal ownership, as well as the use and enjoyment, of the shares on which the dividend is paid.~~

12.5 The fact that the recipient of a dividend is considered to be the beneficial owner of that dividend does not mean, however, that the limitation of tax provided for by paragraph 2 must automatically be granted. This limitation of tax should not be granted in cases of abuse of this provision (see also paragraphs 17 and 22 below). As explained in the section on "Improper use of the Convention" in the Commentary on Article 1, there are many ways of addressing conduit company and, more generally, treaty shopping situations. These include specific ~~treaty~~ anti-abuse provisions in treaties, general anti-abuse rules and substance-over-form or economic substance approaches. Whilst the concept of "beneficial owner" deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on the dividend to someone else), it does not deal with other cases of treaty shopping and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases.

12.6 The above explanations concerning the meaning of "beneficial owner" make it clear that the meaning given to this term in the context of the Article must be distinguished from the different meaning that has been given to that term in the context of other instruments[1] that concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of "beneficial owner" cannot be applied in the context of the Article. Indeed, that meaning, which refers to natural persons (i.e. individuals), cannot be reconciled with the express wording of subparagraph 2 a), which refers to the situation where a company is the beneficial owner of a dividend. ~~Since, i~~In the context of Article 10, the term "beneficial owner" is intended to address difficulties arising from the use of the words "paid to" in relation to dividends~~,~~ rather than difficulties related to the ownership of the shares of the company paying these dividends. For that reason, it would be inappropriate, in the context of that Article, to consider a meaning developed in order to refer to the individuals who exercise "ultimate effective control over a legal person or arrangement."[2]

[Footnotes to paragraph 12.6]

1. *See, for example, Financial Action Task Force,* **International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation – The FATF Recommendations** *(OECD-FATF, Paris, 2012), ~~the Glossary to the Financial Action Task Force's Forty Recommendations (http://www.fatf-gafi.org/glossary/0,3414,en_32250379_32236930_35433764_1_1_1_1,00.html#34276864)~~ which sets forth in detail the international anti-money laundering standard and which includes the following definition of beneficial owner (at page 109): "the natural person(s) who ultimately*

owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement." Similarly, the 2001 report of the OECD Steering Group on Corporate Governance, "Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes" (OECD, Paris, 2001), ~~http://publications.oecd.org/acrobatebook/2101131E.PDF, at page 14,~~ defines beneficial ownership as follows (at page 14):

> ***In this Report, "beneficial ownership" refers to ultimate beneficial ownership or interest by a natural person. In some situations, uncovering the beneficial owner may involve piercing through various intermediary entities and/or individuals until the true owner who is a natural person is found. With respect to corporations, ownership is held by shareholders or members. In partnerships, interests are held by general and limited partners. In trusts and foundations, beneficial ownership refers to beneficiaries, which may also include the settlor or founder***.

2. See the Financial Action Task Force's definition quoted in the previous note. ~~Glossary to the Financial Action Task Force's Forty Recommendations (http://www.fatf-gafi.org/glossary/0,3414,en_32250379_32236930_35433764_1_1_1_1,00.html#34276864).~~

12.~~7~~2 Subject to other conditions imposed by the Article, the limitation of tax in the State of source remains available when an intermediary, such as an agent or nominee located in a Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State (the text of the Model was amended in 1995 ***and in [year of next update]*** to clarify this point, which has been the consistent position of all ~~M~~***m***ember countries). ~~States which wish to make this more explicit are free to do so during bilateral negotiations.~~

Commentary on Article 11 (Interest)

4. Replace paragraphs 9 to 11 of the Commentary on Article 11 by the following:

9. The requirement of beneficial ownership was introduced in paragraph 2 of Article 11 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 interest income merely because that income was ~~immediately received by~~ ***paid direct*** *to* a resident of a State with which the State of source had concluded a convention. [*the rest of the paragraph has been moved to new paragraph 9.1*]

9.1 Since the term "beneficial owner" was added to address potential difficulties arising from the use of the words "paid to … a resident" in paragraph 1, it was intended to be interpreted in this context and not to refer to any technical meaning that it could have had under the domestic law of a specific country (in fact, when it was added to the paragraph, the term did not have a precise meaning in the law of many countries). The term "beneficial owner" is ***therefore*** not used in a narrow technical sense ***(such as the meaning that it has under the trust law of many common law countries[1])***, rather, it should be understood in its context***, in particular in relation to the words "paid … to a resident",*** and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance. ***~~This does not mean, however, that the domestic law meaning of "beneficial owner" is automatically irrelevant for the interpretation of that term in the context of the Article: that domestic law meaning is applicable to the extent that it is consistent with the general guidance included in this Commentary.~~***

[Footnote to paragraph 9.1]

1. For example, where the trustees of a discretionary trust do not distribute interest earned during a given period, these trustees, acting in their capacity as such (or the trust, if recognised as a separate taxpayer) could constitute the beneficial owners of such income for the purposes of Article 11 even if they are not the beneficial owners under the relevant trust law ~~notwithstanding that the relevant trust law might distinguish between legal and beneficial ownership~~.

10. Relief or exemption in respect of an item of income is granted by the State of source to a resident of the other Contracting State to avoid in whole or in part the double taxation that would otherwise arise from the concurrent taxation of that income by the State of residence. Where an item of income is ~~received by~~***paid to*** a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption merely on account of the status of the ~~immediate~~ ***direct*** recipient of the income as a resident of the other Contracting State. The ~~immediate~~ ***direct*** recipient of the income in this situation qualifies as a resident but no potential double taxation arises as a consequence of that status since the recipient is not treated as the owner of the income for tax purposes in the State of residence. [*the rest of the paragraph has been moved to new paragraph 10.1*]

10.1 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"[1] 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.

[Footnote to paragraph 10.1]

1. Reproduced at page R(6)-1 of Volume II of the ***full-length*** ~~loose-leaf~~ version of the OECD Model Tax Convention.

10.2 In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the recipient of the interest is not the "beneficial owner" because that recipient's right to use and enjoy the interest is constrained ~~that recipient does not have the full right to use and enjoy the interest that it receives and this interest is not its own; the powers of that recipient over that interest are indeed constrained in that the recipient is obliged (because of a contractual, fiduciary or other duty) to pass the payment received to another person. The recipient of a interest is the "beneficial owner" of that interest where he has the full right to use and enjoy the interest unconstrained~~ 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 recipient clearly does not have the ~~full~~ right to use and enjoy the interest unconstrained by a contractual or legal obligation to pass on the payment received to another person. This type of obligation must be related to the payment received; it would therefore not include contractual or legal obligations unrelated to the payment received even if those obligations could effectively result in the recipient using the payment received to satisfy those obligations. Examples of such unrelated obligations are those unrelated obligations that the recipient may have as a debtor or as a party to financial transactions or typical distribution obligations of pension schemes and of collective investment vehicles entitled to treaty benefits under the principles of paragraphs 6.8 to 6.34 of the Commentary on Article 1. Where the recipient of interest does have the right to use and enjoy the interest unconstrained by a contractual or legal obligation to pass on the payment received to

another person, the recipient is the "beneficial owner" of that interest. It should also be noted that Article 11 refers to the beneficial owner of interest as opposed to the owner of the debt-claim with respect to which the interest is paid, which may be different in some cases. ~~;also, the use and enjoyment of the interest must be distinguished from the legal ownership, as well as the use and enjoyment, of the debt-claim with respect to which the interest is paid.~~

10.3 The fact that the recipient of an interest payment is considered to be the beneficial owner of that interest does not mean, however, that the limitation of tax provided for by paragraph 2 must automatically be granted. This limitation of tax should not be granted in cases of abuse of this provision (see also paragraph 8 above). As explained in the section on "Improper use of the Convention" in the Commentary on Article 1, there are many ways of addressing conduit company and, more generally, treaty shopping situations. These include specific ~~treaty~~ anti-abuse provisions in treaties, general anti-abuse rules and substance-over-form or economic substance approaches. Whilst the concept of "beneficial owner" deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on the interest to someone else), it does not deal with other cases of treaty shopping and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases.

10.4 The above explanations concerning the meaning of "beneficial owner" make it clear that the meaning given to this term in the context of the Article must be distinguished from the different meaning that has been given to that term in the context of other instruments[1] that concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of "beneficial owner" cannot be applied in the context of the Convention. Indeed, that meaning, which refers to natural persons (i.e. individuals), cannot be reconciled with the express wording of subparagraph 2 a) of Article 10, which refers to the situation where a company is the beneficial owner of a dividend. ~~Since, i~~In the context of Articles 10 and 11, the term "beneficial owner" is intended to address difficulties arising from the use of the words "paid to" in relation to dividends and interest rather than difficulties related to the ownership of the shares or debt-claims on which dividends or interest are paid. For that reason, it would be inappropriate, in the context of these articles, to consider a meaning developed in order to refer to the individuals who exercise "ultimate effective control over a legal person or arrangement".[2]

[Footnotes to paragraph 10.4]

1. ***See, for example, Financial Action Task Force,* International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation – The FATF Recommendations *(OECD-FATF, Paris, 2012), ~~the Glossary to the Financial Action Task Force's Forty Recommendations (http://www.fatf-gafi.org/glossary/0,3414,en_32250379_32236930_35433764_1_1_1_1,00.html#34276864)~~ which sets forth in detail the international anti-money laundering standard and which includes the following definition of beneficial owner (at page 109): "the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement." Similarly, the 2001 report of the OECD Steering Group on Corporate Governance, "Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes" (OECD, Paris, 2001), ~~http://publications.oecd.org/acrobatebook/2101131E.PDF, at page 14~~, defines beneficial ownership as follows (at page 14):***

   > ***In this Report, "beneficial ownership" refers to ultimate beneficial ownership or interest by a natural person. In some situations, uncovering the beneficial owner may involve piercing through various intermediary entities and/or individuals until the true owner who is a natural person is found. With respect to corporations,***

***ownership is held by shareholders or members. In partnerships, interests are held by general and limited partners. In trusts and foundations, beneficial ownership refers to beneficiaries, which may also include the settlor or founder**.*

2. See the Financial Action Task Force's definition quoted in the previous note. ~~Glossary to the Financial Action Task Force's Forty Recommendations (http://www.fatf-gafi.org/glossary/0,3414,en_32250379_32236930_35433764_1_1_1_1,00.html#34276864).~~

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

Commentary on Article 12 (Royalties)

5. Replace paragraphs 4 to 4.2 of the Commentary on Article 12 by the following:

4. The requirement of beneficial ownership was introduced in paragraph 1 of Article 12 to clarify how the Article applies in relation to payments made to intermediaries. It makes plain that the State of source is not obliged to give up taxing rights over royalty income merely because that income was ~~immediately received by~~***paid direct to*** a resident of a State with which the State of source had concluded a convention. The term "beneficial owner" is ***therefore*** not used in a narrow technical sense ***(such as the meaning that it has under the trust law of many common law countries[1])***, 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. ***~~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.~~***

[Footnote to paragraph 4]

1. For example, where the trustees of a discretionary trust do not distribute royalties earned during a given period, these trustees, acting in their capacity as such (or the trust, if recognised as a separate taxpayer) could constitute the beneficial owners of such income for the purposes of Article 12 even if they are not the beneficial owners under the relevant trust law ~~notwithstanding that the relevant trust law might distinguish between legal and beneficial ownership~~.

4.1 Relief or exemption in respect of an item of income is granted by the State of source to a resident of the other Contracting State to avoid in whole or in part the double taxation that would otherwise arise from the concurrent taxation of that income by the State of residence. Where an item of income is ~~received by~~***paid to*** a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption merely on account of the status of the ~~immediate~~ ***direct*** recipient of the income as a resident of the other Contracting State. The ~~immediate~~ ***direct*** recipient of the income in this situation qualifies as a resident but no potential double taxation arises as a consequence of that status since the recipient is not treated as the owner of the income for tax purposes in the State of residence. [*the rest of the paragraph has been moved to new paragraph 4.2*]

4.2 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"[1] 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.

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[Footnote to paragraph 4.2]

1. Reproduced at page R(6)-1 of Volume II of the ***full-length*** ~~loose-leaf~~ version of the OECD Model Tax Convention.

4.3 In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the recipient of the royalties is not the "beneficial owner" because that recipient's right to use and enjoy the royalties is constrained ~~that recipient does not have the full right to use and enjoy the royalties that it receives and these royalties are not its own; the powers of that recipient over these royalties are indeed constrained in that the recipient is obliged (because of a contractual, fiduciary or other duty) to pass the payment received to another person. The recipient of royalties is the "beneficial owner" of these royalties where he has the full right to use and enjoy the royalties unconstrained~~ 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 recipient clearly does not have the ~~full~~ right to use and enjoy the royalties unconstrained by a contractual or legal obligation to pass on the payment received to another person. This type of obligation must be related to the payment received; it would therefore not include contractual or legal obligations unrelated to the payment received even if those obligations could effectively result in the recipient using the payment received to satisfy those obligations. Examples of such unrelated obligations are those unrelated obligations that the recipient may have as a debtor or as a party to financial transactions or typical distribution obligations of pension schemes and of collective investment vehicles entitled to treaty benefits under the principles of paragraphs 6.8 to 6.34 of the Commentary on Article 1. Where the recipient of royalties does have the right to use and enjoy the royalties unconstrained by a contractual or legal obligation to pass on the payment received to another person, the recipient is the "beneficial owner" of these royalties. It should also be noted that Article 12 refers to the beneficial owner of royalties as opposed to the owner of the right or property in respect of which the royalties are paid, which may be different in some cases. ~~;also, the use and enjoyment of the royalties must be distinguished from the legal ownership, as well as the use and enjoyment, of the right or property in respect of which the royalties are paid.~~

4.4 The fact that the recipient of royalties is considered to be the beneficial owner of these royalties does not mean, however, that the provisions of paragraph 1 must automatically be applied. These provisions should not be granted in cases of abuse (see also paragraph 7 below). As explained in the section on "Improper use of the Convention" in the Commentary on Article 1, there are many ways of addressing conduit company and, more generally, treaty shopping situations. These include specific ~~treaty~~ anti-abuse provisions in treaties, general anti-abuse rules and substance-over-form or economic substance approaches. Whilst the concept of "beneficial owner" deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on the royalties to someone else), it does not deal with other cases of treaty shopping and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases.

4.5 The above explanations concerning the meaning of "beneficial owner" make it clear that the meaning given to this term in the context of the Article must be distinguished from the different meaning that has been given to that term in the context of other instruments[1] that concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of "beneficial owner" cannot be applied in the context of the Convention. Indeed, that meaning, which refers to natural persons (i.e. individuals), cannot be reconciled with the express wording of subparagraph 2 a) of Article 10, which refers to the situation where a company is the beneficial owner of a dividend. ~~Since, t~~The term beneficial owner was intended to address difficulties arising from the use of the words "paid to", which are ~~is~~ found in paragraph 1 of Articles 10 and 11 and were ~~was~~ similarly used in paragraph 1 of Article 12 of the 1977 Model Double Taxation Convention, in relation to dividends, interest and royalties rather than difficulties related to the ownership of the shares, debt-claims, property or rights with respect these dividends, interest or royalties are paid. For that reason, it would be inappropriate, in the context of these articles, to consider a meaning developed in order to refer to the individuals who exercise "ultimate effective control over a legal person or arrangement".[2]

[Footnotes to paragraph 4.5]

1. ***See, for example, Financial Action Task Force*, International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation – The FATF Recommendations *(OECD-FATF, Paris, 2012), ~~the Glossary to the Financial Action Task Force's Forty Recommendations (http://www.fatf-gafi.org/glossary/0,3414,en_32250379_32236930_35433764_1_1_1_1,00.html#34276864)~~ which sets forth in detail the international anti-money laundering standard and which includes the following definition of beneficial owner (at page 109): "the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement." Similarly, the 2001 report of the OECD Steering Group on Corporate Governance, "Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes" (OECD, Paris, 2001), ~~http://publications.oecd.org/acrobatebook/2101131E.PDF, at page 14~~, defines beneficial ownership as follows (at page 14):***

   > ***In this Report, "beneficial ownership" refers to ultimate beneficial ownership or interest by a natural person. In some situations, uncovering the beneficial owner may involve piercing through various intermediary entities and/or individuals until the true owner who is a natural person is found. With respect to corporations, ownership is held by shareholders or members. In partnerships, interests are held by general and limited partners. In trusts and foundations, beneficial ownership refers to beneficiaries, which may also include the settlor or founder.***

2. ***See the Financial Action Task Force's definition quoted in the previous note. ~~Glossary to the Financial Action Task Force's Forty Recommendations (http://www.fatf-gafi.org/glossary/0,3414,en_32250379_32236930_35433764_1_1_1_1,00.html#34276864).~~***

4.6~~2~~ Subject to other conditions imposed by the Article, the ~~limitation of tax~~ ***exemption from taxation*** in the State of source remains available when an intermediary, such as an agent or nominee ***located in a Contracting State or in a third State***, is interposed between the beneficiary and the payer, in those cases where the beneficial owner is a resident of the other Contracting State (the text of the Model was amended in ~~1995~~ ***1997*** to clarify this point, which has been the consistent position of all member countries). ~~States which wish to make this more explicit are free to do so during bilateral negotiations.~~