Beneficial Ownership under Tax Treaties

Recent Developments

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Mumbai, International Taxation Conference **5 December 2013**

Overview

1. **Proposed Changes to the OECD Commentary**
2. **Recent judgments in Canada, Denmark and Switzerland**

Proposed Changes to the Commentary on Arts. 10 to 12 OECD Model Tax Convention

Proposed Changes to the OECD Commentary (1)

Discussion drafts on beneficial ownership:

- **In April 2011, the OECD published a discussion draft: *Clarification of the meaning of "beneficial ownership" in the OECD Model Tax Convention* and asked for public comments.**
- **After having received numerous comments, in October 2012, the OECD published the *Revised proposal concerning the meaning of beneficial owner in Articles 10, 11 and 12 of the OECD Model Tax Convention*.**

Proposed Changes to the OECD Commentary (2)

Proposed changes to the Commentary on Art. 10:

- **Para 12 and 12.2: "*immediately received by*" changed to "*paid to*".**
- **Para. 12.1: No reference to meaning in national law, especially trust law.**
- **Para 12.2: First part of old para 12.1**
- **Para. 12.3: Second part of old 12.1**
- **Para. 12.4: Substantial new provision**

Proposed Changes to the OECD Commentary (3)

Proposed changes to the Commentary on Art. 10 (cont'd):

[12.4 New] ***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's right to use and enjoy the dividend is constrained by a contractual or legal obligation to pass on 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 right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person.

Proposed Changes to the OECD Commentary (3)

Proposed changes to the Commentary on Art. 10 (cont'd):

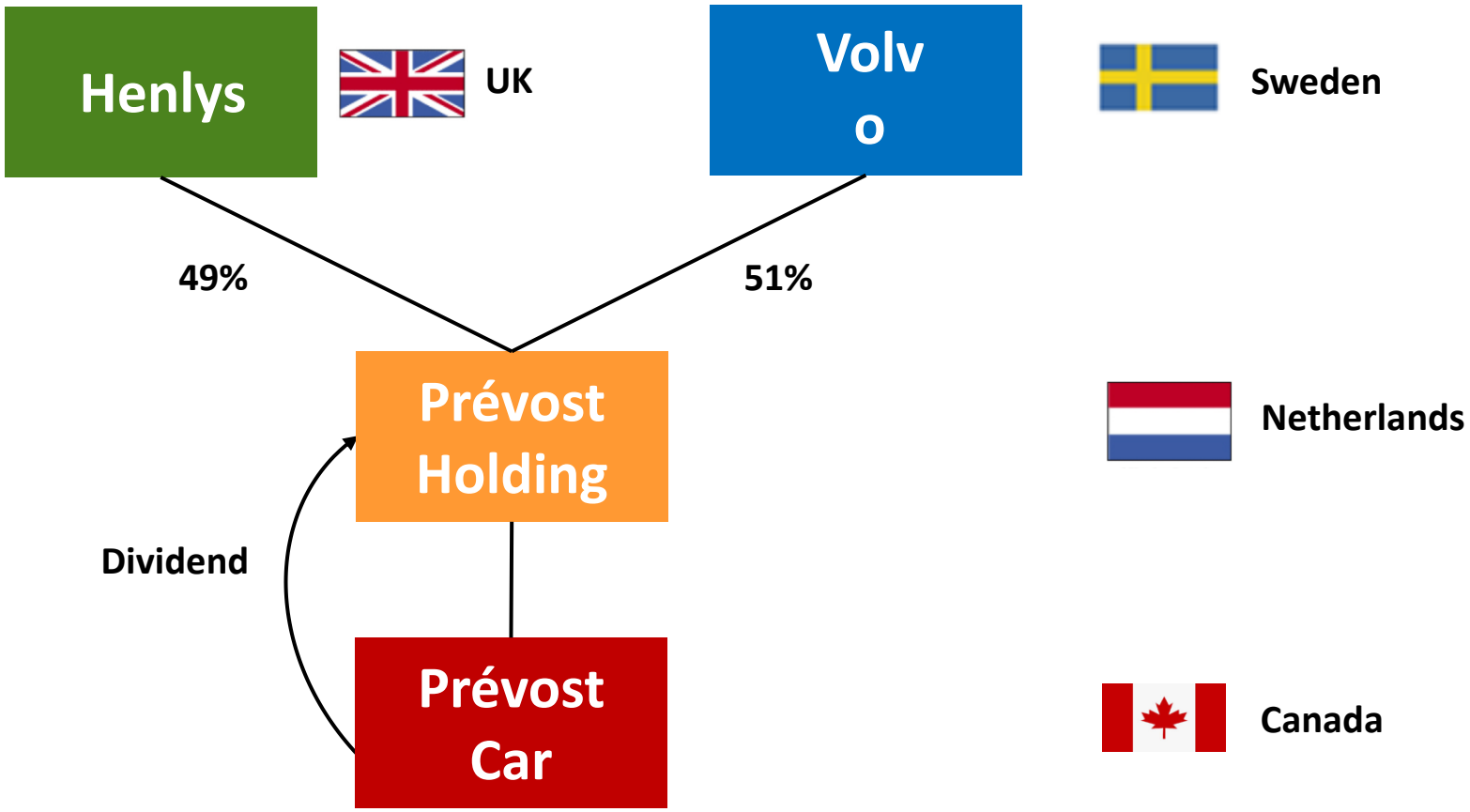
This type of obligation must be related to the payment received; it would therefore not include contractual or legal obligations unrelated to the payment received even if those obligations could effectively result in the recipient using the payment received to satisfy those obligations.

Examples of such unrelated obligations are those unrelated obligations that the recipient may have as a debtor or as a party to financial transactions or typical distribution obligations of pension schemes and of collective investment vehicles entitled to treaty benefits under the principles of paragraphs 6.8 to 6.34 of the Commentary on Article 1.

Where the recipient of a dividend does have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person, the recipient is the "beneficial owner" of that dividend.

Recent judgments

Prévost 2008 / 2009 (1)



Prévost 2008 / 2009 (2)

Tax Court of Canada:

[100] ***In my view the "beneficial owner" of dividends is the person who receives the dividends for his or her own use and enjoyment and assumes the risk and control of the dividend he or she received.***

The person who is beneficial owner of the dividend is the person who enjoys and assumes all the attributes of ownership.
In short the dividend is for the owner's own benefit and this person is not accountable to anyone for how he or she deals with the dividend income.

…

Prévost 2008 / 2009 (3)

Tax Court of Canada (cont'd):

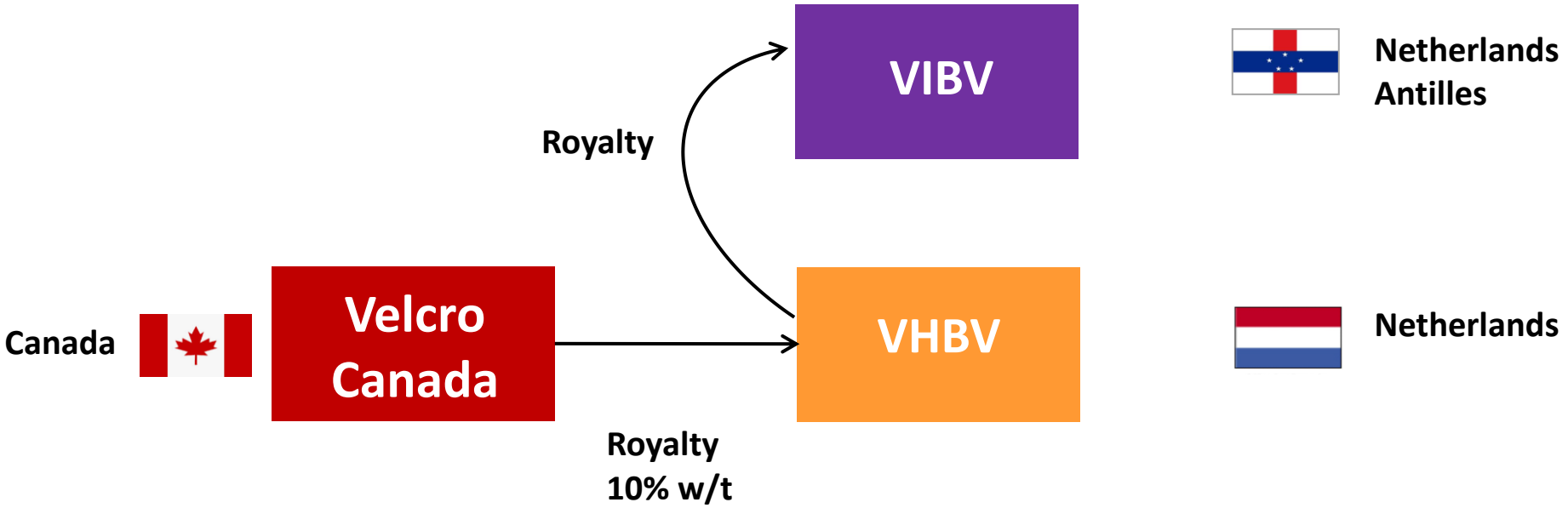
Where an agency or a mandate exists or the property is in the name of a nominee, one looks to find on whose behalf the agent or mandatary is acting or for whom the nominee has lent his or her name.
When corporate entities are concerned, one does not pierce the corporate veil unless the corporation is a conduit for another person and has absolutely no discretion as to the use or application of funds put through it as a conduit, or has agreed to act on someone else's behalf pursuant to that person's instructions without any right to do other than that person instructs it.
For example: a stockbroker who is the registered owner of the shares it holds for its clients. This is not the relationship between PH B.V. and its shareholders.

Prévost 2008 / 2009 (4)

Canada Federal Court of Appeals:

[15] ***Counsel for the Crown has invited the Court to determine that "beneficial owner", "bénéficiaire effectif", mean the person who can, in fact, ultimately benefit from the dividend.***
That proposed definition does not appear anywhere in the OECD documents and the very use of this word "can" opens up a myriad of possibilities which would jeopardize the relative degree of certainty and stability a tax treaty seeks to achieve.
The Crown, it seems to me, is asking the Court to adopt a pejorative view of holding companies which neither the Canadian domestic law, the international community nor the Canadian government through the process of objection, have adopted.

Velcro 2012 (1)

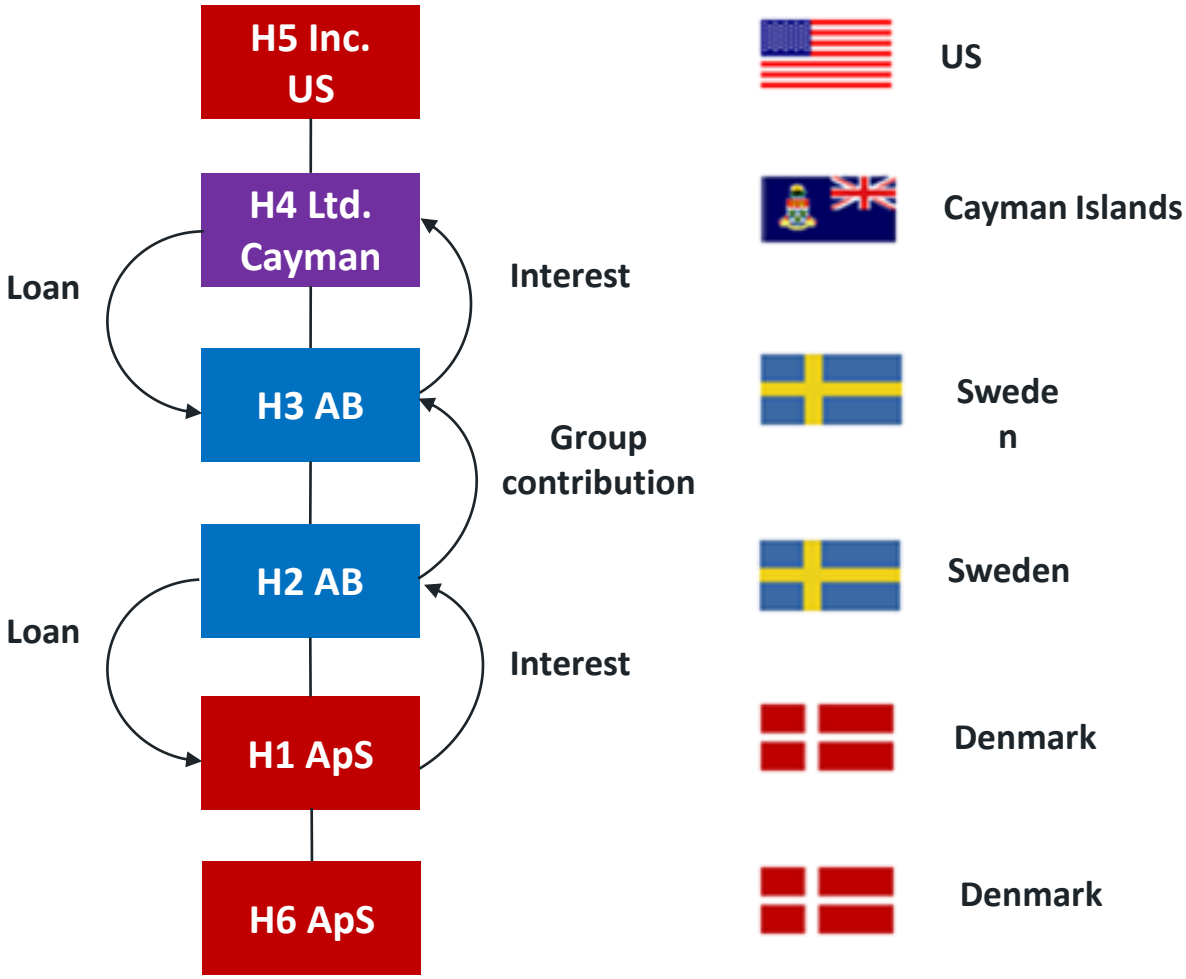


Velcro 2012 (2)

Tax Court of Canada 2008:

[52] ***VHBV obviously has some discretion based on the facts as noted above regarding the use and application of the royalty funds. It is quite obvious that though there might be limited discretion, VHBV does have discretion. According to Prévost, there must be "absolutely no discretion" – that is not the case on the facts before the Court. It is only where there is "absolutely no discretion" that the Court take the draconian step of piercing the corporate veil.***

Cook 2011 (1)


H5 Inc.
US
H4 Ltd.
Cayman
H3 AB
H2 AB
H1 ApS
H6 ApS
Loan
Interest
Group
contribution
Loan
Interest
US
Cayman Islands
Swede
n
Sweden
Denmark
Denmark

Cook 2011 (2)

Danish National Tax Tribunal:

[After reference to para. 12 Commentary on Art. 10/12 OECD MC].

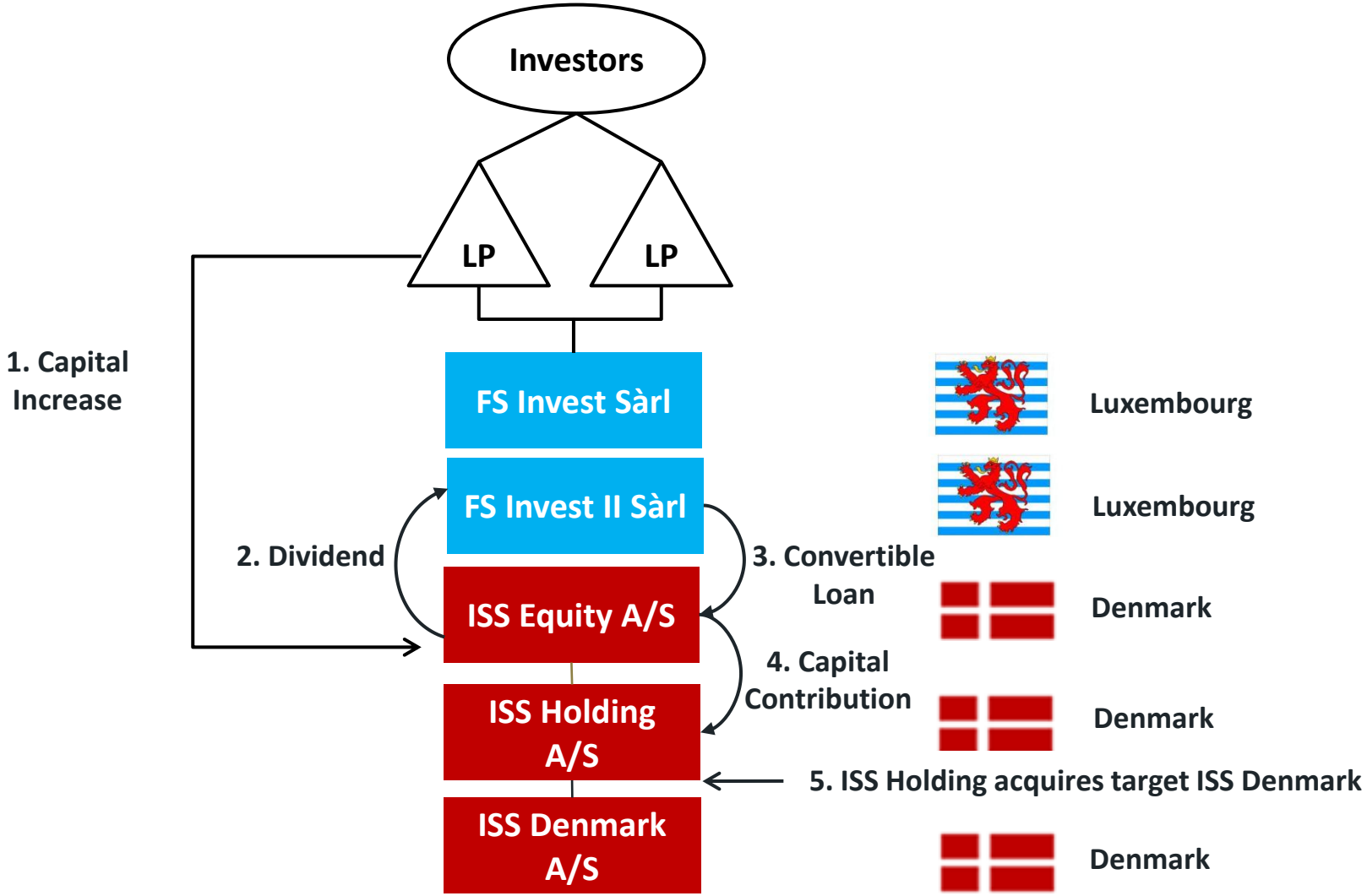
None of the companies established by the restructure had any other activity than being a holding company which is why their expected future income solely would be the ones connected to the holding activity.
By the establishments of debts in connection with the restructuring it had to have been a presumption – in order for the debtor company meet its obligations in relation to the loan – that these companies would be injected with funds from other group companies. This must have been a condition from the beginning.

Cook 2011 (3)

Danish National Tax Tribunal (cont'd):

H2 AB is thus considered to be the conduit company with as few powers over the received amounts that this company neither pursuant to the Nordic Tax Treaty nor the interests and royalties directive can be deemed the beneficial owner of the interest received by the company.
That the transfers between the Swedish companies have taken place by means of a group contribution and not interest is without importance in this connection.

ISS 2011 (1)


Investors
LP
LP
1. Capital Increase
FS Invest Sàrl
FS Invest II Sàrl
2. Dividend
3. Convertible Loan
ISS Equity A/S
4. Capital Contribution
ISS Holding A/S
5. ISS Holding acquires target ISS Denmark
ISS Denmark A/S
Luxembourg
Luxembourg
Denmark
Denmark
Denmark

ISS 2011 (2)

Danish Eastern High Court:

[After referring to the OECD Commentary and noting that under Indofood, the term "beneficial owner" must be interpreted in accordance with its international understanding]

In order for such an intermediary company not to be considered the "beneficial owner", it must be a requirement that the owner exercises control over the company beyond the planning and the management on group level that usually take place in international corporate groups.

In the case at hand it is not necessary to determine whether the underlying investors have exercised such control in relation to FS Invest II S.à.r.l. It follows **[from the definition of abuse in the OECD Commentary]** ***that the person or the company in the state with which the double taxation treaty has been concluded must have been interposed between the payer and the actually entitled party as a conduit that channels the tax-free payment on to the controlling person in a third country without a double taxation treaty.***

ISS 2011 (3)

Danish Eastern High Court (cont'd):

On that basis it must be assumed that disregard of a limitation in the right to taxation at source according to a convention has as a prerequisite that the payment has been channelled on or is at least with certainty intended to be channelled on to persons in third-party countries without double taxation treaties.

The condition is not fulfilled in this case.

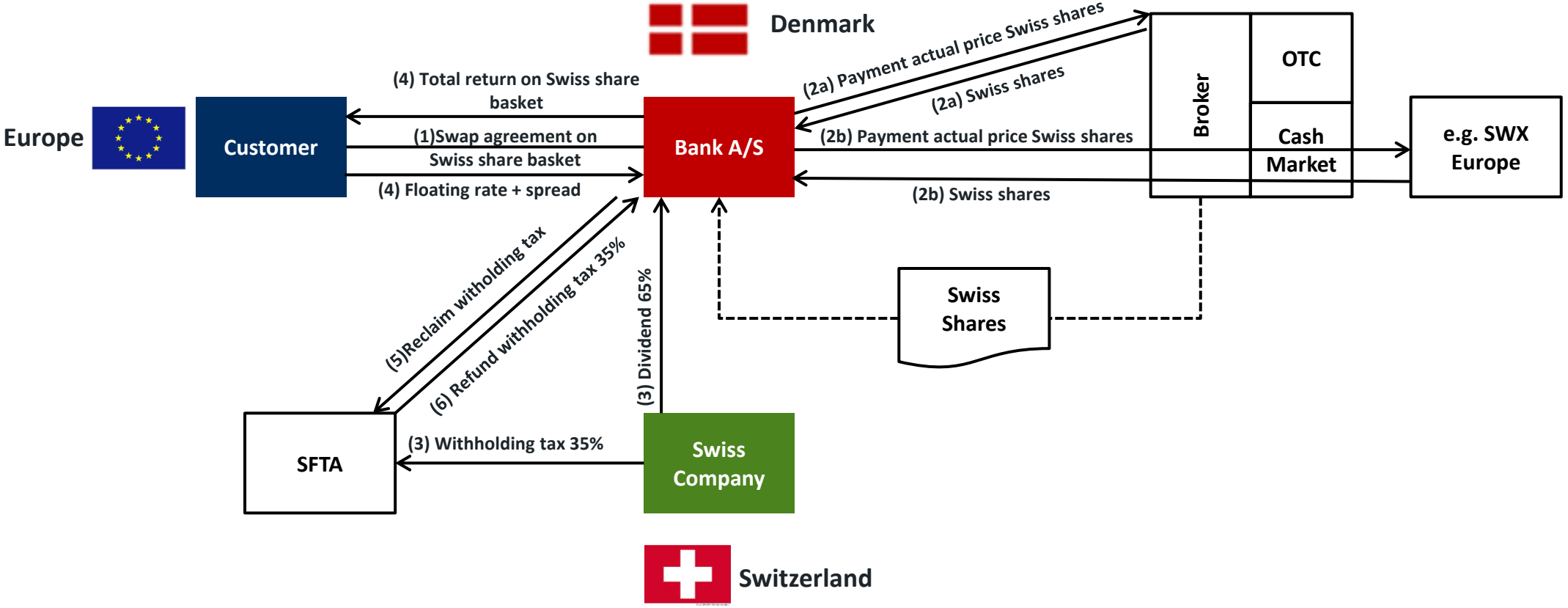
The dividend paid by ISS Equity A/S has not been channelled trough FS Invest II S.à.r.l but has actually been paid back as a loan to ISS Equity A/S. According to the information available, no decisions have been made to later channel on to the ultimate investors the dividend that has been paid back to ISS Equity A/S. As a consequence, FS Invest II S.à.r.l. must be considered the "beneficial owner" of the dividend.

Swiss case of hedged total return swap 2012 (1)

Facts:

- **A Danish bank promised to pay to the swap counterparty the appreciation of a basket of Swiss shares ("underlyings") and the amount of the dividend.**
- **The bank customer promises the Danish bank to pay the amount of the depreciation of the underlyings and a margin.**
- **The Danish bank hedged some (but not all!) of its exposure under the total return swap by acquiring the corresponding amount of the underlyings.**
- **Upon distribution of the dividends, the Danish Bank requested full reimbursement of the Swiss withholding tax under the 1973 tax treaty between Denmark and Switzerland (providing for a 0% residual tax).**

Swiss case of hedged total return swap 2012 (2)



Swiss case of hedged total return swap 2012 (3)

Decision of Swiss Federal Administrative Tribunal:

- **Beneficial ownership describes the intensity of relationship between the taxpayer and the taxable object.**
- **A legal obligation by the recipient of income to pass it on to a third person shows that the use of the income by the recipient is limited, which militates against beneficial ownership.**
- **Likewise, a de-facto obligation to pass on limits the power to use the income.**
- **The key issue is the degree to which generating income is dependent on the obligation to pass it on.**
- **Risks retained are also an element of beneficial ownership, especially the risk that no dividend is paid.**
- **The assessment of beneficial ownership must be made at the time at which income is derived.**
- **Hence, the holding period has no bearing on beneficial ownership, the same way as subjective facts is such as the intention of abuse.**

Swiss case of hedged total return swap 2012 (4)

Decision of Swiss Federal Administrative Tribunal (cont'd):

- **The crucial questions are:**
  - **Would the Bank have been obligated to pay under the swap even if it had not received the dividend?**
  - **Would the Bank have received the dividend even if it had not been obligated to pay the amount of the dividend to the counterparty?**
- **As both questions have to be answered in the affirmative, there is no interdependence between receipt of the dividend and payment under the swap agreement.**
- **"*The missing interdependence … shows that the* [Danish bank] *had effective power to dispose of the dividend payments. The* [Danish bank] *was therefore under no de facto obligation to pass on the payment to a third party*." (cons 6.2.1)**
- **Given this lack of interdependence of receipt of dividend income and payment under the swap agreement, the Tribunal found beneficial ownership to exist.**

Thank you for your attention

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