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By email: jeffrey.owens@oecd.org

Mr. Jeffrey Owens
Director, CTPA
OECD
2, rue André Pascal
75775 Paris
FRANCE

Re: **Comments on Clarification of the Meaning of "Beneficial Owner" in the OECD Model Tax Convention – Discussion Draft**

Dear Mr. Owens:

Kim & Chang is grateful for the opportunity to comment on the OECD's Discussion Draft containing the proposed changes to the Commentary on Articles 10 (Dividends), 11 (Interest) and 12 (Royalties) of the OECD Model Tax Convention to clarify the meaning of "beneficial owner" in the context of holding companies.

As you may be aware, Kim & Chang is widely recognized as Korea's premier law firm with over 800 professionals advising large domestic and international clients across a wide range of disciplines including tax.

We support the initiative to clarify the meaning of "beneficial owner" as tax jurisdictions have inconsistently applied the concept and have been using it (i) to deny tax treaty benefits to legitimately established holding companies and (ii) as a comprehensive tax avoidance tool, both of which we believe is beyond the intent of the beneficial ownership concept. As such, we believe it is important that the clarification be carefully constructed so as to reduce the current ambiguity and to avoid any further confusion over the meaning of "beneficial owner" with respect to holding companies.

Inconsistent Application of "Beneficial Owner"

The concept of "beneficial owner" with respect to holding companies has been inconsistently applied across tax jurisdictions due primarily to the lack of substantive guidance in domestic laws and tax treaties.

The Tax Court of Canada in 2008 ruled that a Dutch holding company was the beneficial owner of dividends received from its Canadian subsidiary as it used and enjoyed the dividends, had risk and control over the dividends and had no legal obligation to distribute the dividends to its shareholders.[1] Similarly, the Danish National Tax Tribunal in two instances recognized a Luxembourg holding company as the beneficial owner of income received from a Danish subsidiary primarily because such income was not immediately paid to shareholders.[2] There are also several U.S. tax cases involving suspected tax avoidance and conduit companies where the question of a taxpayer being eligible for treaty benefits were not dependent on the existence of beneficial ownership.[3] These cases support the argument that the legal or corporate personality cannot be disregarded provided a genuine business purpose exists for the entity in question and suggests that an entity determined to be a non-conduit is presumed to be the beneficial owner of income in question.

In contrast, certain jurisdictions have applied the beneficial ownership requirement as a type of substance over form test and denied tax treaty benefits on the basis that the income recipient was a conduit company or formed primarily for the purpose of tax avoidance. In nearly all of these cases, there is a presumption that a holding company that only owns shares in another company and without physical substance (such as employees and office equipment) is an artificial arrangement that cannot result in the holding company being a beneficial owner of the income in question. However, we are unaware of the OECD ever having commented that employees or other physical substance is a prerequisite for beneficial ownership.

The foregoing is evidence that specific guidance is needed to harmonize how jurisdictions apply the concept of "beneficial owner" to holding companies. Since the tax authorities throughout the world often refer to the OECD Commentary when interpreting Double Tax Conventions, it is critical that the concept of "beneficial owner" is clear and concise to avoid confusion and misinterpretation.

Holding Companies as "Beneficial Owner"

We are unaware of the OECD ever having concluded or commenting that a holding company is "per se" incapable of being a beneficial owner. Indeed, the report "Double Taxation Conventions and the Use of Conduit Companies" (the "1987 Report") referenced in paragraph 12.3 (and similarly 10.1 and 4.2) covers the improper use of "conduit companies" in the context of treaty shopping and discusses several approaches for dealing with certain conduit

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[1] Prévost Car Inc. v. Her Majesty the Queen, 2008 TCC 231 (April 30, 2008).

[2] In a third beneficial ownership case, the Danish National Tax Tribunal applied a consistent legal ownership approach in ruling against the taxpayer. In such instance the income received by a Swedish company from its Danish subsidiary was immediately redistributed to its shareholder.

[3] See SDI Netherlands BV v. Commissioner, 107 T.C. 161 (1996); Northern Indiana Public Service Company v. Commissioner, 115 F.3d 506 (7th Cir. 1997); Ross Glove Company v. Commissioner of Internal Revenue, 60 T.C. 569 (1973); Bass v. Commissioner, 50 T.C. 595 (1968); Sam Siegel v. Commissioner of Internal Revenue, 45 T.C. 566 (March 21, 1966).

companies having "very narrow powers which render it a mere fiduciary or an administrator."[4] In discussing conduit companies, the 1987 Report further states that "[t]he fact that its main function is to hold assets or rights is not itself sufficient to categorize it as a mere intermediary."[5] In addition, the 1987 Report recognizes that "a legal entity is sometimes created in an intermediary country for other than tax purposes"[6] In effect, the OECD recognizes that holding companies are not necessarily conduit companies contrary to the belief of many tax jurisdictions.

While we acknowledge that there are cases where holding companies are utilized solely for tax motivated purposes, holding companies are also often formed for legitimate business reasons. For example, the fund industry utilizes holding companies to facilitate acquisition financing, satisfy regulatory compliance, management investment, and manage local country legal risks, etc. Unfortunately, even "brick and mortar" industries that have established intermediary holding companies for purposes of consolidating their operations in many countries around the world stand the risk of being classified as conduit companies used for tax avoidance purposes.

Consequently, 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. As such, further clarification of this position in the Commentary would be extremely helpful.

"Beneficial Owner" as Anti-Avoidance Rule

We believe the concept of "beneficial owner" was intended to provide clarity and certainty for determining the party in receipt of income (in particular in the countries where securities are held in the nominee or agent's name) and should only be used as an anti-avoidance tool in limited circumstances in contrast to a Limitation on Benefits article or a substance over form doctrine under domestic law. Again, the lack of substantive guidance has caused confusion among taxpayers, tax professionals and tax authorities. As such, we believe a clear and concise definition of "beneficial owner" and concrete examples demonstrating beneficial ownership under various fact patterns (including holding companies) would be extremely helpful in eliminating this confusion.

Paragraph 12.5 (and similarly 10.3 and 4.4) states that a taxpayer being considered to be the beneficial owner does not necessarily mean that such taxpayer is automatically entitled to

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[4] See paragraph II.B.14.b of Double Taxation Conventions and the Use of Conduit Companies (1987, OECD).

[5] Id.

[6] See paragraph I.A.3 of Double Taxation Conventions and the Use of Conduit Companies (1987, OECD) wherein the reporters stated "[I]t is noted that a legal entity is sometimes created in an intermediary country for other than tax purposes (such as access to capital markets, currency regulations, political situations or the need to be present in the country of investment under the 'flag' of the intermediary country), and that does, of course, have tax consequences."

treaty benefits. We fully agree with this view; however, there is a significant danger that tax authorities applying a substance over form concept may use the beneficial ownership requirement only for testing whether a taxpayer is a conduit and not to show that the taxpayer is not a conduit. We would therefore recommend that the sentence stating that the concept of beneficial owner deals with some form of tax avoidance be removed and make clear that the beneficial ownership concept should be applied separately from anti-abuse provisions.

Recommendations for Further Clarification of "Beneficial Owner"

To limit any further confusion and misinterpretation of the term "beneficial owner", we recommend the following clarifications to the Commentary:

- The Commentary should clearly distinguish between a conduit company described in the 1987 Report and a holding company utilized for legitimate business reasons in the context of beneficial ownership and stress that whether the holding company's jurisdiction results in a tangential tax benefit is irrelevant for determining beneficial ownership.

- The footnote to paragraph 12.1 (and similarly 9.1 and 4) should be amended to clarify the language "in their capacity as such" and "the trust, if recognized as a separate taxpayer" as we believe this may be misinterpreted and used inappropriately.

- Paragraph 12.4 (and similarly 10.2 and 4.3) should be amended to clarify the meaning of the language "full right to use and enjoy" as we believe such language is ambiguous and may cause added confusion. We believe a more elaborate and robust explanation is necessary and should be made unequivocally clear whether or not the terms "use" and "enjoy" are legal and economic concepts, respectively. In addition, several concrete examples would assist in eliminating such confusion and uncertainty.

- Paragraph 12.4 (and similarly 10.2 and 4.3) should be amended to more clearly state that only agents, nominees and conduit companies (as discussed in the 1987 Report) do not qualify as a beneficial owner. It should further be clarified that a "contractual or legal obligation to pass the payment received to another person" does not mean payments required under contracts entered into in the ordinary course of business (e.g., loan and credit agreements, hedging transactions, etc.)

- Paragraph 12.5 (and similarly 10.3 and 4.4) should be amended to clearly state that beneficial ownership should only be used as a tax avoidance tool in limited circumstances and that tax avoidance should be addressed in a Limitation of Benefit article.

- While not directly the subject of this discussion draft, tax authorities in several jurisdictions across Asia have been applying the concept of "beneficial owner" to the Capital Gains article of their respective treaties which to our knowledge has never been included in Article 13 (Capital Gains) of the OECD Model Tax Convention or the related Commentary. Such article refers to the "alienation" of property which infers the severance or termination of legal ownership of property, a concept distinct and separate from beneficial ownership. As such, confirmation that the concept of “beneficial owner” is applicable only in the case of dividend, interest and royalty income would bring much needed clarity in this area.

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We are available to further discuss any of our comments with you if any clarification is needed. Kim & Chang thanks you for the opportunity to assist in this important topic.

Very truly yours,

Kim & Chang