

Clarification of the Meaning of “Beneficial Owner” in the OECD Model Tax Convention

Discussion Draft

Response from the Society of Trust and Estate Practitioners

The Society of Trust and Estate Practitioners (STEP) is the worldwide professional body for practitioners in the fields of trusts and estates, executorship and related issues. STEP members help families secure their financial future and protect the interests of vulnerable relatives. STEP promotes the highest professional standards through education and training leading to widely respected professional qualifications. STEP has almost 17,000 members around the world, with branches in 9 EU member states, North America and Australasia as well as a range of international financial centres.

STEP welcomes the opportunity to comment on the Centre for Tax Policy and Administration’s discussion document on the meaning ‘beneficial owner’. We agree that this is an issue that ought to be addressed. Earlier this year STEP prepared a paper, *“The Legal Obligations on Trustees in Common Law Jurisdictions”*, for the Global Forum on Transparency and Exchange of Information for Tax Purposes which noted that “the definition of ‘beneficial ownership’ is particularly problematic”.

In our paper for the Global Forum we argued “‘beneficial ownership’ is a term legislators and regulators have borrowed from the corporate world but its meaning in the trust context, where the owners are the trustee who is acting in the interests of the beneficiaries, can be unclear.” We are disappointed, therefore, at the continued emphasis in the current discussion document on clarifying the meaning of ‘beneficial owner’ in the corporate context with relatively limited discussion of the issue in the trust context. We believe that this represents a missed opportunity on the part of the OECD in terms of clarifying understanding in a key area.

The need for additional clarity

Paragraph 12.1 of the discussion document argues that ‘beneficial owner’ should not be “used in a narrow technical sense (such as the meaning that it has under the trust law of many common law countries)”. It is not just in the field of trust law that ‘beneficial owner’ has been defined in particular, but not necessarily consistent terms. The term can be found in a variety of contexts, most commonly:

- In the context of OECD/Double Tax Agreements regulations and legislation.
- In the context of FATF/national anti-money laundering regulations and legislation.
- In the context of national trust law.
- In the context of national tax legislation.

We would accept the argument that there need be no single agreed definition of 'beneficial owner' that applies in all situations, provided that each definition is clear and there is also clarity as to which definition applies in which circumstances. Unfortunately such clarity is currently lacking. As the prologue to the discussion draft acknowledges, the concept of 'beneficial owner' has in practice given rise to a string of differing interpretations by courts and tax administrations.

STEP believes there is a pressing need for definitional clarity at the OECD level. While the OECD suggests that the meaning it ascribes to 'beneficial owner' should be separate from that used in a technical sense in particular jurisdictions, 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. The latter Directive, for example, relies on OECD terminology to develop a definition of 'beneficial owner' in the trust context which STEP has long argued is both difficult to apply in practice and leaves significant potential gaps.

The issue of varying meanings in varying contexts has also emerged in recent leading court cases in both the UK and Canada (Indofood International Finance Ltd v. JP Morgan Chase Bank NA, E&W Court of Appeal (2006) 8 ITLR 653; (2006) STC 1195 and Prévost Car Inc. v. The Queen (2009), Federal Court of Appeal of Canada 257). The Indofood case is perhaps particularly noteworthy in that the English Court of Appeal decided that the term 'beneficial owner' should not take a meaning according to domestic law but that it should have an "international fiscal meaning".

This illustrates that national legislators and the courts inevitably tend to look to international bodies such as the OECD for guidance. The discussion document notes when the term 'beneficial owner' was first added to the Commentary "the term did not have a precise meaning in the law of many countries" (paragraph 12.1). Since appearing in the Commentary, however, the term has now found its way widely into national legislation and regulation, albeit with varying meanings. STEP members would welcome progress towards a more general and universal definition of the term 'beneficial owner'. If, as we suspect, that proves difficult, the alternative of developing fresh terms to cover particular circumstances appears to be preferable to maintaining the status quo.

'Effective controller' vs. beneficiary

We note that paragraph 12.4 draws a distinction between recipients of a dividend who do not have the full right to use and enjoy a dividend but are obliged to pass the payment received to another person as opposed to dividend recipients who have the full right to use and enjoy a dividend unconstrained by an obligation to pass the dividend on to others. Sensibly the discussion document argues that only the latter group of recipients should be regarded as the 'beneficial owner' of the dividend.

Similar arguments apply in the case of trusts, where trustees own trust assets and receive dividend and interest income from those assets but are bound by the trust deed to pass that income on either to the trust or directly to beneficiaries. In such circumstances it is potentially misleading to regard trustees as beneficial owners. In our paper for the Global Forum we argued that "it would be better to draft legislation and regulations in terms of two distinct groups; those with control of a trust and beneficiaries". In the case of those with 'control', alongside the trustee and settlor this should include anyone with significant influence over the operation of a trust such as protector, enforcer,

custodians and guardians etc. depending upon the powers granted them by the trust deed. Collectively this group might be labelled 'effective controllers'. Those who receive benefit from the trust would then simply be 'beneficiaries'.

The situation in which the trustees do not distribute benefits such as dividends received to beneficiaries over a period of time is discussed in note 1 to Paragraph 12.1 in Article 10 (in essence replicated as Footnote 1 to Paragraph 9.1 in Article 11). This states:

"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 purposes of Article 10 notwithstanding that the relevant trust law might distinguish between legal and beneficial ownership."

It is important to recognise that in these circumstances the trustee does not have the use and enjoyment of dividends unconstrained by obligations to ultimately pass the payment received to another person as discussed in paragraph 12.4 of the Discussion Draft. We would nevertheless agree that where dividends received by trustees are not to be paid out to beneficiaries for some time and where the trust itself is not regarded as a separate taxpayer the trustees should be regarded as the beneficial owners. Such an approach would be consistent with the treatment of collective investment vehicles as outlined in Paragraph 35 of the May 2010 OECD report on "The Granting of Treaty Benefits with Respect to the Income of Collective Investment Vehicles", subsequently incorporated into the 2010 update to the OECD Model Tax Convention. Given the similarities, trustees in these circumstances should, like CIVs, receive the benefits of tax treaties with respect to dividends. We would, however, note that it will be important to specify with care what the 'given period' for non-distribution of dividends might be in order to prevent abuse. STEP would welcome the opportunity of working with the OECD going forward to ensure effective anti-abuse provisions.

While this specific proposal is welcome and well worth pursuing, more broadly STEP is nevertheless disappointed at the limited exploration of the issues surrounding beneficial ownership in the context of trusts. We would urge further work in this area within to develop more meaningful vocabulary that could form the basis of robust systems in not only in the context of tax but also the anti-money laundering context. STEP, of course, would be happy to assist in any way it can with such work.

STEP

July 2011