

**Committee of Experts on International
Cooperation in Tax Matters
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Item 3 (b) of the provisional agenda

Comments on E/C.18/2019/CRP.10 -Beneficial Ownership

Summary

The present Note contains the comments that were submitted by one Member of the Subcommittee on the UN Model Update on the paper E/C.18/2019/CRP.10 on the issue of beneficial ownership, which it was agreed were best included as a separate CRP for discussion at the same time as E/C.18/2019/CRP.10 during the 18th Session of the United Nations Committee of Experts on International Cooperation in Tax Matters.

Comments on Proposal on changes in UN MTC and its Commentaries as per Paper “The concept of beneficial ownership in tax treaties”

I Concept of beneficial ownership

1. I support the need for clarity on the concept of ‘beneficial ownership’ used in Articles 10(2),11(2) and 12(2) of UN MTC and related Commentaries. My comments on proposals in Paper circulated for Subcommittee on Model Updating are given henceforth.
2. Even though, the OECD Commentary2014 on beneficial ownership as in Art 10(2),11(2) and 12(2) has been, as it is, included for the new Art 12A UN MTC 2017 Commentary, it appears that discussion on its inclusion was not done by the then Committee. While it is correct to say that the explanations of BO concept should be consistent for Articles 10,11,12 and 12A, there needs to be discussion in UN Committee on this issue rather than just following Art 12A Commentary.
3. The core issues are rightly identified in para 13 of the Paper:
 - (i) Does the concept of/term ‘beneficial owner’ take a domestic law meaning following the interpretive rules of Article 3(2), or does it rather have an international fiscal meaning/ autonomous treaty meaning?
 - (ii) Is the concept intended to be a narrow and specific anti-abuse rule, or a general principle to counter treaty-shopping?

Comments on (i)

4. I support WP1’s conclusion that the term ‘beneficial owner’ should bear an international fiscal meaning or autonomous meaning rather than domestic law meaning, which is adopted in OECD MTC 2014. Reason for the same would be to have uniformity of approach across countries rather than each having its own interpretation. However, for reasons given, suggestion is to include a definition of term ‘beneficial owner’ for purposes of Articles 10(2), 11(2), 12(2) and 12A (2) in Article 3 along-with related Commentary in UN MTC rather than clarifying through UN MTC Commentary on Articles 10(2) etc.
5. As brought out in the Paper, there have been varying Court decisions in various countries on this aspect. While some (Canada Prevost, US Aiken Industries) have decided the meaning for purposes of Articles 10(2), 11(2) and 12(2) to be as per domestic law, others (UK Indofood) have gone by enjoyment of income or authority over income or privilege over income and contractual obligation to pass it on. Decisions quoted in paper are mostly before change in OECD MTC Commentary in 2014. However, as mentioned, even afterwards, Courts have taken a different view, for instance as in Swiss case of X Bank vs Federal Tax Administration. As noted in Introduction of UN MTC 2017, para 12, provisions of UN MTC are not binding and are themselves not enforceable. The proposed solution to endorse OECD 2014 Commentary addition in UN MTC would therefore not be a solution to this issue. Tax Administrations and Courts in developing countries may still take a different view especially due to Article 3(2) and the problem may continue. It is hence suggested to include a definition of ‘beneficial ownership’ in Article 2 of UN MTC along-with related Commentary. The definition in turn may get included in existing treaties through amendments in due course of time. It would be a cumbersome process but, perhaps a better solution. The Commentary on definition apart from substantive aspects may recommend adoption of the definition for

interpretation of term BO in existing treaties. Whether this would work for interpretation of existing treaties not having BO definition cannot be assured, though it may to some extent work as per ambulatory approach. In any case, it would be a solution at par with proposed clarification in Art 10(2)-12A (2) Commentaries.

6. Suggested definition of ‘Beneficial owner’: Definition can be modelled on basis of ingredients in para 19 of Paper and any other relevant aspects in OECD MTC 2014 Commentary. Related Commentary can be accordingly drafted. UN Subcommittee on Model Update can work on this.

7. In case, the above suggestion on defining BO is not found acceptable by Committee and OECD approach is decided to be followed, there would still be needing to explain basis for not following Article 3(2) in the approach adopted by OECD of international fiscal meaning. This is taken up in following paragraph.

8. Basis for not following Article 3(2): What is the basis for discarding Article 3(2) is not explained in OECD Commentary. This can be a major litigation issue in developing countries, since normally terms not defined in treaty should have meaning as per domestic law of State applying the Convention/treaty. Reason for being able to adopt international fiscal meaning as against domestic law meaning is as stated in Phillip Baker’s comments in his Report to UN Committee in Geneva in 2008, i.e. this a case “where context otherwise requires” Article 3(2) not to apply. It is hence suggested to elaborate on this aspect in UN Model Commentary if a decision is taken by Committee to adopt OECD MTC 2014 Commentary as it is.

Comments on (ii)

9. The response to second question i.e. (ii) of para 3 can be included in UN MTC Commentary on Articles 10(2) etc.

II II. Other Changes in Articles 10-12

10. As stated in the Paper, the changes in OECD MTC 2014 Articles 10(2) and 11(2) were to address situation of direct recipient of income and its beneficial owner being in two different States. Reference is also made to para 12.2 of OECD MTC 2014 on Article 10. There are some issues arising here, as explained henceforth.

11. As explained in para 26 of Paper, under existing UN formulation, in a three country situation of beneficial owner being in one country and direct recipient of income being in a third country, due to linkage of income in question to para 1 of Article 10/11 (referring to income ‘paid to’ resident of other Contracting State) through ‘such’ in para 2 of Art 10/11 and para 1, country of source may not be able to grant benefit of Art 10(2)/11(2) to beneficial owner to whom income is not ‘paid to’. In OECD MTC 2014, there is no modification in para 1 of Art 10/11, where taxation right of State of residence remains hinged on condition of ‘paid to’. Since basic reason for deletion of ‘such’ in para 2 was to remove linkage of income referred to in that para from direct payment, ‘paid to’ in para 1 of Art 10/11 cannot be interpreted as including beneficial owner. In other words, para 1 of Art 10/11 may be interpreted to mean that country of residence of ‘beneficial owner’ does not have right to tax the dividend/interest not ‘paid to’ it. Since taxing rights over income in question in country of residence is also to be governed by Convention, this may create a problem. To avoid this situation, it is better to let

formulation of Art10(2)/11(2) be as per existing UN MTC and clarify in Commentary on UN MTC on Art 10(2)/11(2) etc that 'paid to' in para 1 of Art 10(1)/11(1) covers beneficial owner for purpose of Art 10(2)/11(2).

12. Other issue is in respect of taxing rights of country of residence of direct recipient in a three-country scenario. Condition of beneficial ownership is only for limiting source country taxation. As such, it should not have any bearing on taxation by country of residence of direct recipient of income in a third country. Last sentence of para 12.2 of OECD MTC 2014 Commentary on Art 10 conveys that direct recipient would be regarded as a resident but it would not be treated as owner of income for tax purposes in State of residence. It is further stated that no potential double taxation arises, which means that under Convention between country of source and country of residence of direct recipient, country of residence may not have taxing rights over the income paid to its resident directly who is not its beneficial owner. This is fine where direct recipient and beneficial owner are residents of same State. However, where the direct recipient is a resident of a third State and not its beneficial owner, taxation right by country of residence of direct recipient cannot be curtailed, though para 12.2 of OECD MTC 2014 on Art 10(2) seems to so indicate. Firstly, taxation by country of residence of direct recipient would be governed by its domestic laws and secondly, even under tax treaty between source State and third State, Articles 10(1) and 11(1) as worded would confer taxation right on dividend/interest paid to direct recipient resident of that third State. Omission of 'such' in Art 10(2) etc would not change this. Taxation by source State in respect of direct recipient would not be though limited as per Art 10(2)/11(2) due to direct recipient being not beneficial owner. From this point of view also, existing UN formulation appears to be better.