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Committee of Experts on International  
Cooperation in Tax Matters  
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Update of the UN Model Double Taxation Convention between Developed and  
Developing Countries Beneficial Ownership

Summary

During the 17<sup>th</sup> Session of the United Nations Committee of Experts on International Cooperation in Tax Matters, the Subcommittee on the UN Model Update was directed to carry out further work on the issue of beneficial ownership.

This paper presents the issue at a high level to facilitate further discussion on the inclusion of a clarification project in the work programme of the Subcommittee. To achieve this purpose the paper focuses on the background to the OECD's 2014 Model Update clarification project along with a brief description of the resulting changes. Comment will also be made on the possibility of incorporating the OECD's clarifications into the UN Model to the extent the Committee agrees with the OECD's interpretation. Doing so would achieve consistency within the UN Model Commentaries, as the current Commentaries to Articles 10-12 have not incorporated the 2014 OECD Model guidance on beneficial ownership, but the Commentary to new Article 12A (fees for technical services) does.

The present paper has been

## The concept of beneficial ownership in tax treaties

Introduction into the OECD and UN models

1. The concept of beneficial ownership

between an Indonesian parent guarantor and a wholly owned issuer of loan notes incorporated in Mauritius would not be the beneficial owner of interest paid by the parent guarantor under a loan agreement because the interposed company could not enjoy the 'full privilege' of the interest paid

its decision by examining the substance of the arrangement and whether its purpose was consistent with the object and intention of the treaty. In contrast to *Prévost*, the Supreme Court found a company may be a conduit even in cases where it has some authority over the income received and no contractual obligation to pass it on.

10. Earlier cases also remain relevant and demonstrate the longstanding nature of the issues surrounding the concept's interpretation. For example, the United States case *Aiken Industries v Commissioner of Internal Revenue* (1971)<sup>7</sup> considered the general rule of interpretation in the United States. A Honduran tax treaty required reference to domestic law. *Del Commercial Properties Inc v Commissioner of Internal Revenue* (1999)<sup>8</sup> decided for US tax authorities where a Dutch company was interposed between a US and a Canadian company because the only benefit of doing so was a reduction in US tax. In the Dutch case *Royal Dutch Shell* (1994)<sup>9</sup> the Court took a legalistic approach to determining beneficial ownership and considered whether there was an absolute right to the income, concluding that a recipient was not the beneficial owner of income if it was required to pass the largest part of its income to a third party. This is not exhaustive and there are many other cases that could be cited here.

1. 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?
2. Is the concept intended to be a narrow and specific anti-abuse rule, or a general

- x The concept of beneficial ownership does not take its meaning from domestic law or other OECD instrument, but rather has an autonomous treaty meaning
- x The intention of the beneficial ownership concept was to clarify the use of the words “paid to...a resident” in the Model and so should be read in that context
- x Beneficial owners are those that have the right to use and enjoy the payment unconstrained by contractual or legal obligations to pass the payment on. Essentially meaning that persons acting as fiduciaries, agents and nominees are not beneficial owners
- x Use and enjoyment of property that derives the income is distinguished from the legal ownership of the property and
- x An obligation to pass payments on can be contractual or be found to exist on the basis of facts and circumstances.

#### The case for review

20. One of the fundamental issues with the concept of beneficial ownership is what type of anti-abuse rule it is. That is, is it narrow and targeted, or general in nature intending to address any potential instances of treaty shopping.

21. The adoption of the Base Erosion and Profit Shifting (BEPS) measures in the 2017 UN Model update may now mean this question can be settled. This is because:

- x The anti-abuse rules found in the limitation on benefits (LOB) Article, and the principal purposes test (PPT), address treaty shopping broadly and
- x A new preamble expressly stating that treaties are not concluded to provide opportunities to treaty shop has also been included in the UN model.

Accordingly, it might now be expected that countries rely on these instead of such as beneficial ownership, particularly now that the new preamble (or equivalent text) and the PPT (or detailed LOB combined with an anti-conduit rule) are minimum standards for members of the OECD's Inclusive Framework on BEPS<sup>18</sup>. Further, the inclusion of these treaty shopping protections in the UN Model may encourage developing countries outside the Inclusive Framework to adopt such measures

22. For this reason it could be a good time for the Committee to make the concept of beneficial ownership clearer in scope. Doing so may assist in focusing the resources of developing countries away from definitional arguments and towards applying the new tools to combat treaty shopping and avoidance arrangements incorporated as part of the BEPS project. Professor Baker's 2008 paper<sup>19</sup> similarly identified that continuing to us>>BDC 0.00yC [(b)-4

23. As noted at the 17<sup>th</sup> Session<sup>20</sup>, it is important at least for the UN Model to provide some guidance on the open questions relating to beneficial ownership to avoid unintended differences of interpretation between the two models and to address the problems created by conflicting court decisions. Undertaking a project will allow the Committee to identify areas in which it agrees or disagrees with the OECD on its guidance on the concept of beneficial ownership.

24. This work is relevant not only for articles 10 of the UN Model, but also 12A (fees for technical services). However, note the commentary on Article 12A already incorporates the key elements of the 2014 OECD clarification language. Adopting the same approach for 10 would promote consistency across all Articles.

Other changes to Articles 10/12

25. The texts of Articles 10 and 11 in the OECD Model were also amended in 2014 to address an issue that was raised with how the provisions apply where the direct recipient of the income and the beneficial owner are in two different states.

26. Before the text was amended a literal interpretation of the words “such dividends and such interest” in 10(2) and 11(2) respectively could lead to the conclusion that the dividend/interest income must be that paid direct to a resident of a Contracting State. This is problematic where the direct recipient and the beneficial owner are residents of two different States. This is already addressed in 12.2 of the Commentary but to remove any doubt the text of Articles 10 and 11 were amended to clarify that an intermediary (such as a custodian) located in a third State and interposed between the payer and the beneficial owner does not prevent the limitation of source taxation being provided to the beneficial owner.

27. The changes would also be relevant for Article 12 of the UN Model. Unlike the UN, the OECD Model does not provide for the source taxation of royalties and so does not use the same “such royalties” language in the text.

## Appendix

### Proposed modifications to the UN Model Convention

Proposed changes are shown as ~~for~~ additions and ~~strike through~~ for deletions.

#### Proposed changes to Articles of the UN Model Convention

##### Article 10

2. However, ~~such~~ dividends paid by a company which is a resident of a Contracting State may also be taxed in that State ~~the Contracting State of which the company paying the dividends is a resident and~~ according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

- (a) \_\_\_ per cent (the percentage is to be established through bilateral negotiations)





situation qualifies as a resident but no potential double taxation arises as a consequence of that status since the recipient is not treated as the owner of the income for tax purposes in the State of residence. [the rest of the paragraph has been moved to new paragraph 12.3]

12.3 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 Committee on Fiscal Affairs entitled “Double Taxation Conventions and the Use of Conduit Companies”<sup>1</sup> includes 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 interested parties.

<sup>1</sup> Reproduced in Volume II of the full version of the OECD Model Tax Convention at page R(6)-1.

12.4 In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the direct 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. This type of obligation would not include contractual or legal obligations that are not dependent on the receipt of the payment by the direct recipient such as an obligation that is not dependent on the receipt of the payment and which the direct recipient has 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 22 to 48 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. It should also be noted that Article 10 refers to the beneficial owner of a dividend as opposed to the owner of the shares, which may be different in some cases.

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 paragraph 22 below). The provisions of Article 29 and the principles put forward in the section on “Improper use of the Convention” in the Commentary on Article 1 will apply to

prevent abuses, including treaty shopping situations where the recipient is the beneficial owner of the dividends. 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 on the dividend to someone else), it does not deal with other cases of abuses, such as certain forms of treaty shopping, that are addressed by these provisions and principles and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases.

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. In the context of Article 10, the term “beneficial owner” is intended to address difficulties arising from the use of the words “paid to” in relation to dividends rather than difficulties related to the ownership of the shares of the company paying these dividends. For that reason, it would be inappropriate, in the context of that Article, to consider a meaning developed in order to refer to the individuals who exercise “ultimate effective control over a legal person or arrangement.”

<sup>2</sup> See the Financial Action Task Force's definition quoted in the previous note.

12.27 Subject to other conditions imposed by the Article and the other provisions of the Convention, the limitation of tax in the State of source remains available when an intermediary, such as an agent or nominee located in a Contracting State or in a third State, is interposed between the beneficiary and the payor but the beneficial owner is a resident of the other Contracting State (the text of the Model was amended in 1995 and in 2014 to clarify this point, which has been the consistent position of all Member countries). States which wish to make this more explicit are free to do so during bilateral negotiations.

### Commentary on Article 11

18. The Commentary on the 2017 OECD Model Convention contains the following passages:

9. The requirement of beneficial ownership was introduced in paragraph 2 of Article 11 to clarify the meaning of the words "paid to a resident" as they are used in paragraph 1 of the Article. It makes plain that the State of source is not obliged to give up taxing rights over interest income merely because that income was immediately received paid direct to a resident of a State with which the State of source had concluded a convention. [the rest of the paragraph has been moved to new paragraph 9.1]

9.1 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

State of residence. Where an item of income is received by a resident of a Contracting State acting in the capacity of 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. The immediate recipient of the income in this situation qualifies as a resident but no potential double taxation arises as a consequence of that status since the recipient is not treated as the owner of the income for tax purposes in the State of residence. [the rest of the paragraph has been moved to new paragraph 10.1]

10.1 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 Committee on Fiscal Affairs entitled "Double Taxation Conventions and the Use of Conduit Companies" includes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal

10.3 The fact that the recipient of an interest payment is considered to be the beneficial owner of that interest 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 paragraph 8 above). The provisions of Article 29 and the principles put forward in the section on “Improper use of the Convention” in the Commentary on Article 1 will apply to prevent abuses, including treatyshopping situations where the recipient is the









