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THE BENEFICIAL OWNERSHIP IN OECD'S TAX TREATIES

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The term Beneficial owner can be found in many context and because of this it should not be confused the meaning that it has in OECD's Tax Treaties with the meaning in other rules or conventions (such as the Money Laundering Regulations). This term was introduced in three articles of the OECD's model regarding Dividends[1], Interests[2] and Royalties[3], to address potential difficult arising from the words "paid to … a resident" hence to clarify how these articles applies in relation to payments made to intermediaries. In fact the State of source does not have any obligation to give up its taxing rights solely because one of the incomes abovementioned was paid to a resident of a State with which the state of source has concluded a convention.

The procedure is then to go through the Model of the convention to find a definition, and then to search for an interpretation and a specification.

Taking a look through the Model the definition of the term beneficial owner cannot be found in any of the articles. Therefore as stated in general treaty interpretation rule[4] since there is not a definition we should use the meaning that the term, beneficial owner, has in the national tax law at the time of the facts.

Observing the commentary to the tax model it gives a practical, non-limitative qualification criteria affirming that the beneficial ownership is the "*right to use and enjoy"* an income and that this income must not be "*constrained by a contractual or a legal obligation to pass the payment received"*. The full power on the decisions related to the destination of the income, and the risk related on it, becomes the necessary conditions to be the beneficial owner of an income. With full power on and risk related on the income it is intended that the recipient is not constrained by any obligation, that normally derives from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, substantially, the recipient clearly does not have the full right to use and enjoy the income. Since it was introduced as a clarification it shouldn't understood in a narrow technical sense but it should be used in the light of the object of the convention.

There seems to be a dissonance between what is written in the Model and what is said by the Commentary, but focusing the attention on the general treaty interpretation rule we can highlight the sentence

[1] OECD (2017), "Model Convention with Respect to Taxes on Income and on Capital", in Model Tax Convention on Income and on Capital: Condensed Version 2017, OECD Publishing, Paris. Art. 10 par. 2 "… *dividends paid by a company which is a resident of a contracting state may also be taxed in that State 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…"*.
[2] OECD (2017), "Model Convention with Respect to Taxes on Income and on Capital", in Model Tax Convention on Income and on Capital: Condensed Version 2017, OECD Publishing, Paris. Art. 11 par. 2 "… *interest arising in a contracting State may also be taxed in that State according to the laws of that State, but if the* ***beneficial owner*** *of the interest is a resident of the Contracting State, the tax so charged shall not exceed.."*
[3] OECD (2017), "Model Convention with Respect to Taxes on Income and on Capital", in Model Tax Convention on Income and on Capital: Condensed Version 2017, OECD Publishing, Paris. Art. 12 par. 1 "… *Royalties arising in a Contracting State and* ***beneficially owned*** *by a resident of the other Contracting State shall be taxable only in that other State…"*
[4] OECD (2017), "Model Convention with Respect to Taxes on Income and on Capital", in Model Tax Convention on Income and on Capital: Condensed Version 2017, OECD Publishing, Paris. Art. 3 par. 2 "*As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under laws of that State"*

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"unless the context otherwise requires". It appears that this general rule of using the national tax law can be derogated if required by the context, and this appear to be the occasion. In fact the commentary on the model seems, by itself, to invoke this exception by saying that the term beneficial owner should be interpreted in the context of the Model and not to refer to any technical meaning that it could have under the domestic law of a specific country[5]. Specifying also that the meaning given to this term has to be distinguished from the different definition given from "other instruments" bringing the example of the definition given by the Financial Action Task Force which identify the beneficial owner in the natural person that which exercise the ultimate control on the entity or on the goods[6].

Consequently, it is necessary to understand what the commentary means with "the context and light of purposes of the convention". The main objective of the Convention is to foster goods and services trades and the circulation of persons and capital, through the elimination of the international double taxation over the same income. With the increase in the number of bilateral tax treaties also the risk of abusive behavior has grown, since it is easily usable artificial structures designed to assure both the fiscal advantages contained in specific national laws and the ones contemplated by the Conventions. Therefore is possible to summarize the objectives of the tax treaties in:

- The elimination of a double taxation on the same income,
- The prevention of fiscal evasion and avoidance in the form of Treaty shopping and treaty abuse

Treaty Abuse, in a general definition, is that practice that even in the respect of the treaty regulation, aims to obtain fiscal advantages contrary to the essence of the treaty, in fact every operation that aims to obtain a double non-taxation, or a reduced imposition with condition different from the canonic ones, represent an abuse of the Convention[7]. Therefore there are two elements that are necessary to be present to ensure that a transaction or an arrangement can be identified as an "abuse of the provision of a tax treaty":

- The main purpose of the transaction or arrangement is to secure a fiscal advantage;
- The obtaining of that more favorable treatment is contrary to the object and purpose of the relevant provision

While Treaty shopping can be defined as the operations aimed to allow to a subject to access to conventional advantages that on the ground of its residence he is not entitled to receive. One of the most common practice of treaty shopping is the configuration of conduit structures. From which is possible to deal with the absence of a treaty between the source income country and a third country, through the interposition of an economic entity (conduit) resident in a different country which has stipulated a

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[5] OECD (2017), "Commentary on Article 12", in Model Tax Convention on Income and on Capital: Condensed Version 2017, OECD Publishing, Paris. (par. 4) "... *The term beneficial owner is therefore not used in a narrow technical sense (such as the meaning that it has under the trust law of many common law countries), rather, it should be understood in its context and in the light of the purposes of the Convention…"*

[6] FATF recommendations (OECD-FATF, Paris, 2012) Financial Action Task Force, International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation (page 110) "… *the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement…"*

[7] OECD (2017), Commentary on Article 1, in Model Tax Convention on Income and on Capital: Condensed Version 2017, OECD Publishing, Paris. (par. 61) "… *A guiding principle is that the benefits of a double taxation convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favorable tax position and obtaining that more favorable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions.*

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treaty against the double taxation with the source income country, so that later those incomes will be transferred from the conduit company to the third state.

Basically this does not mean that the national law's interpretation cannot assume relevance but that can find application in those cases in which it is compliant with the OECD commentary. A country can establish some criteria with the purpose to specify the interpretation of beneficial owner as long as these criteria remains in the context of the convention.

National Tax Authorities very often look with suspects to pure holding especially if those have been incorporated in a country with low tax liability and have very limited function and assets. Frequently this is due to the assumption that their only purpose is to obtain a more favorable tax position, since they could easily being established in the countries of residence of their shareholders or of the operative subsidiaries. Notwithstanding, the commentary never mentioned any restriction on passive income holding but only regarding the Conduit companies.

It looks like that a limitation on the applicability of the convention, such as the one on the basis of not having employees, should be considered as overpassing the context and the object of the convention because a general assumption of fraud and abuse cannot justify either a fiscal measure which compromises the principal objective[8] of a tax treaty, or a fiscal measure which prejudices the enjoyment of a fundamental freedom guaranteed by the treaties.

Aptar Case

A U.S. corporation owned holding company in France that in turn owned an Italian operating subsidiary. The Italian subsidiary distributed dividends to its French company and withheld 5% dividend[9]. The French sub-holding applied for the reimbursement of the Italian dividend withheld encountering the refusal of the Italian Tax Authority. Since neither the Italian treatis in force nor the domestic law contain a definition on "beneficial ownership", the Italian tax authority generally rely on the OECD guidelines and existing international case law. Subsequently the Italian Tax Authority gave significant attention to the lack of operational substance of the French sub-holding. Apparently the French sub-Holding could not be considered as having its place of effective management in France because of the lack of business substance. This company infact did not have any premises, staff and equipment and its balance sheet did not record any trade receivables beyond its participation in the Italian subsidiary. In addition it was observed that the French sub-Holding was wholly owned by a US company, country that did not have a tax treaty with Italy providing a similar tax benefit as granted by the Fra-Ita DTAA. Subsequently in their opinion the French sub-Holding was a mere conduit set-up to minimize tax leakage on up streamed income.

This case came to the Italian Supreme Court which sentence[10] rejected the Italian Tax Authority position, since it did not take into consideration the nature of the French company. In fact after observing the nature of the limited activities carried out by the French sub-holding the Court specified that these limited holding activities were not sufficient to conclude that the company did not have a valid residen-

[8] OECD (2017), Commentary on Article 1, in Model Tax Convention on Income and on Capital: Condensed Version 2017, OECD Publishing, Paris. (par. 54) "*The principal purpose of double taxation conventions is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons…*"
[9] As stated in art.10 par. 2 of the Italian-French Double Taxation Avoidance Agreement
[10] Cassazione, Sez. trib., Sent. 28 dicembre 2016 (21 settembre 2016), n. 27113

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cy, from a beneficiary position. In Court's opinion the beneficial ownership should be verified taking in consideration the specific characteristics of the object and the nature of the parent company, that being in this case a holding company, to be compliant with the Convention, would be necessary to address the verification analysis on the autonomous capacity to make decision regarding the use of the income (dividends in this case) received and to exercise power over the applicable funds, rather than concentrate on the lack of an operating structure, on the absence of employee and/or on the low management costs[11].

Where the context requires a different interpretation, of beneficial owner, from the one given by the National Law of a contracting state that apply the Convention, that interpretation should be reassembled from the tools individuated by Convention of Wien, and thus also the applicable rules of international law, in the case of European Country therefore would be relevant the definition given by the EU directives and the sentences given by the European Court of Justice. In this respect it is interesting to breafly analyze a recent decision rendered by the European Court of Justice[12].

Eqiom Case

The case concerned the refusal by French Tax Authority to grant an exemption from withholding tax on dividend distributions by a resident subsidiary to its parent company located in the EU, which is controlled by shareholders residents in a third state. This refusal was based on a French provision that attempts to avoid directive shopping by requiring the taxpayer parent to prove that the principal porpuse or one of the principal purposes behind the structure is not to take advantages of the exemption. The court noted that in order for a domestic legislation to be justified by the need to avoid tax evasion and abuse, its specific objective must be to prevent conduct consisting of the creation of *wholly artificial arrangements*[13]. Thus a general presumption of fraud or abuse cannot justify a tax rule that conflicts with a directive. The Court concluded that the French rules generally covered all situation of a parent company controlled by shareholders in third states and where not specifically designed to exclude only the purely artificial arrangement to benefit from that exemption, and ruled that the French rules were contrary to Article 1(2) of the Parent-Subsidiary Directive, and therefore rejected the French Tax Authority position.

Conclusions

Both the sentences, the Italian supreme court one and the CJEU one, follow the same line of judgment targeting the tax authorities that interpreted the beneficial ownership in a strict way, hampering the freedom of establishment and the freedom of circulation of capital, rights that are defended by both the OECD's Model and by the EU Parent-Subsidiary Directive.

The Courts have determined in practice that the tax authorities may not confine themselves to applying predetermined general criteria but must carry out an individual examination, case by case, of the whole operation in order to determine whether an operation pursues an objective of fraud or abuse. It will be interesting to follow the practical implementation of these judgments by the Tax Authorities, in particular regarding the evidence required to justify an initial refusal of withholding tax exemption.

[11] This elements in fact are typical of pure passive income Holdings
[12] European Court of Justice, Section VI, Sentence 7 September 2017, Cause C-6/16
[13] European Court of Justice, Judgment of the Case C-196/04, Press Release No 72/06, 12 September 2006, *Cadbury Schweppes plc & Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue*

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