



Beneficial Ownership

Certificate Course on International Taxation, Chennai

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Beneficial Ownership

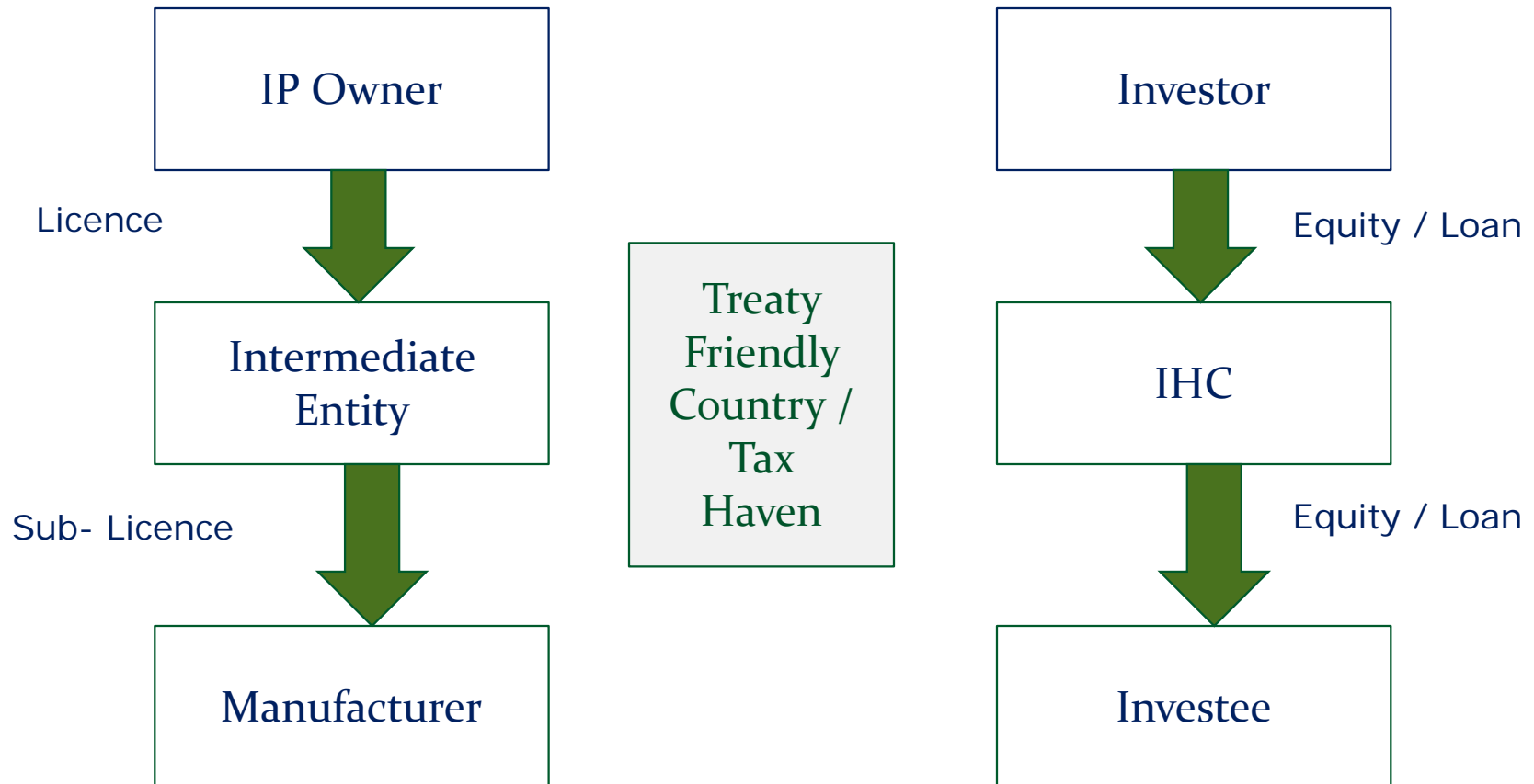
- Primarily used to avoid treaty shopping
 - One of the most important anti-abuse provision
 - US has beneficial ownership as concept [beneficial ownership of the income and also beneficial ownership of the entity]
- A concept widely used but hardly defined
- OECD – Article 3(2)
 - where the term is not defined in the treaty, it should be interpreted based on source country domestic law, unless the context requires otherwise
- OECD Commentary
 - ‘beneficial ownership’ is not used in a narrow technical sense...”



Beneficial Ownership

- English law
 - “beneficial owner”, would exclude a legal owner who is trustee for another
- US Law states that beneficial owner means a person who ultimately controls income
- ‘beneficial ownership’ is a concept akin to adopting principle of substance over form
 - It is fact oriented and therefore is generally not defined in most of the countries
- Beneficial Ownership broadly implies division between the legal rights and rights of enjoyment over the economic benefits, as recognized by law.
- Vogel – It should be in context of treaty and not domestic laws

Beneficial Ownership





Beneficial Ownership

- Cases of conduit company, agent, middleman, etc.
- Cases where no beneficial ownership
 - Mere legal title without any rights [copyrights, patents, trademarks]
 - The right not recognized by law and not enforceable by law
 - An obligation to transfer it to others
- Where the principle is primarily anti-abuse one in nature, whether domestic law meaning should be given at all?
 - Article 3(2) states “unless the context requires otherwise”



Beneficial Ownership

- Tax Residency v. Beneficial Ownership
- Two ways of imposing beneficial ownership requirement
 - In respective Article dealing with nature of income which limits the taxation in source country
 - Dividend
 - Interest
 - Royalties and Fees for Technical Services
 - Limitation of Benefit Clause [LOB]
 - By this an unqualified entity is denied benefit of the treaty itself
 - LOB may be applicable on account of its shareholding
- A concept relevant for passive income
 - However, historically this has not been applied to Capital Gains Article in DTAA



OECD Commentary

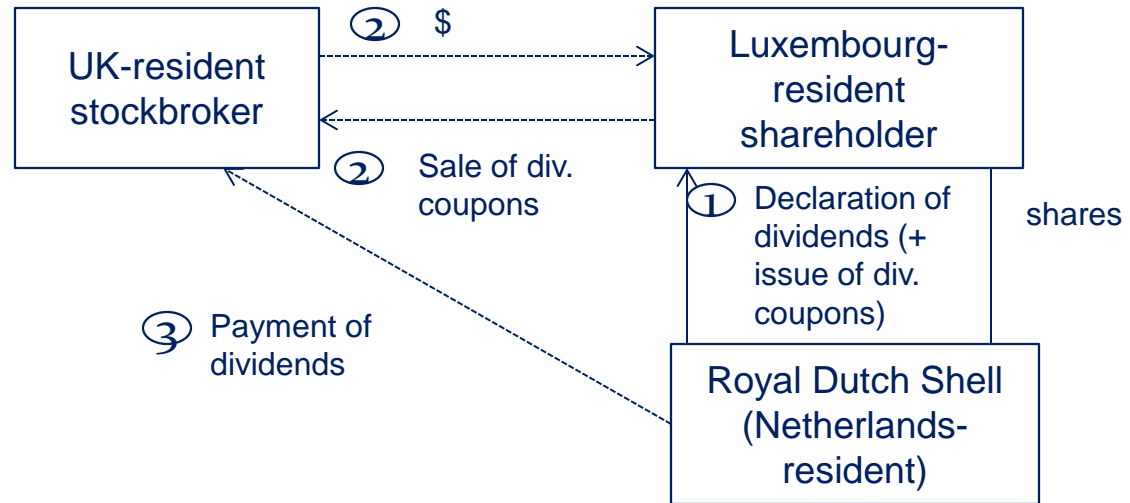
“12.1 Where an item of income is received by a resident of a Contracting State acting in the capacity of **agent or nominee** it would be inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption merely on account of the status of the immediate recipient 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. 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’ concludes 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.**



OECD Commentary (contd...)

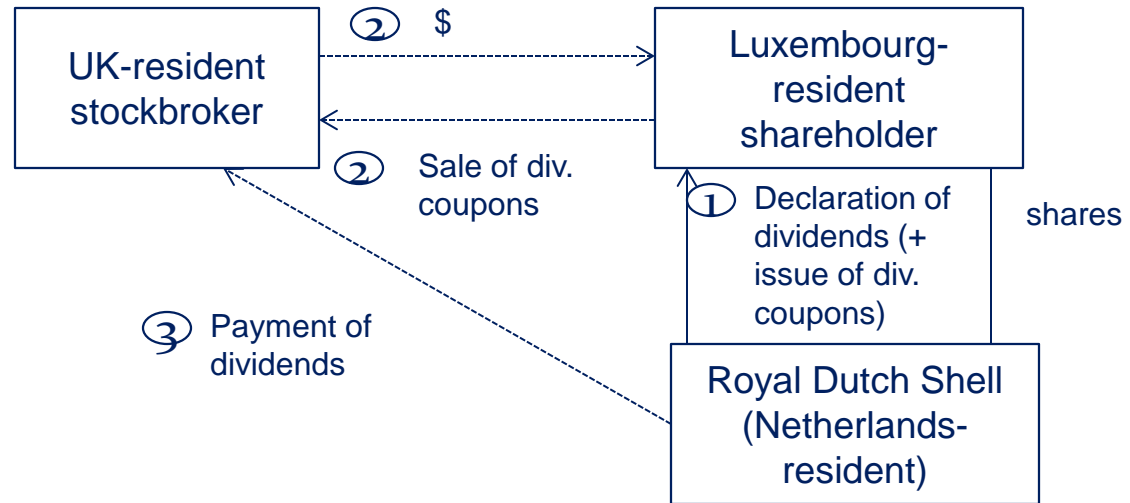
12.2 Subject to other conditions imposed by the Article, the limitation of tax in the State of source remains available when an intermediary, such as an agent or nominee located in a Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State...”: OECD Commentary (paragraphs 12 to 12.2 to the Commentary on Art. 10) [substantially identical comments are contained in the Commentaries on Art. 11 and Art. 12].

Royal Dutch Shell case (Netherlands)



Could the UK-resident stockbroker claim the limitation on Dutch dividend withholding tax, under the UK/Netherlands treaty? In other words, was the UK-resident stockbroker “the beneficial owner” of the dividends?

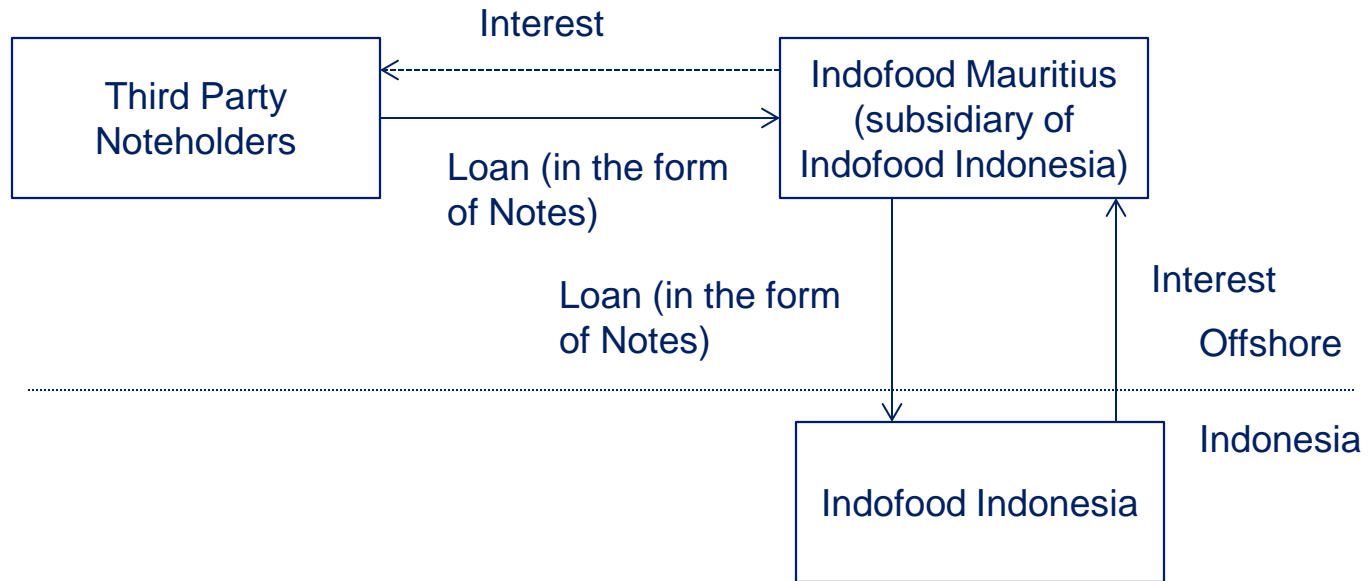
Royal Dutch Shell case (Netherlands)



Per the Court:

“ The [UK- resident stockbroker] has, by purchasing the dividend coupons, become their owner. This Court may further assume that the [UK-resident stockbroker] has, after their purchase, the free disposal of the dividend coupons, and after cashing them, of the distributions received and that, when cashing the dividend coupons, it did not act as an agent or nominee. Under those circumstances, the [UK-resident stockbroker] may be considered to be the beneficial owner of the dividends.”

Indofood Case



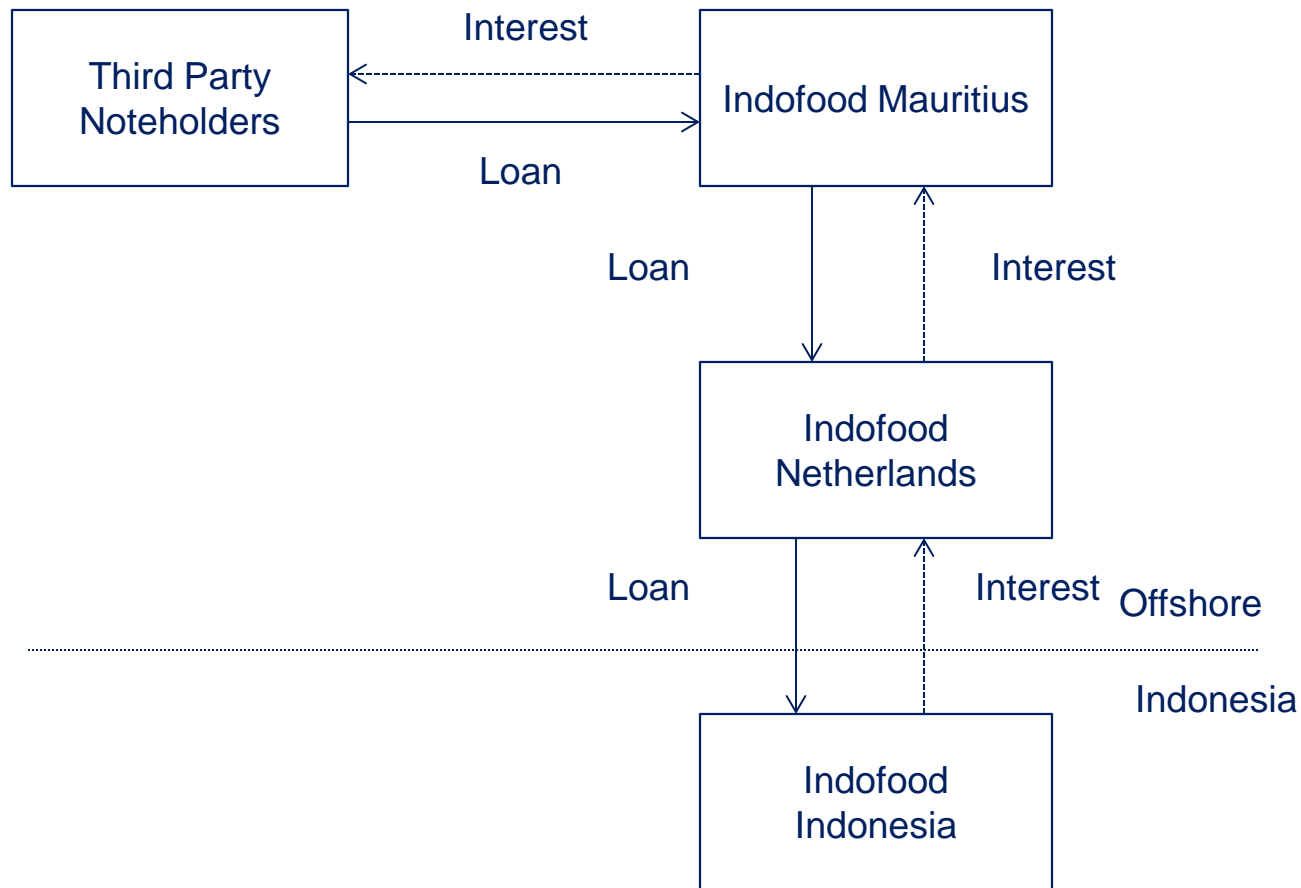
- Indonesia domestic tax law: 20% interest withholding tax
- Indonesia/ Mauritius treaty: 10% (if beneficial owner)
- Indonesia/ Mauritius treaty: terminated in 2005
 - Indofood wanted to redeem the Notes, because of an adverse movement in interest rates and because of the increased “gross up” requirement due to the treaty termination.
 - The treaty termination allowed Indofood to redeem the Notes, unless it could avoid the additional tax by “taking reasonable measures available to it.”



Indofood - Contractual Arrangements

- “[Indofood Indonesia] is obliged to pay the interest two business days before the due date to the credit of an account nominated for the purpose by [Indofood Mauritius]. [Indofood Mauritius] is obliged to pay the interest due to the noteholders one business day before the due date to the account specified by the Principal Paying Agent. The Principal Paying Agent is bound to pay the noteholders on the due date. **[Indofood Mauritius] is bound to pay on to the Principal Paying Agent that which it received from [Indofood Indonesia] because it is precluded from finding the money from any other source by the Note Conditions...**” (Extract from Court of Appeal judgment of the Chancellor) (emphasis added)

Indofood - Structure proposed by Trustee



- Indonesia/Netherlands treaty: 0%/10% (if beneficial owner)



Indofood - Issues before Court of Appeals

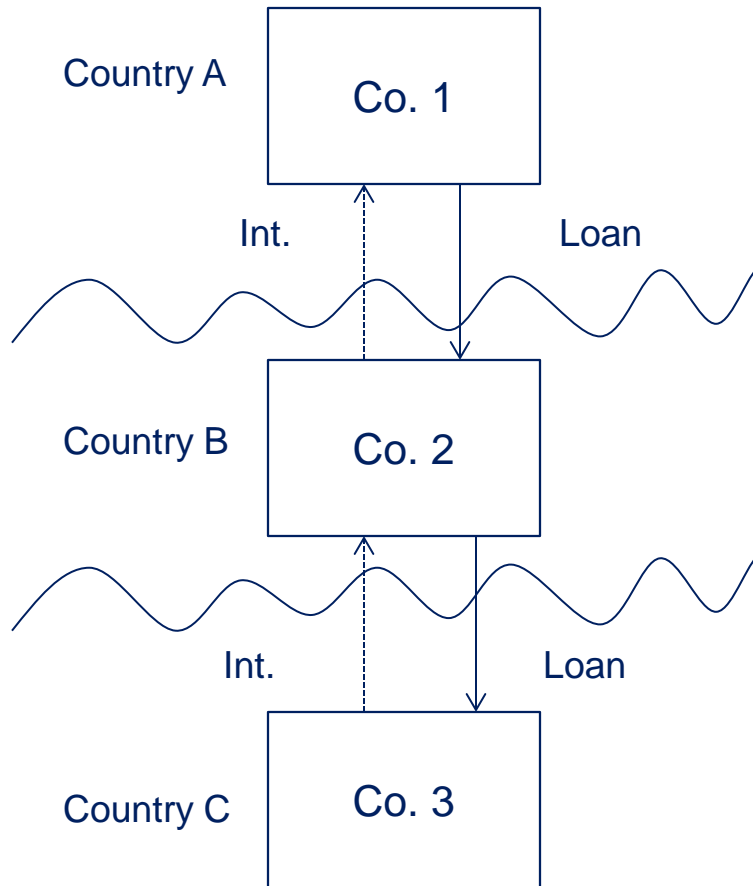
- While none of the parties were from UK, because the choice of law was English, the matter came up before UK Court of Appeals.
- Fundamental issue:
 - Would restructuring the loan (as suggested by Trustee) be a “reasonable measure available to” Indofood?
 - Would the interposed entity (Indofood Netherlands) be entitled to claim 0%/10% rate limitation under the Indonesia/Netherlands treaty? In other words, would Indofood Netherlands be the “beneficial owner” of the interest paid by Indofood Indonesia?
- Consequential issue
 - Under the Actual Structure, was Indofood Mauritius entitled to claim 10% rate limitation under the Indonesia/ Mauritius treaty (prior to termination)? In other words, was Indofood Mauritius the “beneficial owner” of the interest paid by Indofood Indonesia?



Indofood - Decision

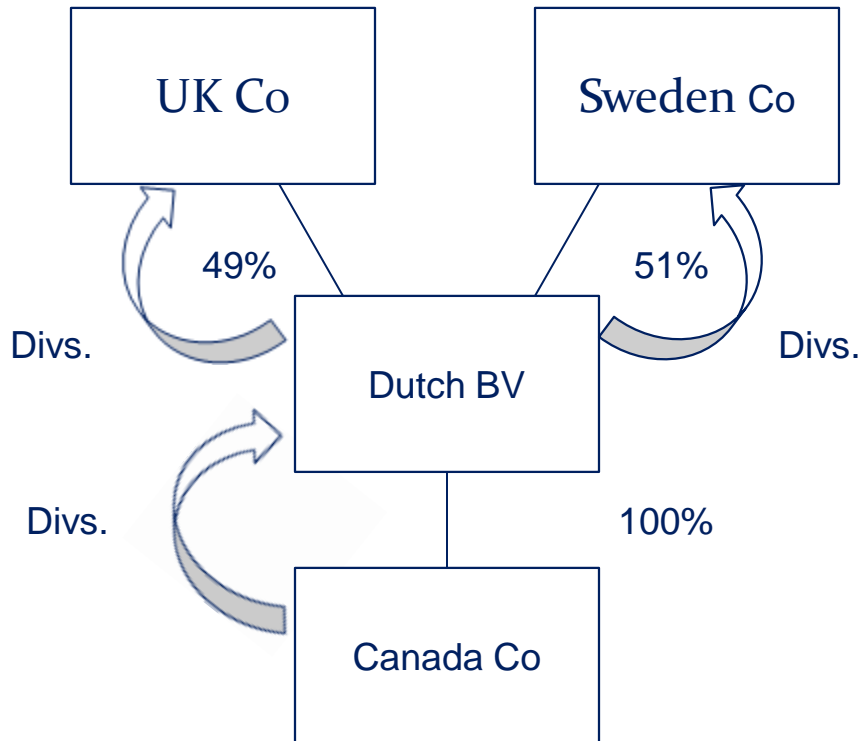
“But the meaning to be given to the phrase ‘beneficial owner’ is plainly not to be limited by [a technical and legal approach which focuses on the contractual arrangements]. Regard is to be had to the substance of the matter. In both commercial and practical terms [Indofood Mauritius] is, and [Indofood Netherlands] would be, bound to pay on to the Principal Paying Agent that which it receives from [Indofood Indonesia].... In practical terms it is impossible to conceive of any circumstances in which either [Indofood Mauritius] or [Indofood Netherlands] could derive any ‘direct benefit’ from the interest payable by [Indofood Indonesia] except by funding its liability to the Principal Paying Agent or [Indofood Mauritius] respectively. Such an exception can hardly be described as the ‘full privilege’ needed to qualify as the beneficial owner, rather the position of [Indofood Mauritius] and [Indofood Netherlands] equates to that of an ‘administrator of the income’.”

“Look through” approach



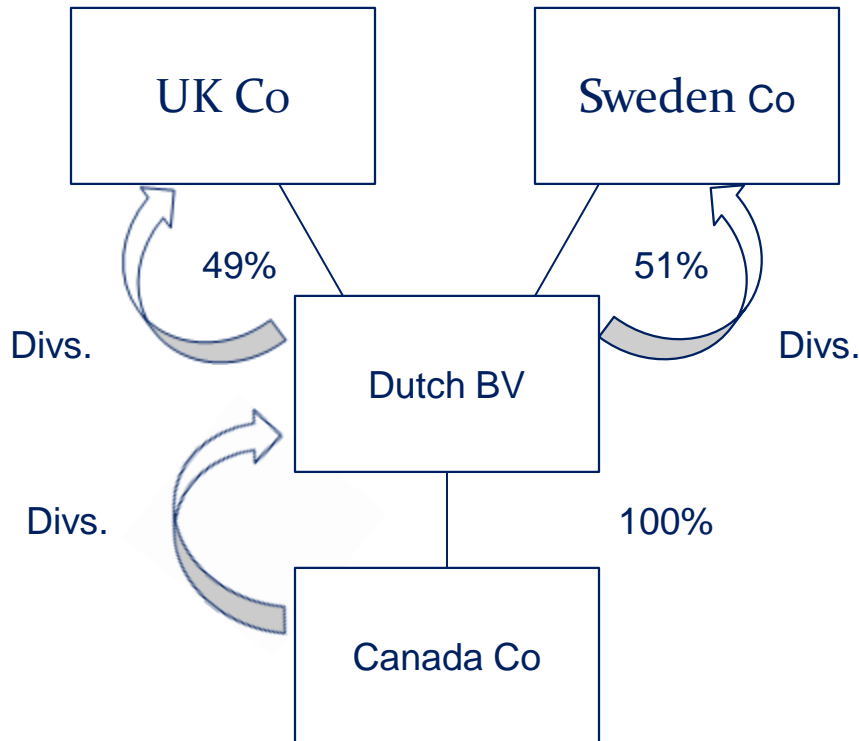
- Country C domestic tax law
IWT rate: 25%
- Country B/ Country C treaty:
5%
- Country A/ Country C treaty:
10%

Prevost



- Dividends paid by Canadian sub to Dutch BV co-owned by Volvo (Sweden) and Henlys (UK)-unrelated to each other.
- Lack of substance in BV: no office, employees, activities or significant assets other than shares in Canada Co.
- Expenses of BV reimbursed by shareholders as needed.
- Shareholders' agreement: Subject to adequate working and investment capital being available to BV, a dividend of 80% of its quarterly net profit after tax should be paid by BV by the end of the next quarter. This agreement was followed in practice.
- Argued by Canadian tax authorities: BV is not "beneficial owner" of dividends for purposes of Canada/Netherlands treaty.
- Residency/ GAAR not argued.
- Assertion that 25% rate could have been assessed, not 10%/ 15%.

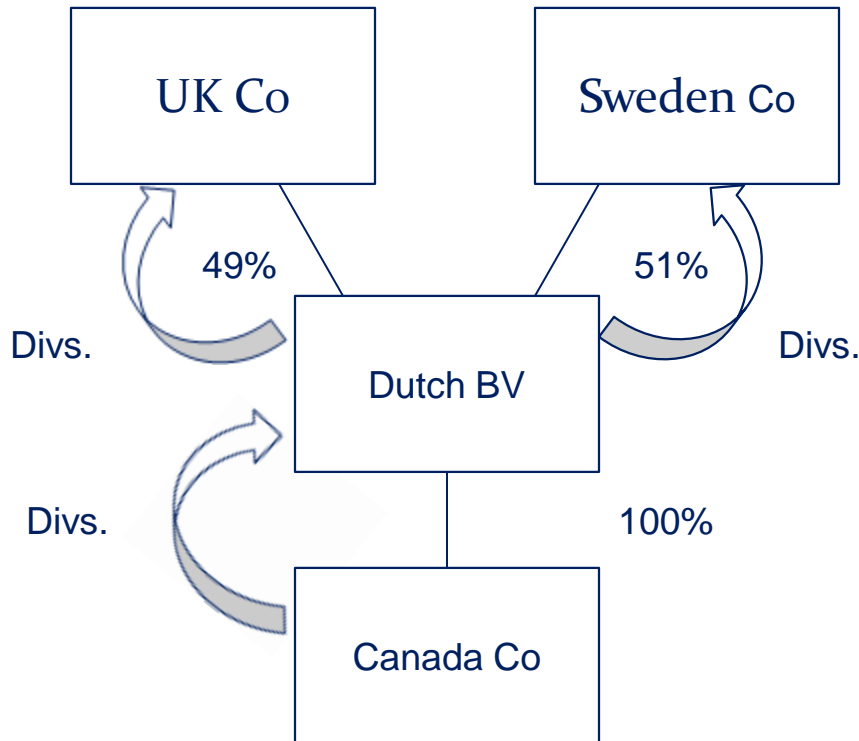
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Tax Court

- “Beneficial owner” is not defined in treaty.
- Art. 3(2) allows Canadian domestic law meaning to be used.
- According to the Court, the Canadian domestic law meaning is :
 - The person who received the dividend for his own use and enjoyment, and assumes the risk and control of the dividend he received. This person is not accountable to anyone for how he deals with the dividend.
- Based on this meaning , Court held that BV was the “beneficial owner”.
- What about shareholders’ agreement?
- Court discussed Indofood and the 2003 amendments to OECD Commentary, but decided not to follow either.

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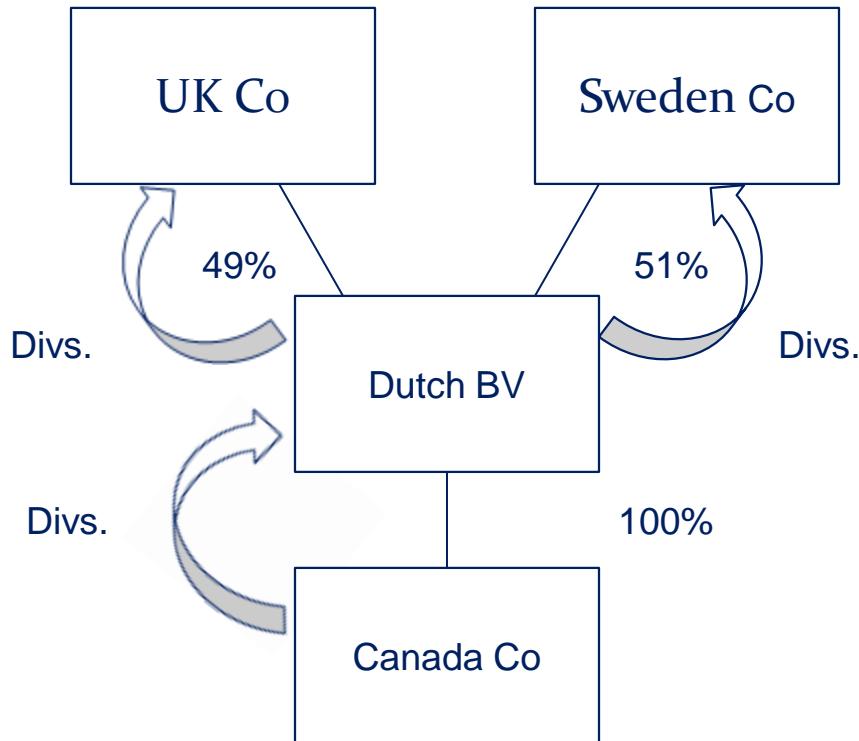


Federal Court of Appeal (26 February 2009)

- Dismissed appeal – i.e. taxpayer wins.
- Subsequent documents can be taken into account in interpreting the Netherlands/ Canada treaty – eg. Current version of OECD Commentary, OECD Conduit Companies Report.
- Express agreement with the Tax Courts’ decision:

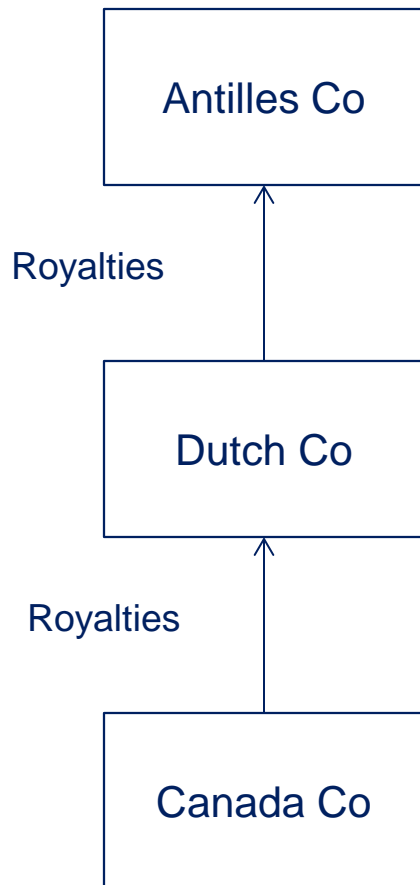
“... the ‘beneficial owner’ of dividends is the person who receive the dividends for his or her own use and enjoyment and assumes the risk and control of the dividend he or she received.... When corporate entities are concerned, one does not pierce the corporate veil unless the corporation is a conduit for another person and has absolutely no discretion as to the use or application of funds put through it as conduit, or has agreed to act on someone else’s behalf pursuant to that person’s instructions without any right to do other than what that person instructs for it, for example, a stockbroker who is the registered owner of the shares it holds for clients.”
(emphasis added)

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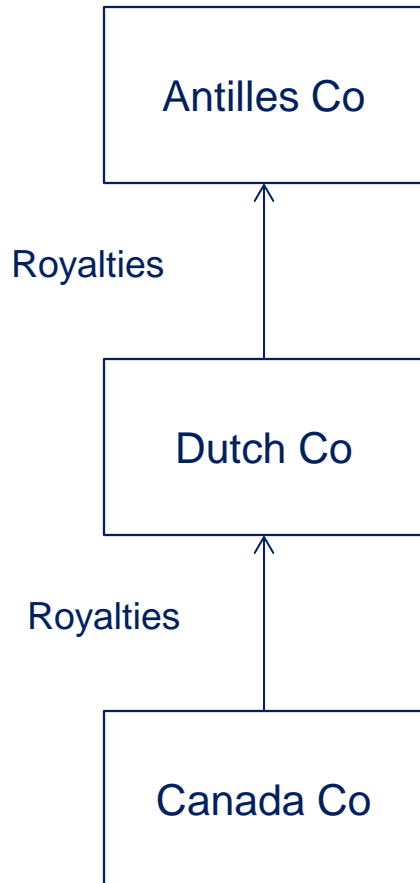
- Key findings of fact:
 - Dutch Co : cannot be said to have “absolutely no discretion as to the use or application of funds put through it as conduit”.
 - There was no pre-determined or automatic flow of funds to Sweden Co or UK Co.
 - Dutch Co was not a party to the shareholders agreement.
 - Neither Sweden Co nor UK Co could take action against Dutch Co for failure to follow the dividend policy in the shareholders agreement.
 - Dutch Co’s constituent documents did not obligate it to pay any dividend to its shareholders.

Velcro Canada



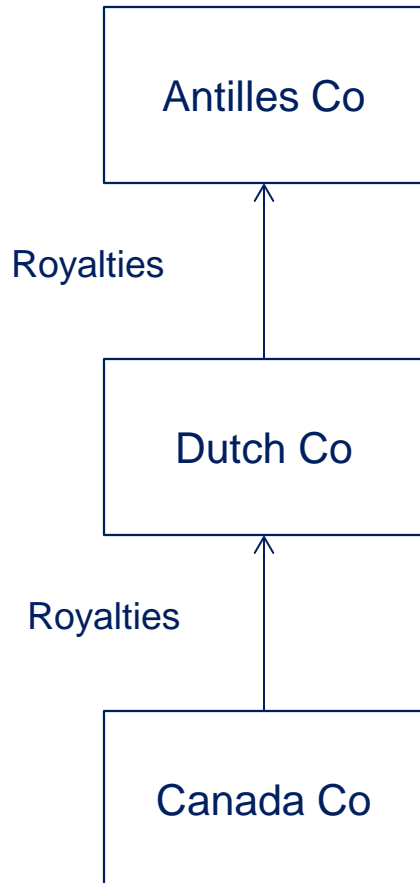
- Antilles Co is the owner of licensed IP
- Antilles Co assigned right to grant licences of IP rights and to royalty payments to Dutch Co but retains ownership of the IP
- Expenses of Dutch Co reimbursed by shareholders as needed
- Dutch Co has substantial cash, investments in subsidiary and loan receivables
- Arm's length person provides office space, banking, bookkeeping, managing directors to Dutch Co

Velcro Canada



- The Court held that, similar to the finding in *Prévost*, there was no “pre-determined flow of funds” from Canada Co to Antilles Co. despite the contractual obligation between Dutch Co and Antilles Co.
- The Court noted that, upon receipt, the royalty payments were intermingled with Dutch Co’s other accounts and used for a variety of purposes, at its sole discretion.
- The funds were transferred to various other accounts in different currencies and used to earn interest and to fund various activities, including loans, investments in subsidiaries, operational expenses and professional fees. The funds were exposed to creditors of Dutch Co.

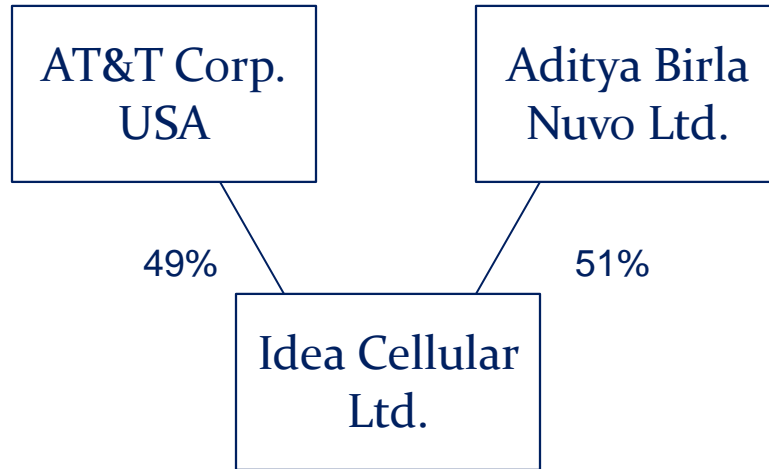
Velcro Canada



- Based on these facts, the Court held that Dutch Co had the “possession, use, risk and control” of the funds, and was the beneficial owner of the royalty income.
- In addition, it was not an agent or nominee. Antilles Co. did not have the power to legally bind Dutch Co and was acting on its own behalf at all times.
- Further, Dutch Co. was not a conduit or “mere channel”. Applying *Prévost*, it was held that a conduit has absolutely no discretion with respect to funds received, which was not the case: “It is quite obvious that though there might be limited discretion, Dutch Co. does have discretion”.

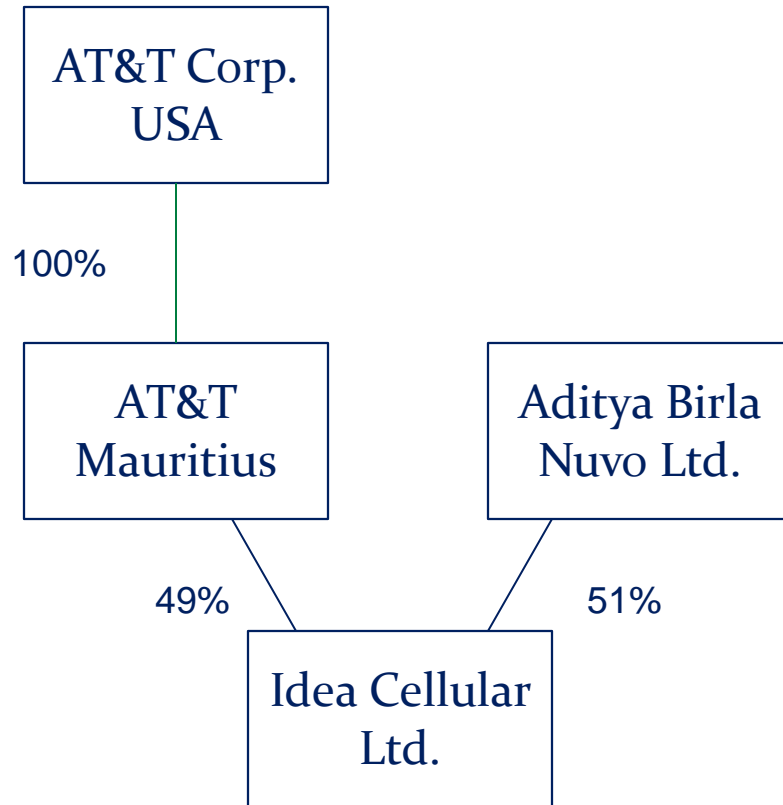


Aditya Birla Nuvo



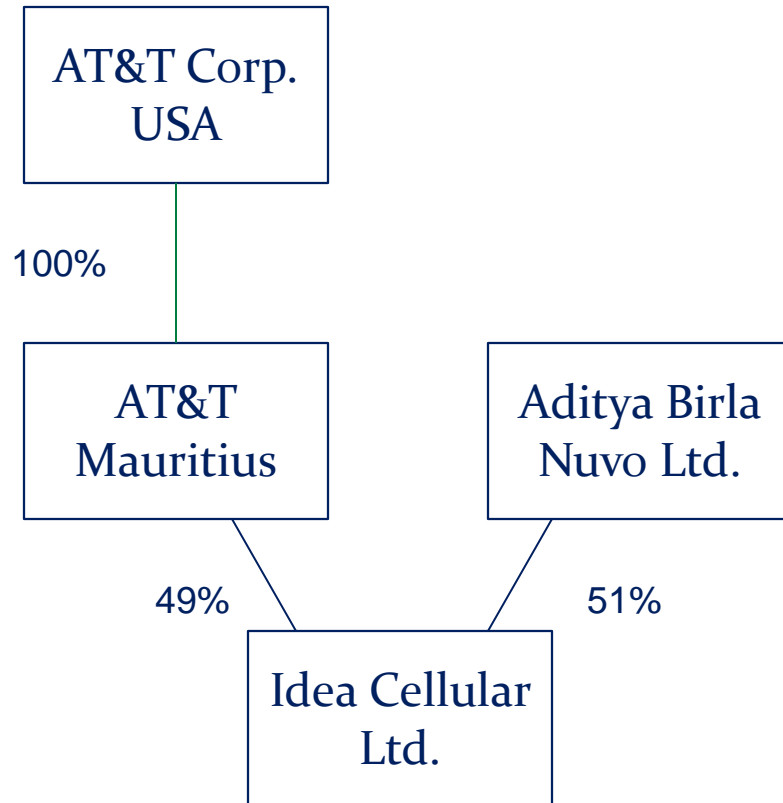
- In 1995, AT&T Corp. & Aditya Birla Nuvo Ltd entered into Joint Venture Agreement to set up Idea Cellular Limited.
- The founders were vested with the control, namely power to direct the management and policies, whether through the ownership of voting securities or by agreement or otherwise.
- JVA parties to subscribe to the shares in the ratio agreed
- The founders were to exercise their rights as members / shareholders and ensure that Articles of JVCo is amended to incorporate provisions of JVA.

Aditya Birla Nuvo



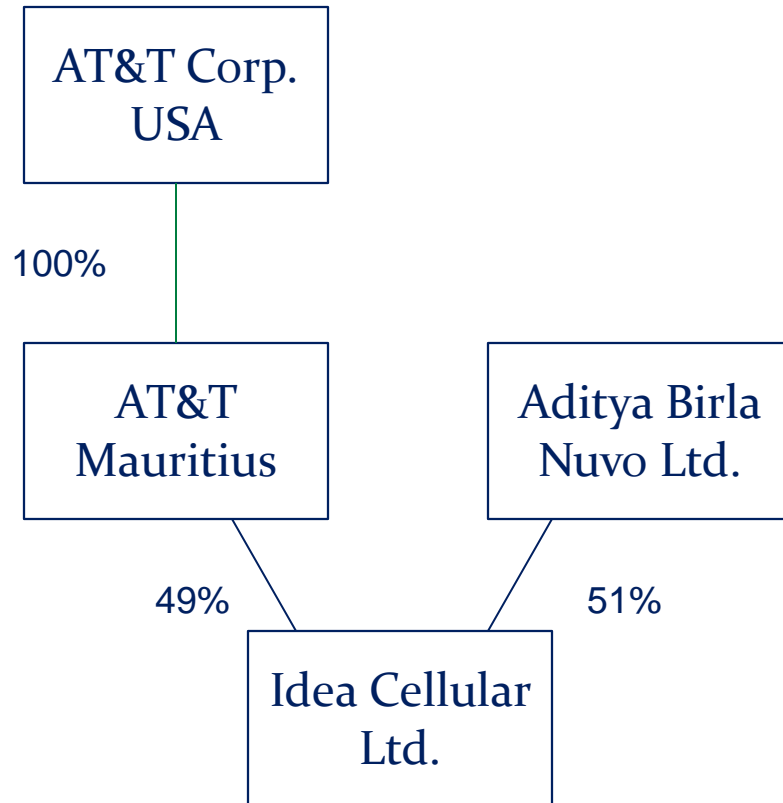
- JVA provided that shares of JVC shall be held by the founders either in their own name or through permitted transferees. The permitted transferees shall be bound by JVA.
- Permitted transferee must be 100% subsidiary of the founder.
- Accordingly, AT&T Corp subscribed shares of Idea Cellular Limited through its 100% wholly owned subsidiary AT&T Mauritius

Aditya Birla Nuvo



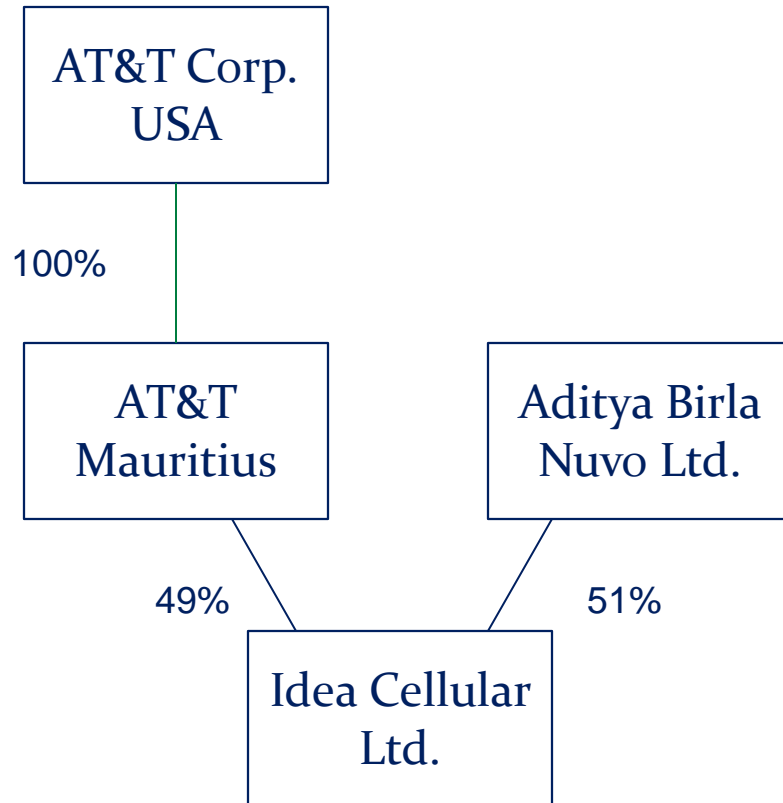
- Founders are eligible to appoint certain directors and also certain decisions would be taken only by identified representatives of founders.
- Entire obligation rests on founders and the permitted transferee is no more than a representative of the founder.
- Tata was also introduced as another JV Partner, however, these facts are not relevant to the issue and hence not discussed.

Aditya Birla Nuvo



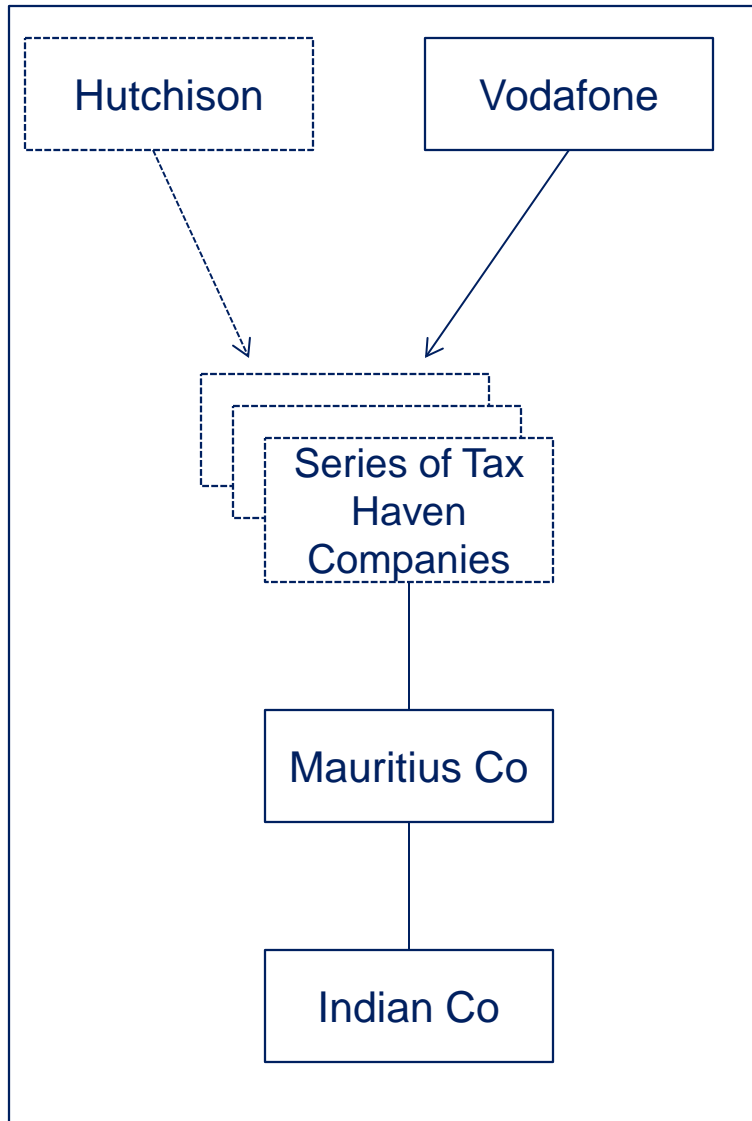
- Aditya Birla Nuvo Limited purchased certain shares of Idea Cellular Ltd. from AT&T Mauritius without deduction of tax at source after obtaining order under Section 195(2).
- Tax authorities issued notice to Aditya Birla Nuvo as representative assessee for non-filing of Return and consequently non-payment of tax.
- Aditya Birla Nuvo Ltd. sought to restrain tax authorities by invoking writ jurisdiction to Bombay HC stating that AT&T Mauritius had valid TRC and therefore the gain was not taxable and hence the notices should be quashed.

Aditya Birla Nuvo



- The Court observed that based on the terms of JVA, AT&T Corp. USA may be considered as beneficial owner of the shares held by AT&T Mauritius as AT&T Mauritius effectively had very limited rights.
- Agreement for sale of share was also signed by AT&T Corp., which cannot be ignored.
- Other rights under JVA were being exercised by AT&T Corp.
- Thus, it prima facie appeared to the Court that AT&T Corp. USA may be treated as beneficial owner and therefore notices cannot be quashed.
- These are only observations of the court and no conclusion has been drawn.

Vodafone



- Vodafone Ruling while did not really focus on beneficially ownership of share, it did refer to as a concept in relation to alternate arguments put forth by the tax department.
- In this case also, the Supreme Court laid the law that you have to respect the structure.
- Simply having layer of companies with very little business objective does not automatically calls for rejection of structure.
- Each company has authority to decide their activities and unless and until these rights are surrendered or compromised, it cannot be treated as not being the beneficial owner.



Limitation of Benefits

- United Mexican States / Tajikistan / Iceland / Armenia
 - A person other than individual has to be a qualified entity for taking benefit [therefore non-qualified entity not entitled to benefit]
 - Qualified entity
 - A Government entity
 - A company which is
 - Listed and is regularly traded; or
 - At least 50 % of aggregate vote / value of shares are owned by individuals resident in the contracting state or by companies 50 % of which is owned by individuals residents
 - Partnerships or AOP, 50 % of beneficial interest wherein is owned by individuals resident in contracting state
 - Charities / tax exempt entity whose activities are mainly carried out in a contracting state
 - Qualified Entity not entitled to benefit if more than 50 % of its gross income is paid or payable to persons who are not residents



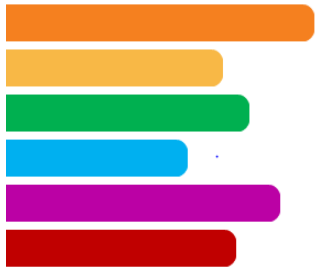
LOB – Anti Abuse

- Mozambique / Luxembourg / Myanmar / Syria / Kuwait
 - Nothing to affect the domestic provision to prevent tax evasion
 - No benefit available if main purpose or one of the main purpose of creating the enterprise to take benefit of the DTAA which otherwise would not have been available
 - Legal entities not having bona fide business activities not entitled
- Singapore
 - Only applicable to income remitted in a contracting state
 - Also exclusion of conduit companies
 - 200,000 SGD / Rs. 50.00 lacs expense



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