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Re: Clarification of the Meaning of "Beneficial Owner" in the OECD Model Tax Convention – discussion draft

Dear Mr. Owens,

We welcome the opportunity to provide some comments on the OECD discussion draft on the *Clarification of the Meaning of "Beneficial Owner"* released on 19 April 2011 and the proposed changes to the Commentary on Articles 10, 11 and 12 of the OECD Model Tax Convention (Draft).

We commend the OECD for its efforts in updating the OECD Commentary of the Model Tax Convention to deal with the meaning of "beneficial owner" which is still one of the most debated issues involving the application of tax treaties. As often when additional guidance is provided, some issues are clarified and new ones arise. The points below refer to specific paragraphs which contain amendments in the Draft. We hope that you may find this contribution helpful to the discussion and future amendments to the Commentary of the OECD Model Tax Convention.

- Paragraphs 12.1 to Article 10; 9.1 to Article 11 and 4 to Article 12

> *The term "beneficial owner" is therefore not used in a narrow technical sense (such as the meaning 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 the light of the object and purposes of the Convention, including avoiding of 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.

Article 3(2) OECD MC provides that, only where no domestic definition for tax purposes is available of the term "beneficial owner", the context - which includes the guidance provided in the Commentary - becomes relevant. Considering that basic interpretation principle the reference in the Draft according to which *"the domestic law meaning is applicable to the extent that it is consistent with the general guidance included in this Commentary"*[1] is not clear. This reference does not seem to be in line with the general interpretation principle of the OECD and neither with those that are laid down in the Vienna Convention on the Law of Treaties. And it gives rise to some questions:

- Should this indeed be the interpretation route to be followed, how should it be applied in practice?
- Should the domestic interpretation be 100% in line with the OECD guidance? What if it deviates on minor issues? And what if it deviates on substantial issues? Where is the line to be drawn? It may be expected that when states have a (clear cut) domestic definition of the term for tax purposes that definition most probably will prevail regardless of what is laid down in the Commentary. Therefore, more guidance on the interaction between the commentary and domestic definitions would be welcome.

In addition, keeping the reference to domestic tax laws rather then an autonomous interpretation of this term may not ensure the desired consistency and uniform interpretation as conflicts are likely to arise about the exact meaning of "beneficial owner" giving rise to situations of double taxation.

- Paragraphs 12.2 to Article 10; 9 to Article 11 and 4.1 to Article 12

The terms "immediate recipient" and "received by" have been replaced, respectively, by "direct recipient" and "paid to". Some guidance on the reason to adopt these new terms would be helpful.

In addition, the replacement and emphasis given to the term "paid to" may give rise to some questions. One wonders why the link to the wording "paid…to a resident" is made (again) especially because these words are not even included in the relevant paragraphs[2]. For both dividends and interest the source state needs to apply a lowered withholding tax rate as long as the beneficial owner is located in the resident state of the direct recipient. Whether the beneficial owner is the direct recipient or indirect recipient should not matter. The same applies regarding royalties. The source state may not tax if the beneficial owner of the royalty is resident in the other state. This interpretation seems to be confirmed by the paragraph 12.7 (on dividends), 11 (on interest) and 4 (on royalties) which show that the

[1] Suggested paragraph 12.1 on article 10 OECD MC, 9.1 on article 11 OECD MC, 4 on article 12 OECD MC

[2] The term "beneficial owner" is used in paragraph 2 of article 10 and 11 OECD MC and in paragraph 1 of article 12 OECD MC. The words "paid… to a resident" are not used in these paragraphs. The words "paid…to a resident" are however used in article 10(1) OECD MC and 11(1) OECD MC.

beneficial owner is still entitled to the tax treaty benefits regardless of whether he is the direct recipient of the payment or not. It is not entirely clear why this intensified emphasis on the link with "paid…to a resident" is made. What would happen if the direct recipient and the beneficial owner are resident in two different states?

- Paragraphs 12.4 to Article 10; 10.2 to Article 11 and 4.3 to Article 12

The amended draft commentary provides a definition of "beneficial ownership" as follows:

> *The recipient of the* [dividend/interest/royalties] *is the beneficial owner where he has the full right to use and enjoy the dividend/interest/royalties unconstrained by a contractual or legal obligation to pass the payment received to another person*.

In the negative definition it is also said that someone is not the beneficial owner when:

> *does not have a full right to use and enjoy the* [dividend/interest/royalties] *and this* [dividend/interest/royalties] *is not its own*.

We praise the definition of "beneficial ownership" provided in these paragraphs. In particular we welcome the clarification provided in the Draft that beneficial ownership meaning is linked to the attributes of ownership. Some issues may however arise in adopted wording in what refers to:

- What is the exact meaning of full right to use and enjoy?
- When is such right unconstrained?
- The positive and negative definition of "beneficial ownership" relies essentially on the expression *full right to use and enjoy.* However a reference is also made to that this right is not *unconstrained by a contractual or legal obligation to pass the payment* (, which seems to imply that "control" is an element to be considered[3]. Some further clarification would be welcome in this regard.

- Paragraphs 12.5 to Article 10; 10.3 to Article 11 and 4.4 to Article 12

> *The fact that the recipient of a* [dividend/interest/royalties] *is considered to be the beneficial owner of that* [dividend/interest/royalties] *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*

[3] See pra. 100 of decision on Prevost Car Inc. V. Her Majesty the Queen, 2008TCC231, of 22 April 2008 which referred that: *"In my view the "beneficial owner" of dividends is the person who received the dividends for his or her own use and enjoyment and assumes the risk and control of the dividend he or she received."* [underline JvW/BdS]

> *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/interest/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.*

The statements stated in the above referred paragraphs imply that the interpretation of the term "beneficial owner" is being used as a measure to tackle tax avoidance. Particularly interesting is the reference that even if a person is to be regarded a beneficial owner this does still not mean that the benefits should be granted to that beneficial owner as there is no such obligation in abuse-situations. Issues may arise regarding:

- How can there be abuse situations specifically regard to article 10, 11 and 12 OECD MC if the beneficial ownership definition is as such to combat the relevant abuse?
- Which type of abuse is thought of under these provisions which would not be caught under the "beneficial owner" definition?

It would be useful to clarify these issues and in particular that the beneficial ownership tests cannot be challenged by the application of domestic anti-abuse provisions. This is as much relevant as under the proposed amendments, "beneficial ownership" is being given a treaty meaning with a limited reference to domestic law (only in cases when it is consistent with the guidance in the Commentary), while states remain free to apply their own anti-avoidance legislation with its domestic law meanings.

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We appreciate the opportunity to provide our comments on this discussion draft and remain at your disposal for any questions regarding this letter.

Respectfully,

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