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London, July 14, 2011

Subject: **Ernst & Young's comments to the Proposed Changes to the Commentary on articles 10, 11 and 12 of the OECD Model Tax Convention**

Dear Mr. Owens,

Thank you very much for the opportunity to provide comments on the discussion draft on the proposed changes to the Commentary on articles 10, 11 and 12 of the OECD Model Tax Convention (hereinafter: 'the Proposed Changes') dated April 19, 2011. We hereby would like to provide you with our comments and thoughts on the Proposed Changes.

As mentioned in the introduction to the Proposed Changes, the concept of 'beneficial owner' mentioned in articles 10, 11 and 12 has given rise to different interpretations by courts and tax administrations globally. We understand the purpose of the Proposed Changes aims at clarifying the meaning and interpretation of the term 'beneficial owner' in the OECD Model Tax Convention in order to prevent potential double taxation and non-taxation arising from such different interpretations. We understand this aim such that the term 'beneficial owner' should come to have a single international tax treaty meaning, instead of different meanings under different treaties and under the domestic laws of the various countries. We welcome this objective in light of the risks of double or non-taxation arising from the current different interpretations in various countries. We do however have serious concerns that this stated objective will not be met with the Proposed Changes. We will explain our concerns below.

1 Current Commentary and Proposed Changes

1.1 *Introduction*

First of all, it must be made clear beyond any doubt that, as mentioned in the introduction, the Proposed Changes are indeed a clarification to the meaning and interpretation of the term 'beneficial owner' and are not meant as a change. In our view, this is of utmost importance for

the interpretation of the Proposed Changes by tax payers, tax authorities and tax courts globally.

In spite of the fact that the introduction mentions that the Proposed Changes are a clarification, the Proposed Changes could still be interpreted by tax authorities and tax courts as a change given their wording.

We therefore kindly but firmly request the OECD to explicitly make clear that the Proposed Changes solely are a clarification and not in any way a change.

1.2 *Article 10*

The current Commentary provides:

> *'12.1 Where an item of income is received by a resident of a Contracting State acting in its capacity as 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 recipient of the income as a resident of the other Contracting State. (...). 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 Commentary on Fiscal Affairs entitled "Double Taxation Conventions and the Use of Conduit Companies" concludes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interest parties.'*

Based on the current Commentary, a resident of a Contracting State would not be considered the beneficial owner of dividends, interest or royalties received, if such resident merely acts as agent or nominee in respect of the income, or if such resident merely acts as conduit company with very narrow powers.

The Proposed Changes (among others) add the following:

> *'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 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.'

Assuming the Proposed Changes are indeed a clarification in our view they should be interpreted as clarifying when a resident merely acts as an agent, nominee or conduit company with very narrow powers. In this case it would however be clearer if the Proposed Changes would mention that:

'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 ***[any]*** *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* ***[full]*** *payment received to another person. The recipient of a dividend is the "beneficial owner" of that dividend 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]****. 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* ***[any]*** *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.'*

If, however, the Proposed Changes are interpreted as a change to the meaning and interpretation of the term 'beneficial owner', paragraph 12.4 could be read as to accept as the beneficial owner only the person that has the full right to use and enjoy the dividend legally and in substance. Any legal (or other) obligation to pay (part of) the amount received to another person would then seem to disqualify the recipient of the dividend as the beneficial owner and as a result would seem to jeopardize that person's access to the treaty benefits. Furthermore this interpretation could raise fungibility issues: any amount paid by the recipient could be raised as a potential loss of the fullness of the ownership.

Although this clearly cannot be the OECD's intention, we believe that there is a serious risk that certain tax authorities and tax courts will interpret the Proposed Changes as such, leading to significant overkill.Such potential overkill can lead to substantial confusion and uncertainty as well as, ultimately, (financial) market disruption.

For instance, many persons that are entitled to and are receiving dividends have other cash flow costs that they are obliged to pay and they may well finance those costs out of the dividends received. These could for instance be employment expenses, investment obligations, financing expenses such as interest or obligations to pay preferred dividends, or simply the obligation to return the principal on a loan, etc. If interpreted as a change, the Proposed Changes could be read as not distinguishing between the types of legal obligation and therefore any obligation that would exist prior to receiving the dividend could therefore arguably be used by tax authorities of the payor state for denying the beneficial ownership of the recipient. This obviously is not desirable and should be prevented.

A more specific, simple example in this respect would be an entity that (on average) receives EUR 5 million dividends annually from a certain share interest. The entity financed this share interest with equity as well as a loan payable and the interest payments on the loan payable equal EUR 4 million annually. Although we believe this cannot be the OECD's intention, we also believe that there is a serious risk that certain tax authorities and tax courts will hold that the entity is not the beneficial owner of the dividends based on the text of the Proposed Changes.

On a separate note, 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. In other words: it cannot be the case that there is no beneficial owner.

1.3 *Article 11*

For our generic comments with respect to the Proposed Amendments to the Commentary on article 11, we kindly refer to paragraph 1.2. In this paragraph we will describe the potential overkill with respect to interest.

More specifically with respect to interest, for instance, most financial institutions will have obligations to pay to their creditors a significant portion of the interest they receive with respect to their loans receivable (i.e. to the extent the receivables on their balance sheets are not financed with equity but with debt): this is simply their ordinary course of business.

Furthermore, also in their ordinary course of business, financial institutions (e.g. banks, insurance companies, group treasury centers etc.) typically engage in financial instruments under which they have the obligation to pay to other persons amounts that are based on or a function of amounts received by that financial institution. More so than with dividends, the potential overkill mentioned in paragraph 1.2, also in view of the fungibility of money, can lead to substantial confusion, uncertainty and ultimately, (financial) market disruption.

A simple example of the potential overkill mentioned in paragraph 1.2 in relation to interest would be an entity that receives EUR 10 million of interest and that is contractually obliged to pay EUR 9 million to its creditors under its own financing obligations. Although we believe this cannot be the OECD's intention (especially in the case that the entity has substance, incurs risk with respect to its loans receivable and earns an arm's length remuneration with respect to its financing activities), we believe that there is a serious risk that certain tax authorities and tax courts will hold that the entity is not the beneficial owner of the interest based on the text of the Proposed Changes.

Another example would be a multinational that wishes to obtain funds for its worldwide operational activities and incorporates an entity in a country that the financial markets are familiar and comfortable with, which issues bonds in the market. The entity on-lends the funds obtained from the bond issuance to various group companies and earns a remuneration with respect to its financing activities that is at arm's length based on the risks/capitalization of the entity and its activities. It uses the interest received from the loans granted to its group companies to fulfill its interest payment obligations to the bond holders. Also in this case, we believe that there is a serious risk that certain tax authorities and tax courts will hold that the entity is not the beneficial owner of the interest based on the text of the Proposed Changes.

In this respect, also please note that should the entity not be considered the beneficial owner of the interest received from group companies severe practical complications will arise, e.g. with respect to how the group companies paying the interest to the entity will determine which party should be considered the beneficial owner of the interest (as the interest is paid to bond holders from different countries whose identity/residence may not even be known).

1.4 *Article 12*

For our generic comments with respect to the amended Commentary on article 12, we kindly refer to paragraph 1.2. In this paragraph we will describe the potential overkill with respect to royalties.

A simple example of the potential overkill mentioned in paragraph 1.2 in relation to royalties would be a software company which receives EUR 5 million of royalties in connection to a software licenses to its clients but also is contractually obliged to pay on EUR 4 million for the use of two other software programs embedded in the software it licenses out.

Although we believe this cannot be the OECD's intention (especially in the case that the entity has substance, incurs risk with respect to its royalties received and earns an arm's length remuneration with respect to its licensing activities), we also believe that there is a serious risk that certain tax authorities and tax courts will hold that the entity is not the beneficial owner of the interest based on the text of the Proposed Changes.

Although the above example is a very black and white example where treaty access must not be denied, the authors of the changes will recognize that there are many business cases where it is less black and white but where treaty access should still not be denied. As mentioned the current wording of the Proposed Changes provides for significant overkill and can be very disruptive to a global business community where cross border intangible licensing has become essential.

1.5 *Conclusion*

The Proposed Changes are presented as a clarification. As mentioned above it must in our view be made clear beyond doubt by the OECD that they indeed are a clarification to the meaning and interpretation of the term 'beneficial owner' and that a change is not intended. In addition, to underline that the Proposed Changes are indeed a clarification, the wording of paragraph 12.4 should be amended as suggested above.

In the current wording, paragraph 12.4 of the Proposed Changes could be interpreted by tax authorities and tax courts as a change entailing a significant tightening of the term 'beneficial owner' that in our view, except in the most clear cut cases of beneficial ownership, could allow source states to claim lack of beneficial ownership more or less at will.

An interpretation that any legal (or other) obligation to pay (part of) the amount received to another person would disqualify the recipient of the dividend, interest or royalty as the beneficial owner has far too wide implications, is illogical (we also refer to the abovementioned examples) and therefore is not suited as a guiding principle.

As mentioned above, we welcome the aim to clarify the meaning and interpretation of the term 'beneficial owner' and we appreciate the need for anti-abuse provisions. However, the Proposed Changes, if interpreted as a change, will create confusion and uncertainty as their wording allows countries to deny many legitimate (i.e. non-abusive) treaty claims, which may also lead to (financial) market disruption. The Proposed Changes will in that case be a basis for legal disputes and will lead to more instead of less uncertainty on the interpretation of the term 'beneficial owner' than currently is the case. Therefore, if the Proposed Changes – in spite of their introduction as a clarification – 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.

In our view, the term 'beneficial owner' should have a single (and simple) international tax treaty meaning not resulting in an increase in its application as an anti-abuse provision. We will expand in this respect in the next paragraphs.

2 International tax treaty meaning of the term beneficial ownership

In the Proposed Changes the following is provided in respect of the international tax treaty meaning of the term beneficial ownership:

'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, 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.

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 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".'

The Proposed Changes to paragraphs 12.1 and 12.6 (as well as to paragraphs 9.1, 10.4, 4.1 and 4.5) thus make clear that the term 'beneficial owner' does not refer to any technical meaning that it could have under the domestic law of a specific country, and that in fact the term beneficial owner did not have a precise meaning in the law of many countries when the term was added to paragraph 1 of the Commentary to articles 10, 11 and 12. Furthermore, the Proposed Changes to paragraphs 12.1 and 12.6 (as well as to paragraphs 9.1, 10.4, 4.1 and 4.5) thus make clear that the term 'beneficial owner' does not refer to the individuals who exercise ultimate effective control over a legal person or arrangement.

These Proposed Changes indeed could clarify the meaning and interpretation of the term 'beneficial owner' and lead to a single international tax treaty meaning of the term 'beneficial owner', which we consider a necessity. We also consider it a core task of the OECD to provide guidance in this regard in light of the risks of double or non-taxation arising from the current different interpretations in various countries and therefore welcome the Proposed Changes to paragraphs 12.1 and 12.6 (as well as to paragraphs 9.1, 10.4, 4.1 and 4.5).

3 The beneficial owner concept in an anti-abuse context

Many tax treaties contain the term 'beneficial owner' as well as one or more other anti-abuse provisions which prevent and/or correct the improper use of tax treaties. In the Proposed Changes the following is provided in this respect:

'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.'

As mentioned above, although the Proposed Changes to paragraph 12.4 (as well as to paragraphs 10.2 and 4.3) are presented as a clarification, they could in their current wording also be interpreted as a significant change to the meaning and interpretation of the term 'beneficial owner', i.e. in the sense of an increase in its application as an anti-abuse provision.

In our view, the term 'beneficial owner' should not be used to prevent and/or correct the improper use of tax treaties in situations other than those described in the current Commentary (i.e. if a resident acts as an agent or nominee in respect of the income, or if such resident merely acts as a conduit company with very narrow powers).

We strongly believe that there should be a universal definition of the term 'beneficial owner' that merely defines the owner of income for tax purposes, without any further motives of preventing treaty abuse other than under the current Commentary. This should be a simple

definition that - ideally - should be interpreted the same way all over the world. Any other definition than the current definition of beneficial owner will lead to differing interpretations, confusion, uncertainty, legal disputes and potential (financial) market disruption. Therefore, we suggest seeking global support for a simple definition of beneficial ownership, in line with the existing definition (i.e. excluding the agent, nominee and conduit company with very narrow powers). At the same time, specific anti-abuse provisions should be developed to counter the abuse of tax treaties. Such anti-abuse provisions should be agreed upon on a bilateral basis. Should treaty partners wish to include anti-abuse provisions in a tax treaty, such provisions should be specific, clear and proportional, thus preventing overkill, legal disputes and uncertainty. In the following paragraph suggestions in this respect will be made. We strongly believe that this approach provides for a much stronger and cohesive tax treaty framework.

4 Anti-abuse provisions

If the Proposed Changes - in spite of their introduction as a clarification - are to be interpreted as a change, as mentioned above the Proposed Changes to paragraph 12.4 (as well as to paragraphs 10.2 and 4.3) of the Commentary should not be implemented. Instead of the undesirable increase in the application of the term 'beneficial owner' as an anti-abuse provision that would result from such implementation, specific anti-abuse provisions could be included in tax treaties based on the preferences of the treaty partners. Anti-abuse provisions that would limit the access to specific treaty benefits with respect to dividend / interest / royalty payments that could be agreed upon by treaty partners include the following:

1. Minimum risk/equity requirements; a resident could be required to run a certain minimum risk with respect to the dividend / interest / royalty payments it receives, i.e. - in case of interest - if the relevant loan receivable would not be repaid a certain minimum percentage of the resulting loss should be borne by the resident (lender). The resident (lender) should then also have a certain minimum equity to bear such risks. Such minimum risk/equity requirements could potentially be combined with minimum substance/functionality requirements;
2. Base erosion provisions; the percentage of a dividend / interest / royalty payment a resident receives and pays on to a non-resident could be made subject to a maximum. In this respect, safe havens should be included for situations in which the dividend / interest / royalty payment a resident receives is smaller than a certain percentage of the residents total income;
3. Limitation on Benefits provisions; the access to specific treaty benefits with respect to dividend / interest / royalty payments could be made subject to meeting certain specific tests (e.g. a publicly traded company test, an active trade or business test or a headquarters test, etc.)

5 Conclusion

As mentioned above we welcome the OECD's objective to clarify the meaning and interpretation of the term 'beneficial owner' in light of the risks of double or non-taxation arising from the current different interpretations in various countries.

We support he Proposed Changes to paragraphs 12.1 and 12.6 (as well as to paragraphs 9.1, 10.4, 4.1 and 4.5).

However, the current wording of the Proposed Changes to paragraph 12.4 (as well as to paragraphs 10.2 and 4.3) can be interpreted differently and can result in more instead of less uncertainty on the interpretation of the term 'beneficial owner' than currently is the case. For further details in this respect reference is made to paragraph 1.5.

Therefore, the OECD should explicitly make clear that the Proposed Changes solely are a clarification and not in any way a change. Furthermore, the text of paragraph 12.4 should be amended accordingly (as outlined above). If a change is intended in our view the Proposed Changes to paragraph 12.4 (as well as to paragraphs 10.2 and 4.3) should not be implemented. If desired, treaty partners can instead include further anti-abuse provisions in the relevant tax treaty, in which respect suggestions have been made above in paragraph 4.

We would obviously be happy to further elucidate the above. Therefore, please do not hesitate to contact us should you have any questions or requests with respect to the above or otherwise. Thank you,

Yours sincerely,
For Ernst & Young International Tax Services,

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