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Chartered Institute of Taxation
Excellence in Taxation

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Dear Mr Owens

Clarification of the meaning of 'beneficial owner' in the OECD Model Tax Convention

We refer to the public discussion draft on the clarification of the meaning of 'beneficial owner' in the OECD Model Tax Convention published on 29 April 2011, which includes proposed changes to the Commentary on Articles 10, 11 and 12 of the OECD Model Tax Convention.

We agree with your underlying objective in trying to address a problem that has arisen in some countries, namely, that the expression is being used for purposes beyond that for which it was intended and this, as a result, puts more weight on the expression than it can bear.

The means by which this is sought to be achieved in the proposed amendments to the Commentary is not the best in our view. We believe that the suggested changes to the Commentary are neither necessary nor helpful. We are aware that there are some difficulties that arise in cross border transactions where the relevant tax authorities have different views of the meaning of beneficial ownership, but the proposed amendments do not give certainty, and indeed even make the position rather less clear than it is now.

For many countries, such as the UK, where the meaning of beneficial owner is well understood, the use of it in Articles 10, 11 and 12 does not currently present an issue. However, it would become an issue in the UK if the OECD Commentary is amended and the attempt to define the concept conflicts with what jurisdictions such as the UK understand the meaning to be.

Article 3(2) of the OECD model directs the use of domestic law where a term is not defined in the model and has a well-understood meaning under the laws of the relevant State. However, Article 3(2) is not an invitation to contracting states to make up their own definitions. Where States do not have the concept of beneficial ownership in their domestic law, then the advice of the OCED in paragraph 12.2 of the Commentary ought to be implemented and a meaning agreed by the contracting States to a treaty. In our view, any difficulties that may have arisen in this area would be obviated by this. The OECD should strongly encourage this approach, noting that the EU has done so in the Interest and Royalties Directive by adopting language that tracks that found in the existing Commentary.

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We are of the view that the existing OECD Model and Commentary works, and changes to the Commentary are not required unless they increase understanding of the term. In our view, the proposed changes do not increase understanding. There are a number of basic problems and uncertainties that the proposed amendments create and we discourage their adoption:

- Paragraphs 12.4 and 12.5 are too wide and vaguely drafted. For example, it is not apparent that the wording proposed would permit a company to pledge shares or loan notes and any resulting income to its bank as security for a loan without losing relief from withholding tax. Still less clear is the position of syndicated loans, securitisations and other situations which are in the UK safe harboured by the HMRC guidance in the International Manual at paragraph 332040 - on the basis that they are not abusive transactions, often because the lender/beneficial owner are themselves eligible for treaty relief.

- Paragraph 12.4 indicates that the perceived abuse is not limited to the cases referred to in that paragraph (agent, nominee, etc) but does not explain the scope of the abuse principle, nor where its proper limit actually lies. Nor does it clarify who, in the cases referred to, should be treated as the beneficial owner and eligible for relief which, in the light of the purpose of tax treaties of avoiding double taxation, should not be ignored. As such, it offers little clarification on the application of the relief beyond what is presently understood, and because of the wide wording of the paragraph actually makes the position more obscure.

- The last sentence of paragraph 12.6 is very difficult to follow. It should be possible to reword that sentence to read more easily.

- In the first sentence of paragraph 12.7, we are uncertain what is meant by the phrase 'limitation of tax'. We suggest that a note referring to where the 'limitation of tax' is explained further is included.

- Paragraph 12.1 (and paragraph 9.1 re article 11) appears to be almost contradictory, because it says that *'The term "beneficial owner" is therefore not used in the narrow technical sense (such as the meaning that it has under the trust law of many common law countries)….*' but the next sentence goes on to say that *'This does not mean, however, that the domestic law meaning of "beneficial owner" is automatically irrelevant…*'. Thus it is unclear from this paragraph when or indeed whether the domestic law meaning is meant to apply, as opposed to the meaning which is *'in particular in relation to the words "paid…….to a resident"*. The example in the footnote to paragraph 9.1 leaves doubt by saying that income accumulated in a discretionary trust 'could' be treated as being beneficially owned by the trustees. Most importantly, the Commentary flies in the face of decided case law (*Prevost Car Inc v the Queen* [2009] FCA57) where the Federal Court of Appeal of Canada confirmed that Canadian domestic law (both common and civil) was the correct law to apply and that it was consistent with the existing Commentary.

This last point highlights our view that wherever possible, beneficial ownership should be given its meaning under domestic law. Where that is not possible, States should be encouraged to follow the advice of the OCED in paragraph 12.2 of the Commentary and agree a meaning in the treaty. Changes to the Commentary that make this simple approach clear would be helpful.

Yours sincerely

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Chairman, International Taxes Sub-Committee

The Chartered Institute of Taxation

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