Interpreting the Concept of “Beneficial Ownership”

By

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Abstract

The concept of “beneficial ownership” is frequently used in international tax treaties. The concept is applied in situations where taxpayers may be benefiting indirectly from the advantages a particular treaty provides by interposing a corporation in a “tax-favourable jurisdiction” for the purpose of paying less tax than the corporation might pay in other jurisdictions. This corporate behaviour is called “treaty shopping.” Recent constructions of the term “beneficial ownership” in legal literature and case law, and by national tax agencies have been contradictory. Thus, there is a need for clarification both in Canada and internationally. The author of the thesis comes to the conclusion that a new definition is not desirable and that a strict interpretation of the current concept is the lesser evil. However, he argues that, if the concept is to be effectively used to tackle the kinds of arrangements it was intended to challenge, the assistance of a substance-over-form component is inevitable. He proposes some ways this component might be developed.
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INTRODUCTION

Although the term “beneficial ownership” is employed in many international tax treaties, the concept of “beneficial ownership” does not have a well-accepted interpretation. The appropriate interpretation of “beneficial ownership” has, in fact, been the contested issue in a number of important tax disputes, for example, the one dealt with in a recent decision of the Federal Court of Appeal. The Advisory Panel on International Taxation, which was established by the Canadian government, acknowledged the uncertainty about the meaning of the term in a report it issued in December 2008, but the panel decided to adopt a “wait and see” approach to the issue of interpretation. The uncertainty surrounding the meaning and application of the concept of “beneficial ownership” has created a gap in understanding that urgently requires attention by Canada and other governments. According to an opinion written in 1989, “there seems little chance of there being an accepted universal meaning of the term beneficial owner.” The events of the next twenty years have shown the correctness of this statement.

1 The term is contained in all of Canada’s treaties.
3 “Neither Canada’s tax treaties nor its domestic law define ‘beneficial owner’. Courts in Canada and other countries have attempted to interpret or define what ‘beneficial owner’ means, and the Panel heard that it might be best to wait for a globally agreed definition before taking unilateral action in this regard.” Advisory Panel on Canada’s System of International Taxation, Final Report: Enhancing Canada’s International Tax Advantage (Ottawa: Department of Finance, 2008) (‘Advisory Panel Report’) at paragraphs 5.61–5.68, online:<www.apcsit-gcrcfi.ca/index-eng.html>.
4 J. Avery Jones et al., The Treatment of Trusts under the OECD Model Convention, European Taxation (1989 BTR 41) at 379.
Third-party entities frequently try to benefit from provisions of a bilateral tax treaty that provide relief by establishing a “conduit entity” in a friendly contracting state. The intermediary is then often overlooked through consideration of the identity of the true or “beneficial owner” of entities. The practice of locating these “conduit entities” in attractive locales is known as treaty shopping. Recent decisions and administrative directions with respect to the meaning of the expression “beneficial ownership” seem almost hopelessly unclear. Case law contains contradictory statements, and various authors have provided a number of competing meanings for the expression.5

In this thesis, I examine and critically evaluate the concept of “beneficial ownership” in bilateral tax treaties and make a number of recommendations about how the concept ought to be construed in order to resolve the current uncertainty and controversy. This thesis addresses the question about how the expression “beneficial ownership” should be interpreted as a normative matter. The objective of the thesis is to develop clarifications that are internationally applicable, and, therefore, I propose an interpretation that favours international harmonization in tax law. To this end, the thesis contains seven parts. The first part sets out the framework of the study. Part II reviews several fundamental issues relating to international tax treaties. Part III provides an account of treaty abuse and treaty shopping. The fourth part sets out the historical background of the interpretation of “beneficial ownership” by the Organization for Economic Cooperation and Development (OECD) from the time the term was first introduced in its model treaty to the present. Part V addresses the interpretations of the term in case law and legal literature. The sixth part deals with the international interpretive gap by proposing a meaning for “beneficial

ownership” that is consistent with the dominant direction of existing legal materials and with the normative and pragmatic reasons for the use of the expression. This interpretation also accommodates the relevant policy objectives. The conclusion is drawn that expansion of the strict, narrow interpretation that “beneficial ownership” has received up until now is not a sound approach and that a “main purpose” test is a more adequate response that could be employed to further develop the concept. Part VI presents a summarizing statement of conclusions reached.

**PART 1: METHODOLOGY**

This study focuses on the OECD Model Treaty, but it is important to understand that other model treaties are also used across the world. Of these others, the UN Model Treaty and the U.S. Model Treaty are the most important. The differences among them do not need to be discussed in this thesis, except for the observation that the treaties may lead to different conclusions about the interpretation of the OECD Commentaries (a topic that will be addressed in the next part). The UN Model Convention was created in order to rectify imbalances in OECD Model Treaties that may be agreed to by the government of a developed state and the government of a developing state. The UN model is adapted to suit importing countries’ particular interests. The U.S. Model Treaty deals more with provisions against treaty shopping. The U.S. model incorporates a Limitation on Benefits provision (hereafter, “LOB provisions”), but it does not contain withholding tax provisions for interest and royalties.

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6 LOB provisions are defined in Part 5.
Because I take as a premise the reality that the “beneficial ownership” concept will probably remain in current tax treaties in the coming years, this thesis attempts to find the interpretation that best fits the current context of international tax law. No provision is made for a new definition, and the conclusion is drawn that that a new definition would not be a desirable solution. The question therefore can be posed this way: Assuming that the status quo remains in effect at this time, how should the “beneficial ownership” concept be interpreted in order to achieve its intended purpose? Even if OECD members make efforts to define, modify, or replace the expression, the renegotiation of current treaties to bring them into conformity with the new principles could be accomplished only over a long period of time. In addition, it appears that new treaties and recently signed renegotiated treaties have continued to adopt the “beneficial ownership” requirements for passive income articles. Yet there has been a trend towards inclusion of LOB provisions in addition to the “beneficial ownership” concept in several recently negotiated treaties. Despite the fact that “beneficial ownership” has attracted much criticism in recent years, the concept will probably have to be accommodated by the international community at this time. There have been calls for OECD assistance in the process of defining beneficial ownership and in the general reform of the anti-avoidance provisions of the OECD Model Treaty. This study attempts to discover the most useful and beneficial interpretation that may be attributed to the concept during the time before the completion of the OECD’s work.  

This study also focuses on the use of “beneficial ownership” in the passive income articles (Articles 10, 11, and 12) of the OECD Model Treaty. These articles consider three kinds of

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7 This study is international in scope, but references to the Canadian context are made from time to time so that the reader can better understand the practical applications of the international tax law notions referred to throughout the text.
income, i.e., dividends, interest, and royalties. These kinds of income are incorporated in the vast majority of treaties based on the OECD Model. All the ideas expressed in this paper are applicable to these three kinds of passive income. Any relevant distinctions will be made when necessary. Article 13, regarding capital gains, necessitates a different analysis, which will not be undertaken here.

What is a Conduit Company and What Kinds of Schemes are Usually Involved?

In the analysis of the “beneficial ownership” concept and its anti treaty-shopping function, the practical reality of its application cannot be ignored. As mentioned above, the concept of beneficial ownership appears in Articles 10, 11, and 12 of the OECD Model Treaty and in the sale of shares provision (Article 13). For this reason, this study will not go beyond the day-to-day schemes used in practice to circumvent the fiscal consequences of withholding taxes.\(^8\) This analysis focuses mainly on what have been called “direct conduit” schemes even though beneficial ownership issues may occasionally arise in other kinds of circumstances. “Direct conduits” have been described with precision by the OECD Committee on Fiscal Affairs.\(^9\)

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9 “A company resident of State A receives dividends, interest or royalties from State B. Under the tax treaty between States A and B, the company claims that it is fully or partially exempted from the withholding taxes of State B. The company is wholly owned by a resident of a third State not entitled to the benefit of the treaty between States A and B. It has been created with a view to taking advantage of this treaty’s benefits and for this purpose the assets and rights giving rise to the dividends, interest or royalties were transferred to it. The income is tax-exempt in State A, e.g. in the case of dividends, by virtue of a parent-subsidiary regime provided for under the domestic laws of State A, or in the convention between States A and B.” OECD, *International Tax Avoidance and Evasion, Four Related Studies, Double Taxation Conventions and the Use of Conduit Companies*, Issues in International Taxation, (OECD, 1987), No. 1.
A jurisdiction’s ability to attract holding companies to its territory is based on the following criteria. First, a tax treaty should enable the taxpayer to obtain dividends from subsidiaries at a low rate of withholding taxes or with no withholding tax at all. Second, the corporate tax of the holding company’s jurisdiction must be low. Profits on the sale of shares in the subsidiary must also be taxed at a low rate. Third, the dividends directed to the upper tier company must be subject to low withholding tax rates in the holding company’s jurisdiction.

The OECD report on conduit companies suggests a number of non-tax reasons for companies’ establishment of intermediary holding corporations. For example, the goal might be to secure better access to capital markets. The corporation might also be set up because of currency regulations or the political situation in the country where the investment is made. Another nontax reason why corporations may use a holding company is the need by two parties to a joint venture agreement for a neutral corporation set up in a third jurisdiction. The purpose is to establish an unbiased common enterprise that will undertake the project. The corporation may also be used to allow the reduction of risk when a new business is started (e.g., securitization issuance). Another use of such a corporation is to share risks with other corporations (e.g., limited liability). The circumvention of non-tax legislation is another possible purpose. For example, in the media industry, corporations may be set up to prevent excessive concentration of media ownership in jurisdictions where there are laws that monitor the media (although this legislation is usually enacted at the domestic level). Holding corporations are included in one subcategory of businesses that bear the appellation “Special Purpose Vehicles” (hereafter, “SPV”).
Due to the public’s suspicious attitude towards them, very little information on conduit corporations is made public. Some reports have attempted to describe them. 10 It should be noted that the excerpt quoted in footnote depicts “mailbox” companies that are considered the less substantive conduits, since they barely fulfill the domestic residence requirements.

**PART 2: ABOUT TAX TREATIES...**

### 2.1 History

When an issue about the interpretation of any text arises, it is important to go back to its origins in order to determine its intended purpose. Tax treaties are no exception. For this reason, this discussion includes a review of these treaties’ origins and of their subsequent changes in direction.

Tax conventions, as they are known today, have their origin in the work of the League’s Fiscal Committee. A report about an investigation of the economic consequences of double taxation

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10 “Trust (Note: The term “trust” in the Netherlands does not mean the same thing as the term “trust” in Anglo-Saxon law) offices provide various services to their client. The primary function of a trust office is to provide substance. Trust offices incorporate legal entities on behalf of clients, mostly multinationals and provide them with an address, management and administration. These are essential under substance over form requirements which require that a company have a real presence in the country and in turn are essential in order to benefit from local tax advantages. Consequently, most mailbox companies are located at the same address as the trust office. Clearly, personnel is not a requirement for substance, as most trust clients report zero when asked for the number of employees. In addition, the trust office may provide administrative and support services such as the organization of shareholder meetings, and give advice on legal and fiscal matters, although the latter is mostly undertaken by specialized consultancy firms.” M. van Dijk, F. Weyzig, and R. Murphy, “The Netherlands: A Tax Haven?”, SOMO, November 2006.

was made in 1927\textsuperscript{11} and presented to the Financial Committee. The report identified and explained the relevant factors that should be used in allocating the right to tax between two states (e.g., territorial connection, kind of income). Since the presentation of that report, the principal objective of tax treaties changed from exchange of information and mutual assistance to the avoidance of double taxation. When the Organization for European Economic Cooperation (renamed the Organization for Economic Cooperation and Development in 1961) was created in 1948 and took over some of the League’s functions, it continued to adopt resolutions regarding double taxation and tax conventions. In 1963, the Fiscal Committee of the OECD presented the well-known convention that has been widely used to this day and that now bears the name of OECD Model Tax Convention on Income and Capital (“OECD Model Convention”). The OECD Model Convention has been revised and updated many times since 1963. The most important changes were made in 1977, 1992, and 2000.

From time to time, the OECD issues commentaries regarding its Model Convention. The revisions in the commentaries elaborate and refine the interpretations in the Model Convention.

\textbf{2.2 Purpose of Tax Treaties}

The purpose of tax conventions has gradually changed from their first objective, i.e., “information exchange and mutual assistance,” and has incrementally moved towards the purpose of avoidance of double taxation. The latter is now considered the main objective of tax

conventions, although, as will be discussed, this objective is more generally seen as involving the allocation of taxing rights among sovereign states. At this time, the avoidance of tax evasion, which is different from tax avoidance, is undoubtedly an additional reason for the existence of tax conventions. The names of the main models of tax conventions have changed during the past few decades, and the result is that all of the conventions currently bear names that suggest that the avoidance of double taxation is not the only objective of the conventions.  

Since there has been a shift in the legislative forum that is vested with the duty to prevent double taxation from treaty law to domestic law, one can no longer assert that the avoidance of double taxation is the main objective of tax treaties. The allocation of taxation rights is now considered the main purpose of tax treaties. Obviously, the ultimate objective of this allocation is the indirect prevention of the occurrence of double taxation. This view has become a general consensus. The problem of treaty shopping arises because of unequal distribution, since, ideally, only the state of residence should be entitled to levy a tax on passive income. However, source states have generally maintained their right to levy a tax on those kinds of income (withholding taxes), a way of behaving that has created disparities between jurisdictions.

In 2003, the OECD amended its commentary and explicitly addressed the question of the prevention of tax avoidance as a purpose of tax treaties. Weeghel argued in 1998 that the prevention of tax evasion is an explicit objective of tax treaties that are based on an OECD


Model Convention. However, he suggested that this objective does not go as far as encompassing tax avoidance or preventing the improper use of tax treaties.\textsuperscript{14} The OECD commentaries of 2003, coupled with recent works by respected scholars, suggest that the opposite may be truer. Avi-Yonah proposed that the whole issue should be seen as a principle that prescribes that a taxpayer should be taxed once, not more and not less. He named this rule “The Single Tax Principle.”\textsuperscript{15} In other words, this principle means that both the prevention of double taxation and of double non-taxation should be the purpose of taxation in general. This theory has received significant support from the academic sphere as far as the OECD Model is concerned. But with regard to the UN Model, some developing countries may have the opposite goal (making double non-taxation an objective of tax treaties, in the hope that this policy may attract investment). This thesis assumes that the prevention of tax avoidance (or of double non-taxation) is probably a purpose of tax treaties based on the OECD Model.

Since the rise of recent phenomena such as international tax evasion, tax planning, and money laundering (problems that prompted the OECD to issue a series of reports on these subjects in the late 1980s), information exchange as a purpose of tax treaties resurfaced, and cooperation among tax administrations seems to be a practice that will continue to grow over the years.\textsuperscript{16}

The purpose of a given tax convention will of course depend on the policy objectives the contracting states want to pursue. Governments may not share the same policy objective when

\textsuperscript{14} Stef van Weeghel, \textit{The Improper Use of Tax Treaties} (Kluwer Law International, 1998) at .35.
they enter into a treaty negotiation. This divergence may occur for a whole array of reasons driven by economic, structural, or demographic considerations. For example, Canada is an exporting country and consequently has an interest in signing numerous tax treaties. Weeghel explains: “Of course, the policy of one treaty partner may conflict with the policy of the other treaty partner, in which case the question arises whether employment of the treaty by a taxpayer contrary to the policy of one state but not contrary to the policy of the other state may be improper.”17 This idea has significant relevance in the context of “beneficial ownership” since most of the time a holding company will be established in a “tax favourable jurisdiction” that seeks to attract foreign capital by offering tax advantages. In such cases, the policy motive of each of the contracting states is significantly different, and that difference may affect the outcome of an anti-avoidance challenge on the question of “improper use.” Another issue that arises is change in policies. The “beneficial ownership” concept first appeared in the 1977 OECD Model Treaty. Numerous changes have occurred since then in the economic and political spheres, and, in response to those changes, the tax policies of many countries may also have been transformed.

Reciprocity is another fundamental element of tax treaties. No treaty will be ratified if no concessions are made on both sides. In this case again, the belief that the equation is as simple as it seems is misleading. In practice, numerous factors are involved. For example, one author has said that the results of a treaty negotiation will mostly be a consequence of current tax planning by citizens.18

17 See footnote 5 p.107
18 See footnote 9.
2.3 Tax Treaty Interpretation

In legal theory, a tax treaty is like any other convention entered into by two or more subjects of international public law (sovereign states). One feature that is peculiar to tax treaties resides in the relation between treaty subject and treaty object. Since the main purpose of tax treaties is to allocate the taxing rights of both parties, the conclusion may be drawn that, in this balancing relationship, one state will lower its tax levy in favour of the other in relation to certain kinds of income and vice versa. Any advantage, for example, in the form of a deduction, a credit, or an exemption, may result in a benefit to the taxpayer that is then seen as a resource that should be protected. This “treaty object vs. treaty subject” relationship may somehow affect tax treaty interpretation in ways that are different from the application of treaties that convey rights and obligations mainly to the states themselves, with no or little repercussions for citizens.

Since tax treaties are incorporated into domestic law or, in some countries, are automatically a constituent of domestic law, they are interpreted under both international public law and internal law. Since domestic tax legislation has peculiar interpretative rules with regard to tax matters, some interpretation issues may arise. Further analysis of this question is not the objective of this thesis. Suffice it to say that domestic tax legislation is generally interpreted strictly and in favour of the taxpayer when a situation that presents an ambiguity that cannot be resolved arises.

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19 Geoffrey T. Loomer, See footnote 25 at 17.
Aside from those peculiarities, tax treaty interpretation should not differ from traditional international treaty interpretation and thus should be subject to the Vienna Convention on the Law of Treaties (hereafter “Vienna Convention”)\(^{20}\).

2.4 The OECD Commentaries

Although it is clear that the core of bilateral tax treaties based on the OECD Model Treaty should be interpreted according to the usual rules of interpretation as they appear in the Vienna Convention and in international public law, it is less obvious how the commentaries issued by the Committee on Fiscal Affairs of the OECD (hereafter “CFA”) should be taken into account when a tax treaty has to be construed. At the outset, it should be noted that paragraph 29 of the Introduction to the current OECD Model Treaty states that the commentaries are not intended by the CFA to be binding. From the OECD perspective, the commentaries are mere “recommendations,” not “decisions.” In addition, the OECD Model Treaty is only a model and not even a convention. The conclusion may be drawn \textit{a fortiori} that the commentaries about a “model” treaty should not receive the weight normally attributed to directives issued with respect to a duly ratified treaty.

According to one line of thinking, the OECD commentaries that were already issued at the time the bilateral OECD Model Treaty was concluded should constitute an essential source of

interpretation on occasions when the treaty is construed. Several arguments may be asserted in
favour of this viewpoint, and some of them are mentioned here. For example, the assumption
has been made that, in instances where contracting states have negotiated a tax treaty and used
the OECD Model as their blueprint, the negotiations have inevitably involved discussions about
not only the actual provisions of the OECD Model, but also about the attached OECD
commentaries. In such cases, a contracting party is not justified in ignoring the commentaries
after having taken them into account in the negotiation sessions. In Canada, this seems to be the
view adopted in MIL Investments. Justice Bell refused to take into account amendments to the
commentaries made after 1977, however.

Art. 31(1) of the Vienna Convention states that “A treaty shall be interpreted in good faith and
in accordance with the ordinary meaning to be given to the terms of the treaty in their context
and in the light of its object and purpose.” Some authors have suggested that the commentaries
were legitimately incorporated in tax treaty interpretation through reference to that provision by
giving some evidence of what the “ordinary meaning” of a term is. With reference to another
matter, Article 3(2) of the OECD Model Treaty provides that undefined terms should be given
the meaning they have under domestic law “unless the context otherwise requires.” The authors
of The Interpretation of Income Tax Treaties with Particular Reference to the Commentaries on
the OECD Model have suggested that “context in Article 3(2) has a wider meaning than textual
context and includes the commentaries current when a bilateral treaty was concluded.” With
regard to the issue of defining “beneficial ownership,” these authors maintain that the OECD


23 D. Ward et al., The Interpretation of Income Tax Treaties with Particular Reference to the Commentaries on the
OECD Model (IBFD Publications BV, 2005) at 1-350.
commentaries to articles 10, 11, and 12 are clear enough to make them part of the “context” that permits a deviation from the general rule that enjoins reference to domestic law.

With regard to commentaries issued at some point subsequent to the initial treaty negotiation, there is not a clear answer to the question about whether they should apply to tax treaties in the same way that commentaries already issued at the time of negotiation apply. One of the problems that arises is that, since such commentaries were not issued at the time of negotiation (and consequently could not have been taken into account by the parties), making the commentaries binding on parties would go against the principles underlying *pacta sunt servanda*, since the commentaries did not exist when the contract was formed and thus were outside the contemplation of the parties. In addition, under the constitutional laws of some states, reference to such commentaries might usurp the role of legislative bodies, since this reference could result in indirect amendment of the domestic law of the contracting states without any sanction from legislative bodies.

A new commentary may have a diverse range of functions. For example, it may “fill a gap in existing commentary by covering matters not previously mentioned at all,” “amplify the existing commentary by adding new examples or arguments to what is already there,” “record what states have been doing in practice,” or “contradict the existing commentary.” The suggestion has been made that commentaries that attempt merely to construe the words of the OECD Model Treaty on the basis of its current terminology and that do not contradict other commentaries can be
said to have the same weight as the commentaries that were already issued at the time the Model Treaty was issued. 24

Summary

In this part, I explained that tax conventions are used to allocate taxing rights among contracting states, with the objective of avoiding double taxation. The nature of the “Single Tax Principle” was described, and the conclusion that the prevention of tax avoidance is now probably one of the purposes of tax treaties was stated. The idea that tax treaties should not be interpreted differently from other international public law treaties was expressed. In this part, the statement was also made that the assertion is reasonable that OECD commentaries issued at the time when treaty was negotiated should be included in the interpretive sources when a treaty term has to be construed. It is questionable whether the same assertion applies to commentaries issued subsequent to the negotiation.

PART 3: IMPROPER USE OF TAX TREATIES AND TREATY SHOPPING

3.1 Improper Use of Tax Treaties

It is important to note at the outset that the expression “improper use of tax treaties” is the appropriate description of the kind of behaviour revenue agencies want to tackle. The term is somewhat broader than reference to the mere “abuse” of tax treaties, a term that tends to be

24 See footnote 19.
employed in domestic ant avoidance legislation and that is often described as behaviour that is not in conformity with the purpose of a provision that has been exploited. Nonetheless, for the purpose of this study, both expressions are used interchangeably.

With the objective of providing some clues about what should be considered “improper use of tax treaties,” the OECD proposed a “guiding principle” in the 2003 amendments to the commentaries. The amendment suggests that treaty benefits should be denied when the main purpose of an arrangement is to secure tax advantages and when that outcome violates the objective and purpose of the provisions used. Loomer refers to the two as the “subjective requirement” (the former) and the “objective requirement” (the latter).25 Those two criteria are found in numerous domestic GAAR provisions.

Treaty abuse “defeats fundamental and enduring expectations and policy objectives shared by both states and therefore the purpose of the treaty in a broad sense.”26 The conclusion may be drawn that the mere use of a treaty to gain tax benefits is not enough evidence to support a judgment that abuse has occurred; instead, proof of the abusive element itself is required.

Weeghle suggests that improper use of tax treaties occurs as a phenomenon that may be explained by the attitude of suspicion, which has been observed among OECD members, about the improper use of tax treaties. However, there is divergence among members of the international community about what constitutes improper use of tax treaties. (Academic

25 Geoffrey T. Loomer, Tax Treaty Abuse: Is Canada Responding Effectively?, Oxford University Centre for Business Taxation, WP 09/05.
discussions have focused mainly on treaty shopping, although other types of improper use of tax treaties surface from time to time; indeed, a taxpayer may improperly “use” a treaty that legitimately protects him without doing any “shopping”). Nonetheless, some schemes are clearly extreme and, as such, can be either included in or discarded from the concept of “abuse.” The taxpayer need not be “excessively correct” and has the right to arrange transactions so as to avoid double taxation. Still, the statement can be made that a treaty cannot be used in a manner that would result in the evasion of taxes. Furthermore, recent trends suggest that the use of a treaty should not lead to double non-taxation. Provisions of treaties should also be applied in ways that conform with the normal rules of interpretation. Weeghle explains: “The difficulty starts if the acts of the taxpayer are in compliance with the provisions of the treaty and the domestic laws of the contracting states, but the result does not square with the purpose of the treaty or with the intentions of the contracting states.”

3.2 Treaty Shopping

In a tax law context, setting up a company in a particular jurisdiction for the purpose of taking advantage of the tax treaties that the jurisdiction has ratified can, in a tax law context, be considered treaty shopping. Searching for a more favourable treaty should not necessarily be equated with treaty abuse; a question about whether the occurrence is an indirect breach of a

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28 See footnote 14.
29 See footnote 14, p. 97.
provision through a violation of its objective, spirit, and purpose needs to be asked. Even if treaty shopping may be seen as a phenomenon that in itself has a negative impact, this interpretation does not necessarily imply that treaty shopping’s manifestations are objectionable in all cases, since only the improper use of tax treaties can be challenged. The occurrence of an improper use necessarily involves a violation of the objective and purpose of the treaty.

Treaty shopping has been described by Vogel as “a situation where transactions are entered, or entities are established, in other States, solely for the purpose of enjoying the benefit of a particular treaty rules existing between the State involved and a third State which otherwise would not be applicable.” This definition and definitions developed along the same lines have created a general consensus. The only distinction that arises concerns the degree of intention on the part of the entity that established the intermediary. Some definitions of treaty shopping specify that the only motive for the transaction should be to benefit from tax advantages, while others specify that the main motive for the transaction must have been tax reasons.

From these definitions, the conclusion may be drawn that judgments about the improper use of tax treaties require the objective element (proof of a violation of a treaty objective) in relation to the “guiding principle,” while the definition of treaty shopping includes a requirement only for the subjective element. Comparison of the two concepts is not appropriate. The first one is used to target uses of tax treaties that are objectionable from a policy standpoint mainly because they result in tax avoidance that violates the objectives of treaties. In contrast, “treaty shopping” tends


31 See footnote 26.
to be used to describe behaviours that, both individually and taken together, lead to negative consequences for international tax law cohesion, aside from “avoidance of tax” behaviour. Thus, I find it necessary to distinguish between treaty shopping that is seen as a phenomenon with bad consequences from a policy standpoint, and cases of treaty shopping that are seen as specific transactions involving the selection of a treaty in order to claim its benefits and that are or may be considered abusive.

What mischief is involved in “shopping” for an advantageous tax treaty? The answer is threefold. First, the OECD opinion is that treaty shopping should not be allowed because it extends an agreement economically to persons resident in a third state in a way that was unintended by the contracting states. The practice therefore breaches the reciprocity of benefits. Second, a party to a treaty negotiation would expect that the amounts for which it concedes benefits would “fall under the normal taxing regime of that (the other) State,” a disposition that does not occur in treaty shopping arrangements. Finally, the state of residence of the ultimate recipient of the income has no longer an incentive to enter into treaty negotiations with the source state, since it can already access the benefits through indirect mechanisms. Beyond these three reasons, there is a tax avoidance element to treaty shopping; the practice will lead to tax base erosion since the amount of tax that would otherwise be withheld by the resident country may be significantly reduced (or sometimes eliminated altogether) as a consequence of the arrangement.

A simplistic argument that has received some attention from tax scholars is that treaty shopping will be harmful because everyone says so. In fact, during the past few decades, as planning
schemes have become more and more complex, numerous countervailing attempts have been made by many countries, and these attempts have had some attention from academic scholars as well. This universal effort to prevent treaty shopping gives customary authority to the idea that at least some kinds of treaty shopping are “bad.” In a more general sense, any kind of “improper use” of tax treaties may be a threat to the very existence of treaties because some countries might unilaterally decide to terminate the treaties because of the improper use of treaties to which they have been subjected. States might simply decide not to renew treaties, a step that could impair the goal of international tax harmonization.

Nevertheless, some analysts have argued that treaty shopping should be seen only as a form of tax planning that happens to involve a treaty as part of the overall arrangement. In other words, these authors suggest that shopping for a treaty is no different from a mere constituent transaction that could be regarded as comprised within the Duke of Westminster principle.

Some benefits of treaty shopping have been identified. In some cases, treaty shopping permits the achievement of the main goal of tax treaties, which is to prevent double taxation. When a company’s managers establish a corporation in an advantageous jurisdiction for the sole purpose of benefiting from tax advantages, they may only be ensuring that they will not be taxed twice on the same amounts, depending on the domestic tax laws and the treaty involved. This kind of action may occur in unusual circumstances, where the country of residence does not provide or provides very limited deductions, exemptions, or credits on certain amounts paid to the source country.

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Tax benefits are not always monetary in nature. In tax law practice, cases seem to exist where the application of a tax treaty or a domestic disposition applicable to foreigners is so difficult to comply with that the difficulties by themselves explain why tax planners will advise their clients to set up companies in jurisdictions that have treaties with a lower burden of compliance.\(^\text{33}\)

With respect to the “avoidance” aspect of treaty shopping in relation to economic policy, some analysts say that the money saved by corporations that use a holding company, will be recovered through the additional investments the corporation will be able to make as a result of saving tax, even taking into account the base erosion factor. This additional income will then be subject to tax and so on. The accuracy and relevance of this kind of argument is doubtful. The argument does not differ from general arguments in favour of lowering the tax burden on corporations.

From an economic policy standpoint, the Joint Committee on Taxation pointed out that treaty shoppers exist in both the outbound and inbound contexts: “Further complicating the picture is an issue not mentioned in the consultation paper, namely outbound treaty shopping transactions. Obviously, Canadian taxpayers engage in transactions intended to reduce or eliminate foreign taxes which involve reliance on outbound provisions of Canada’s tax treaties. The economic benefits of such transactions to Canada cannot be readily estimated, but this behaviour casts some considerable doubt on the proposition that a unilateral assault on inbound treaty shopping is necessarily in Canada’s overall economic interest.”\(^\text{34}\)

\(^{33}\) In Canada, an example of such an instance has surfaced in one of the submissions sent to the Advisory Panel on International Taxation in relation to the CRA administrative rules regarding withholding taxes from the sale of Canadian property by nonresidents. *Ms. Kimberly S. Blanchard (Weil, Gotshal, & Manges LLP).*

\(^{34}\) Submission sent to the Advisory Panel on International Taxation by The Joint Committee on Taxation of the Canadian Bar Association and the Canadian Institute of Chartered Accountants, 15 July 2008, p.4.
The Netherlands and Luxembourg are often used as bases for the establishment of holding corporations, and reliable reports from these jurisdictions can be consulted in order to gather examples of benefits obtained by resident countries whose treaties are shopped. The SOMO Report\textsuperscript{35} maintains that the Netherlands will take advantage of the situation by taxing at a very low rate the financial flows that come under its corporate taxing power. The nation’s residents also receive advantages from this situation through the high number of tax consulting, trust, and accounting service providers\textsuperscript{36} that have established themselves in Amsterdam’s financial district. This situation improves the nation’s competitive advantage position in relation to non tax haven neighbours who also compete for these capital flows. The same report suggests, however, that these advantages to the Netherlands are far outweighed by the disadvantages the situation causes for the Netherlands and the international community as a whole. The report mentions the following negative impacts of the use of the Netherlands in this way: the practice reduces the tax base of the source country and thereby reduces the amount of resources available for public spending. In addition, the tax burden is shifted to other sources of income such as labour, and the ability of small companies to compete against multinational corporations is reduced. The first two arguments might easily be made about any situation that results in a reduction of the corporate tax base, and some would counter the argument by pointing out that the situation simply redirects resources from publicly decided spending to privately decided spending. The third argument seems to have some strength, and the issue may be debated by those in the field of economics. The fact that, as was mentioned, treaty shopping is done both ways and that the

\textsuperscript{35} The Centre for Research on Multinational Corporations (“SOMO”) is a Dutch Research and Advisory bureau that investigates the impact of multinational enterprises and the internationalization of business. The reader of this article must be aware that it may have a particular agenda. SOMO, November 2006, online: http://www.somo.nl/html/paginas/pdf/netherlands_tax_haven_2006_NL.pdf> (May 2007).

\textsuperscript{36} “It has been estimated that the activities of the 12 500 Special Financial Institutions present in the Netherlands, which facilitate these flows and largely consist of mail box companies and paper headquarters, generate some 2 500 direct jobs and a total direct revenue for the Dutch State of 1.7 billion Euros.”
bilateral perspective needs to be considered somewhat mitigates all four arguments. Regarding social policy, the report states that flexible tax legislation such as in legislation in the Netherlands attracts companies of dubious value and money-laundering operations.

Canadian courts seem to have adopted the view that the specific practice of treaty shopping is not inherently objectionable.\(^{37}\) This view seems to be affirmed correctly, but it needs to be considered in context. To “shop” for a treaty seems to be legitimate as long as the introduction of a company is not done for the main purpose of benefiting from tax advantages. In order for the action to be objectionable, a violation of the purpose of a treaty also needs to occur. Therefore, even though treaty shopping has negative consequences of its own as a phenomenon, it does not have its own criterion for what would make it objectionable, and so the practice is assimilated to improper use of tax treaties for the purpose of this discussion.

**Summary**

In this part, I explained that determinations about the improper use of tax treaties generally require two elements: (1) an intention to avoid taxation, and (2) a violation of the purpose and objective of the provisions used. The definition of treaty shopping encompasses only a subjective disposition. As an international phenomenon, treaty shopping (aside from the base erosion that it implies) has negative consequences for both parties to the treaty shopped and for multilateral interests in general. Even if a few benefits may are obtained, the benefits are difficult to ascertain. When treaty shopping is seen from a multilateral standpoint, the fact that it is harmful

seems obvious. The opinion of this writer is that the massive international response to the practice is justified.

**PART 4: THE EXPRESSION “BENEFICIAL OWNERSHIP”**

**4.1 History**

The expression “beneficial ownership” first appeared in the OECD Model Treaty in 1977. It has its origins in English trust law, where it was contrasted with the concept of “legal ownership.” The legal owner has the title to the property, while the beneficial owner has the use of property. The “beneficial owner” was usually seen as the one who had most of the attributes of ownership, not taking into account the legal title. The expression “beneficial ownership” remains undefined in terms of the OECD Model. The two main features of the OECD commentaries in 1977 were that “agents or nominees” would not be considered beneficial owners and that contracting parties were free to make the terms more explicit during negotiations. Some have said that the slight differences between the terms “agents” and “nominees” are not significant enough to proceed with a separate analysis. In 1986, the OECD Report on Conduit Companies provided a further explanation: “Thus the limitation is not available when, economically, it would benefit a person not entitled to it who interposed the conduit company as an intermediary between himself and the payer of the income.” The assumption may be made that the OECD tried to add an economic criterion to it. The “beneficial ownership” limitation would also apply to other cases where a

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person enters into contracts or takes over obligations that endow him or her with functions similar to those of a mere administrator or fiduciary. This provision was added in the 1986 OECD Report on the Use of Conduit Companies. Thus “a conduit company can normally not be regarded as the beneficial owner if, though the formal owner of certain assets, it has very narrow powers which render it a mere fiduciary or an administrator acting on account of the interested parties (most likely the shareholders of the conduit company).”

These excerpts refer to the following aspects of “beneficial ownership”: (1) an economic component, and (2) the fact that entities with “narrow powers,” to the point that they can be seen as mere fiduciaries or administrators, may be denied treaty benefits.

In 2003, the commentaries were partly modified through the addition of the stipulation that the expression “would be understood in its context and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.”

The OECD Report on Conduit Companies also states that the fact that the purpose of a company is only to hold assets does not make it illegitimate, but specifies that this purpose may indicate that further investigation is required. These statements constitute all the assistance that may be found in OECD publications.

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Some authors have suggested that the expression is not meant to be used as an anti-avoidance tool. The proponents of this view\textsuperscript{40} argue that the concept was intended to protect the source state and ensure that the taxpayer seeking the benefit is the very person to whom the income is attributed under the law of the state. In fact, the term was used in few tax treaties prior to 1977 and interpreted in that fashion. According to this interpretation, the “beneficial owner” of an income is solely the person to whom an amount is distributed and who actually pays tax on it. In other words, the term “beneficial owner” is equivalent to a “subject to tax” criterion. Although this interpretation has gained little backing in the academic sphere, it needs to be mentioned because it relates directly to the topic at hand. A more consistent and ascertainable view is that the “beneficial ownership” concept was introduced in the OECD Model to combat what was perceived at that time as abusive transactions in the context of withholding taxes.

The term “beneficial ownership” is not defined in Canada’s Income Tax Act, but it is used in several of the law’s provisions. A recent study\textsuperscript{41} concludes that “the expressions ‘beneficial owner’, ‘beneficial ownership’ and, for that matter, ‘owner’ for the purposes of the ITA, is no longer obvious. To the contrary, multiple meanings for these expressions exist, and credible legal argument leads to the conclusion that for different tax purposes, different or multiple taxpayers may be considered owners or beneficial owners of property.” Furthermore, none of the interpretations that the term may have in private law could, by analogy, be potentially applicable to an international context. In trust law, where the expression originates, its various meanings


are unconvincing for international tax purposes. In addition to a lack of precision in the use of the term in Canada, complications arise from the fact that Canada is a federal country with two legal traditions: common law prevails outside of Quebec, and the Civil Code is used in Quebec (CCQ). Therefore, some issues may arise when terms are undefined in a federal statute, because in that case, the term finds its meaning in the private law of the province where the legal event occurs. The expression “beneficial ownership” has its roots in trust law, but no such concept exists in the CCQ. Therefore, the use of the term without definition in a tax treaty that has been incorporated under domestic legislation (as it must be under Canadian law) leaves considerable room for diverse, contradictory, and uncontextualized interpretations. These difficulties are reasons why the Canadian government may gain significantly from participating in the laborious task of defining “beneficial ownership” in relation to international tax matters. This view is reinforced by the recent calls for a brand new international meaning of the term. 42 In many respects, the debate about what the term “beneficial ownership” means within Canadian law mirrors the debates that inevitably arise when two nations are involved in investing with meaning a bilateral tax that affects them.

4.2 The Need for a New Meaning

As mentioned earlier, the terms of article 2(3) of the Model Treaty are to the effect that undefined terms should take the meaning they have under the domestic law of contracting states. Walser said at the 52nd Congress of the International Fiscal Association that “The point of providing a lower rate of source state tax for dividends beneficially owned by a parent corporation is to avoid multiple layers of corporate level tax. The underlying problem of multiple corporate level tax only exists if the residence country views the parent entity as the beneficial owner of the dividends that are received from the other country; thus, in this context it makes sense to ask not only whom the source state views as the beneficial owner but whom the residence country views as the beneficial owner.”

Thus, the assertion can be made that states are better off interpreting the beneficial ownership concept in the same way. Walser also noted that “the history of the Model Convention, as well as the fact that many Member countries do not have under their internal law refined definitions of beneficial ownership, may provide a context for deviating from a unilateral reference to domestic law definitions.”

The international business community would also benefit from such a general understanding since it would reinforce harmonization in international tax matters. As Luc De Broe writes: “If it is left to each State to construe the term under its domestic law, one abandons the principle of reciprocity, a fundamental cornerstone on which each tax treaty is built, and no longer strives to achieve a uniform application and interpretation of tax treaties, which is one of the goals pursued

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44 Idem, 43.
by the OECD. Certainty to the taxpayer becomes illusory. A review of this series of arguments seems to indicate that in Canada certainly, and also internationally, there is a need to clarify the uncertain meaning of “beneficial ownership.”

**Summary**

This part included a review of the historical background of the expression. Taken together, the OECD commentaries and the OECD Report on Conduit Companies make the interpretation that “agents or nominees” are not beneficial owners. The same applies to corporations whose powers are so narrow that they are considered to be mere “fiduciaries or administrators.” In addition, the fact that a corporation’s purpose is to hold assets is not a satisfactory basis for the conclusion that it is not a beneficial owner. The conclusion was drawn that, for various reasons, there is a need to develop a more precise meaning for “beneficial ownership” both in Canada and other jurisdictions around the world.

**PART 5: THE PAST INTERPRETATIONS**

In this part reviews the interpretations that have been supported by tax scholars and the courts. Before this review, I prepare for the arguments that will be presented by listing and explaining the anti-avoidance mechanisms generally available to tax administration bodies.

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“Limitation on benefits” provisions are treaty articles detailing the circumstances under which a taxpayer will not be able to seek treaty relief. This very broad term includes any specific provision that addresses the improper use of treaties. The provisions normally set out the criteria that need to be fulfilled so that administrative bodies can ensure that specific transactions do not lack substance. For example, there may be some threshold of resident state direct ownership, a certain number of employees required, and so on. In addition to such specific objective tests, LOBs very often include broad substance-over-form and *bona fide* requirements that are meant to ensure that there are no ways to circumvent the objective tests. One value of LOBs is that they sort “on the line” legal events and, right from the start, distinguish the ones considered legal from the ones that are not considered legal. They are known for providing objectivity and certainty, which are essential to an adequate international flow of capital (although substance-over-form requirements attached to it can somehow bring uncertainty back).

Making a provision more and more detailed provides more certainty in some respects (when the precisions are not claimed to imply that what has not been detailed is not caught by the provision), but a very large number of details in an LOB rule may trigger alternative tax-planning strategies that are intended to avoid overwhelming compliance requirements. Some papers submitted to the Advisory Panel on International Taxation suggest that ill-advised avoidance strategies may be a consequence of the new LOB rule implemented in the 5th protocol of the Canada-U.S. tax treaty. The implementation of LOBs also creates disparities in
international fiscal affairs, a development that is not desirable at a worldwide level if we take for granted that some resources are always saved when uniformity and certainty in tax planning is furthered.

**Inherent Abuse of Law Doctrine in Tax Treaties**

Some authors\(^\text{46}\) have recently asserted that there is now enough authority to declare the existence of an inherent norm regarding the international abuse of rights. This norm, however, would apply to all international treaties and not specifically to tax treaties. These authors maintain that there are no reasons why tax treaties should constitute an exception. Therefore, according to this line of thinking, some exceptional avoidance transactions should be treated in terms of their substance rather than in terms of their form. There is no consensus on that, however.

**Other Express Anti-abuse Principles in Tax Treaties**

Some tax treaties include a definitely stated anti-abuse principle that is akin to the OECD’s “guiding principle.” Such principles usually incorporate either the objective test or the subjective test, or, in some cases, both. These principles may be used alone or may serve as supplements to LOB rules. They can be said to be safeguards of substance-over-form.

Domestic General Anti-avoidance Rules

General anti-avoidance rules can take different forms, but they usually require that there be a tax benefit to a taxpayer for a transaction that is contrary to the purpose of the legislation providing for the transaction and that is also not made for bona fide purposes. This kind of transaction will be recharacterized by tax authorities regardless of its form.

5.1 “Beneficial Ownership” as a Concept Implied in All Tax Treaties

According to this view, the “beneficial ownership” concept is implied in all tax treaties, whether or not it has been incorporated. The rationale is that there are certain terms within and outside of the passive income articles that can be used to achieve the same results that the “beneficial ownership” concept is supposed to attain. This is Vogel’s view. In practice, such terms have been successfully used in this way.

For example, the term “paid to” seems to imply that payments must be made to the actual person entitled to the payment. The term “payment” has a generally accepted definition. Hence, no person but the creditor is entitled to receive a payment. When an agent or nominee is interposed between a debtor and a creditor, he or she is an agent either for the former or for the latter.

48 Articles 10, 11, and 12 all include the term “paid to”: e.g., Article 11: “Interest arising in a Contracting State and paid to a resident of the other Contracting state may be taxed only in that State.”
Because of that fact, payments made to those entities would be excluded from treaty protection automatically without reference to the “beneficial ownership” concept. On this issue, a controversy has arisen between two reputable international tax scholars, i.e., Weeghel and Vogel. The latter argues that a payment made to an intermediary should be regarded as a payment made to the principal, and, thus, because the intermediary does not have sufficient importance in the relationship, the country where the holding corporation is established is simply disregarded. Vogel suggests that all treaties contain an implicit beneficial owner requirement and that the same results are achieved whether a conduit scheme is analyzed under the “beneficial ownership” requirement or under the wording of the provisions on passive income and “the general principles regarding treaty shopping.”

Weeghel’s opinion is that the terms regarding “payment” should not intermingle with “beneficial ownership” requirements or be used as a tool to prevent treaty shopping. He maintains that “paid to” should remain in the private law context of the relationships between a debtor and a creditor. To counter Vogel’s arguments, he cites a statement issued by the OECD in the Report on Double Taxation and the Use of Conduit Companies to the effect that member states should rely on the antiavoidance provisions of their treaties, but, if such provisions do not exist, benefits should be given, with the justification that the contract is the law of the parties. This statement is in accordance with the pacta sunt servanda principle and also seems to be in agreement with the penal aspect of tax legislation interpretation, to the effect that fiscal provisions should be strictly construed. The matter is further complicated by the fact that there are two tendencies in

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50 “Existing conventions may have clauses with safeguards against improper use of their provisions. Where no such provisions exist, treaty benefits will have to be granted under the principle of pacta sunt servanda even if considered improper,” from Report on Double Taxation and the Use of Conduit Companies.
jurisprudence that proceed in opposite directions, for example, Aiken Industries\textsuperscript{51} (adopts Vogel’s view) and MacMillan Bloedel\textsuperscript{52} (adopts Weeghel’s view). In the Aiken Industries case, a company was set up in Honduras for the sole purpose of receiving dividend payments of an amount equal to the amount the company was obligated to pay to its upper-tier company under an original loan evidenced by a promissory note. The court said: “In deciding whether a given taxpayer in a specific instance is protected by the terms of a treaty, we must give the specific words of a treaty a meaning consistent with the genuine shared expectations of the contracting parties (…) Applying these principles we find that the interest payments in question were not ‘received by’ a corporation of a contracting state. (…) We interpret the terms ‘received by’ to mean interest received by a corporation of either of the contracting states as its own and not with the obligation to transmit it to another. The words ‘received by’ refer not merely to the obtaining of physical possession on a temporary basis of funds representing interest payments from a corporation of a contracting State, but contemplate complete dominion and control over the funds.”

The other case, MacMillan Bloedel, is a Canadian case, with facts that are quite complex. Suffice it to say that the treaty was literally interpreted, and the judgment was that it is not appropriate to read any ant avoidance requirements into the document when they are not expressly stated.

The “residence” requirement can also be used to prevent treaty shopping. The concept of residence has possible antitreaty-shopping implications. “Residence” can be an effective ground for challenging a significant number of situations that were intended to be dealt with through the

\textsuperscript{51} Aiken Industries v. Commissioner of Internal Revenue, 56 T.C. 925 (1971).
\textsuperscript{52} MacMillen Bloedel Ltd. v. MNR, 79 DTC 297 (TRB).
“beneficial ownership” concept. Indeed, transparent entities can be effectively challenged under residence requirements.

In this thesis, there is no attempt to provide an exhaustive description of where the law stands in terms of agency/principal legal relationships. The relationships can in fact become quite complicated and, in the end, the legal effects of such relationships will depend largely on the specific terms of the contract of representation. Civil and common law systems also differ in substance in terms of agency (or mandate) relationships.

One can affirm, without a doubt, that residence is the primary basis for domestic taxation. Consequently, depending on the definition of residence in the domestic laws of the countries involved, the same taxpayer can be taxed twice on his or her income due to the fact that the taxpayer can be determined to have residence in two or more states. This can occur in a number of circumstances. For example, two states may apply two different sets of criteria to determine residence, or they may apply the same criteria but interpret them in a distinct way. As a result, almost all treaties now contain a “tiebreaker” rule that severs residence between two countries for international tax purposes. Domestic tax laws generally divide the population into two groups; either you are a resident or a non-resident of a specific country. As was said in De Beers Consolidated,53 “(A company) might have its chief seat of management and its centre of trading in England, under the protection of English law, and yet escape the appropriate taxation by the simple expedient of being registered abroad and distributing its dividends abroad.” The consequence of this kind of division is that there needs to be some reality and substance in a corporation’s status for it to be considered “a resident” for international taxation purposes. It is a

question of reciprocity. Accordingly, some tests have attempted to overcome the disadvantages of a strict application of the incorporation test. Among these tests, the requirement for a “place of central management and control” has had considerable popularity. According to this principle, the incorporation expedients will be disregarded for tax purposes if the effective management and control lie in a different jurisdiction.

The “location of management” and other similar concepts are related factors that are used in several countries. The meaning of “management” or “control” varies widely from one jurisdiction to the other. According to Rohatgi\textsuperscript{54}, “Generally, central management and control signify the ultimate level of policy decision-making or superior control (e.g. board of directors), while operational management denotes day-to-day management of the business (e.g. top-level executives). Day-to-day management deals with administrative tasks. The principle of central or superior management is used in several countries.” Analyzing the management and control test, the \textit{Hoge Raad}\textsuperscript{55} (The High Court of the Netherlands) has stated that the residence of a company is the place where the board of directors conducts its management function. The nature of the management and control depends on the type of business involved. One can wonder what would constitute sufficient substance in the cases of companies whose only purpose is to hold assets.

In numerous cases, residency status has been denied to entities. Even when the entities incorporated in a given jurisdiction, the judges held that they lacked any substance and that, as a matter of fact, their management and control were not exercised in the country in which they were incorporated.

\textsuperscript{54} Roy Rohatgi, \textit{Basic International Taxation} (Kluwer Law International, 2002).
\textsuperscript{55} Hoge Raad, 23 September 1992, BNB 1993/193, 3.3.3.
Walser provides this example of an agency relationship that would not pass the beneficial owner test: “(a company) receives and pays over matching amounts of income, takes no risk and collects no more than perhaps a small fee for its services. In these cases it is reasonably clear that the intermediary is not the beneficial owner. An intermediary of this type has no effective dominion and control over the income, takes no risk and collects no more than perhaps a small fee for its services.”\textsuperscript{56} If this description is true, one can wonder in which circumstances, if any, that kind of entity would reach a level of substance sufficiently high to pass the “management and control test” under the residency requirement. Most of the time, such an entity could be challenged under both the “residence” principle and the “beneficial ownership” concept. This overlap seems to be the basis on which Vogel’s theory stands\textsuperscript{57}.

5.2 The Beneficial Ownership Concept Excludes Only Agents and Nominees

At this point, a distinction needs to be made between the authors who argue that the expression was intended to exclude only agents and nominees and the authors who suggest that the expression \textit{should} exclude only agents and nominees. Proponents of the first argument have become rare over the years.\textsuperscript{58} They argued that the OECD’s intention in 1977 was to make “beneficial ownership” perform the function of providing precision or specifying a treaty term, and that the redundancy commented on by Vogel had been foreseen and expected. The

\textsuperscript{56} See footnote 5.
\textsuperscript{57} Idem
subsequent amendments to the commentaries and the very text of the OECD Report on Conduit Companies proved the first group of proponents wrong because they opened the door to an economic interpretation (which is by nature broader).

The second group of proponents argue that only agents and nominees should be included in the aim of the “beneficial ownership” expression. Weeghel seems to think that this option is better, provided there are amendments to the definition of residence that prevent situations of double taxation. Some proponents in the second group urge states to adopt LOB rules in addition to the “beneficial ownership” concept. This proposition is explored below.

5.3 The Beneficial Ownership Concept Excludes Agents and Nominees and Conduit Companies Akin to Mere “Fiduciary or Administrators”

This approach goes one step further than the previous arguments in the sense that it integrates the “company with narrow powers” addition to the OECD Report on Conduit Companies. That interpretation may be divided into two separate constructions.

The first interpretation would be the one adopted by the Supreme Court of Canada in the Prevost Car case, in which the statement was made that only if the intermediary is “legally bound” to redirect the income to the final recipient will treaty benefits be denied. It is fair to say that this statement leads to the same result that would attained by a common law interpretation. This is why the judgment has been said to be very close to a “common law meaning,” since the person
who is legally bound to redirect amounts does not have the ultimate “enjoyment” of the rights at stake.

The *Prevost Car* case involved a UK company and a Swedish company that incorporated a holding corporation in the Netherlands (“Dutch Co”) for the purpose of holding the shares of their newly acquired Canadian enterprise *Prevost Car*. The Canada-Netherlands tax treaty provided for withholding tax rates of five percent, which was fifteen percent less than the Canada-UK tax convention rate otherwise applicable. The Dutch Co had no employees, no office, and no assets except for the shares of *Prevost Car*. Payments were made from time to time from *Prevost Car* to Dutch Co and, in turn, to its English and Swedish shareholders. A dividend agreement existed between British and Swedish companies, but Dutch Co was not a party to it. The agreement set out a dividend payment policy that specified how dividends were to be distributed. The CRA judged that the ultimate shareholders (in this case the English and Sweden parents) were the beneficial owners of the amounts directed to Dutch Co. The court stated: “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 (…) 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.” The Federal Court of Appeal disagreed, holding that the Dutch Co had the full ownership of the dividends it received until it decided to make a distribution to its shareholders. Accordingly, it held that Dutch Co was the beneficial owner of the amounts received.
This approach has the advantage that it is easy to apply. It also sorts out legal events at the outset and therefore provides certainty to taxpayers. One major issue with this interpretation is that it does not further the primary goals of tax treaties. According to this approach, corporations that establish an intermediary in a “tax favourable jurisdiction” only for tax purposes may do so provided that they allocate all ownership attributes to the intermediary, even if in fact the intermediary automatically redirects the income to its parent. This case scenario is clearly caught by the definition of treaty shopping. These kinds of schemes result in all three negative impacts of treaty shopping mentioned in Part II. One could also argue that these arrangements are not in agreement with the OECD’s “guiding principle” since there is, in such cases a transaction made mainly for tax purposes that violates the objective of the treaty. Since the prevention of tax avoidance is one of the purposes of tax treaties, there is the implication of “improper use” in such cases. However, this analysis may be too simplistic. It is not clear whether tax authorities consider these kinds of transactions abusive.

A second, broader interpretation excludes intermediaries that redirect amounts to the final recipients even though legally they are not obliged to do so. This approach has the same advantages as the first one in blatant cases, but a factual determination would be necessary for all the other cases, and this need to establish facts could lead to complexity and uncertainty for taxpayers. The factors that would have to be taken into account are the ones usually found in LOB provisions (direct ownership, residence, number of employees, etc). The statement has also been made that such an interpretation would denature the very purpose of the “beneficial ownership” concept by giving it tax avoidance properties instead of confining it to the role of treaty-shopping response tool.
This approach could be assimilated to an economic approach since it necessitates a determination about who benefits economically from the income. Hence, what is said in this section could apply *mutadis mutandis* to the discussion in the following section.

**5.4 An Economic Approach**

At the outset, it is important to specify that terms such as “economic approach,” “substance-over-form,” and “business purpose” are all related, though not identical in meaning. For example, if the term “beneficial owner” is to be defined as the person who is the recipient of the economic benefits, this interpretation could also be said to be a substance-over-form approach, since the pure legal form would be disregarded in such an instance.

An economic approach, the approach favoured by the OECD in 2003, is in line with the prevention of tax avoidance, which is a tax treaty purpose defended by the OECD. An economic approach best fulfills this objective. This interpretation mandates identification of the person who economically benefits from the amounts being transmitted. An inquiry about facts is thus necessary.

This seems to be the approach adopted in the *Indofood* decision. 59 Indofood was a Mauritian subsidiary of PTISM, an Indonesian parent company. PTISM wanted to raise debt through bond distributions. To take advantage of favourable withholding tax rates, it set up Indofood in

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Mauritius, a country whose treaty with Indonesia included favourable withholding tax rates. Hence, Indofood was in charge of the distribution to the international bondholders, who were represented by JP Morgan. Indofood had to make interest payments to its bondholders on certain dates. This scheme was working well until the day Indonesia decided to revoke its treaty with Mauritius, a move that caused a difference of ten percent in the applicable withholding tax rates. The contract with the bondholders included the possibility of such a change in tax legislation and provided that, in such event, Indofood could repay its bonds at par unless another reasonable alternative was possible. JP Morgan argued that a company could be set up in the Netherlands and take on Indofood’s functions by getting the rights and liabilities of Indofood transferred to it. Thus, this case was decided in a private law context, and the opinion expressed about the meaning of beneficial ownership was hypothetical.

The court came to the conclusion that a Dutch company would not be recognized as the beneficial owner of the amounts since it would not enjoy all the privileges of ownership. Another fact, apart from the hypothetical circumstances of the decision, may have influenced the decision. Indonesia has a domestic substance-over-form approach that was taken into account by the court, and, therefore, one cannot conclude that the court provided a substance-over-form input to the “beneficial ownership” concept.

One of the positive aspects of an economic interpretation is that it furthers all the goals of tax treaties. However, *bona fide* holding corporations could be unjustly subject to challenges. The nature of corporations that have the sole purpose of holding assets and that are established for legitimate business purposes determines that the amounts they receive are intended to benefit
their parents economically. Another issue is that a factual inquiry is always a difficult task to undertake.

**PART 6: ANALYSIS**

On the basis of the material that has been elaborated in the previous parts, this study comes to two conclusions. The first one is that a strict interpretation unsupported by other mechanisms is, for various reasons, not desirable to adopt. Among its disadvantages is the fact that a strict interpretation would leave too many improper uses of treaties untargeted. The second conclusion is to the effect that expansion of the definition of “beneficial ownership” is not an appropriate solution, partly because the task is almost impossible to undertake. A third aspect of the conclusion reached involves exploration of other responses to treaty shopping that could be used to offset the unfortunate results of an isolated “strict construction” type of application.

**6.1 Rejection of a Strict Interpretation: Something More than “Beneficial Ownership”**

It seems that, in the end, the main issue that arises in dealing with the “beneficial ownership” concept is that its properties really exist between subjectivity and objectivity. Generally speaking, objective properties are straightforward because they provide objective criteria for determining whether a given scheme is legally valid. No factual analysis is required when objective criteria are used as standards. The opposite is true for subjective criteria. Indeed, a
subjective analysis requires a factual inquiry, and its results are therefore less predictable because numerous factors are involved. Subjective criteria are the foundation of a substance-over-form approach. The common law meaning of beneficial ownership tends to make the balance lean on one side (objectivity), whereas the “international fiscal meaning” (or economic approach) tends to make the balance lean on the other (subjectivity). This incompatibility has been noted by Arkwright and Chiew⁶⁰: “Although the beneficial ownership concept was introduced into DTAs largely as a mechanism to deal with anti-treaty abuse, there are no relevant references in the dividend, interest and royalties articles to the purpose or the motivation of the taxpayer or taxpayers concerned. Thus, it could be said that there is some disconnect between the purpose of the introduction of the beneficial ownership requirement and the way in which it must be dealt with in practice. In practice, the question of who is the beneficial owner of the underlying asset is a matter of legal interpretation and not a question of subjective or even objective purpose of the relevant taxpayer.” In other words, one can say that the concept of “beneficial ownership” lacks effectiveness because it attempts to countervail treaty shopping without requiring an analysis that takes into account the intention of the parties. Indeed, the very definition of treaty shopping, as mentioned in Part III, includes a subjective element: “The establishment of an entity for the only purpose of (…)”. For this reason, an effective response to the manifestations of treaty shopping should probably integrate a subjective element.

As far as the OECD is concerned, the fact that the 1977 commentary uses the terms “such as an agent or nominee” suggests that entities other than agents or nominees were intended to be excluded from “beneficial owner” status.

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Another argument is that, even if one does not subscribe to Vogel’s view that the “beneficial ownership” concept is implied in all tax treaties, one is forced to admit that there is an obvious overlap between “beneficial ownership and other treaty terms used with or outside of the passive income articles. Therefore, if “beneficial ownership” is to have some sphere of its own, it cannot be limited to a strict interpretation. However, curiously enough, one is also forced to recognize that an extension of the definition is not desirable. This apparent contradiction is explained below.

6.2 Expanding the Definition Is Not a Sound Idea

Despite the fact that a strict interpretation is not appropriate, this writer still holds the opinion that expansion of the definition is not desirable. The first problem is that it is not clear how the definition could be amended to expand its meaning without entering into a complex factual analysis. As De Broe writes (answering his own question about circumstances where companies have very narrow powers that render them mere fiduciaries): “There is a myriad of factual circumstances that vary from case to case and that it is impossible to answer them on the basis of the vague and subjective criteria ‘similar functions’ and ‘very narrow powers’ set forth in the Conduit Companies Report.”\(^{61}\) This objection suggests that expansion of the definition in a way that would provide precision about the “narrow powers” category is an almost vain enterprise. The same author also says: “In view of the almost infinite variety of facts where the interpretation of ‘beneficial ownership’ is called to be applied, it is hard to see how the OECD

\(^{61}\) Footnote 44.
can give any further practical guidance on the construction of the term.” The extent of the *Prevost Car* interpretation and its “legally bound” doctrine is probably as far as one can go without entering the substance-over-form domain.

A second issue is that altering the “beneficial ownership” concept with a substance-over-form input would somehow denature the objective properties of the concept. This writer argues that the “beneficial ownership” concept is better suited to the objective domain because an inquiry about an avoidance intention of parties is not connected in any way to the attributes of ownership. In that sense, a criterion based on intentions has very little relationship to the common meaning of the words “beneficial” and “ownership.”

As was mentioned in the introduction, the statement that analysts are generally pessimistic about the possibility of investing “beneficial ownership” with a widely accepted meaning is accurate. The differences between the common law and civil law systems are only a one of the multitude of obstacles to a definition of ‘beneficial ownership’.

### 6.3 By Which Mechanisms Can the Expression Best be Completed?

If neither a strict interpretation nor the expansion of the definition is appropriate, then what kind of explanation would be suitable? Alternative solutions are explored here.

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62 See footnote 44.
At the outset, it is worth quoting the ninth recommendation of the OECD report on harmful tax competition: “that 1) countries consider including in their tax conventions provisions aimed at restricting the entitlement to treaty benefits for entities and income covered by measures constituting harmful tax practices and; 2) consider how the existing provisions of their tax conventions can be applied for the same purpose; 3) that the Model convention be modified to include such provisions or clarifications as are needed in that respect.” Each one of these options has its advantages and disadvantages. The proposed alternatives below take into account the pros and cons of amending treaties through the use of current expressions already in tax treaties and modifications of the OECD Model. Another factor is that this study is more concerned with multilateral interests rather than with bilateral or unilateral ones.

Completing the Expression with an LOB Provision

This solution seems to have gained popularity in recent years. Some authors suggest the continued adoption of a strict definition of beneficial ownership that excludes only agents and nominees, and the addition of LOB provisions in tax treaties to ensure substance. Others have advanced the idea that the “common law meaning” should prevail and that states should complete the expression with LOB provisions. Since the differences between the two alternatives are minor, they will be examined here through the same analysis.

The general advantages and disadvantages of LOB provisions mentioned above also apply in this case. The addition of such provisions is a generally desirable solution, but it requires
amendments to treaties that do not currently provide for LOBs. Such a solution is difficult to choose since, in the end, the LOB provision’s success in completing the meaning of “beneficial ownership” will depend mainly on the provision’s content. LOB provisions may already contain substance-over-form safeguard provisions, which may in some ways be useful tools in the process of completing the “beneficial ownership” concept. Yet some of these safeguard provisions apply to cases where an LOB provision is claimed in the first place, not to articles outside the provision. LOB provisions seem to attract the attention of scholars who see the primary characteristic of treaty shopping as “lack of substance.” This view is well founded. This writer holds that one can legitimately state that LOB provisions are concerned with lack of substance; “residency” is concerned with the location where this substance lies,” and “beneficial ownership” is concerned with the ownership of the amounts distributed. The only problem with the view that treaty shopping is an issue of “lack of substance” is that it disregards the fact that bona fide special purpose corporations may be seen as lacking sufficient substance even though their establishment in a third jurisdiction is completely justified from a business standpoint. This problem is one of the reasons why a very high level of care needs to be exercised in the drafting of LOB provisions.

The analysis of the interaction between LOB provisions and the “beneficial ownership” concept, which can be quite complex, will be left for exploration in another paper. The goal of this study is to find an adequate interpretation that favours multilateral interests. LOB provisions can create significant disparities in international tax law. Unless LOB provisions tend to become more uniform over time, they will not encourage harmonization in international tax law.

63 Loomer, see footnote 25; De Broe, see footnote 44.
Completing the Expression with Domestic Anti-avoidance Rules

The use of domestic anti-avoidance rules seems to be a sound approach. Most developed countries already have domestic mechanisms (including GAARs) to counter tax avoidance. However, this type of solution could create problems. First, it would create disparities in application between states and, consequently, uncertainty in tax planning. Second, numerous developed nations have adopted domestic GAARs in their domestic tax legislation, but some have not. Third, not all states can easily apply domestic law to international situations since their constitutional law may prohibit such treaty overrides. However, some analysts have suggested that the problems related to treaty overrides are exaggerated. In practice, state actions that will result in treaty overrides are very rare. All analysts seem to agree that treaty overrides should be “used sparingly and with caution.”  

A treaty override is a measure that is prohibited in international public law. Article 26 of the Vienna Convention provides that international treaties are binding and performed in good faith and, most importantly, article 27 stipulates that a contracting state cannot invoke its domestic law as a justification for failure to perform treaty responsibilities. A 1989 OECD report on the improper use of tax treaties addressed this question by stating that prevention of abuse “could be achieved through domestic legislation but the State concerned should first ensure that there is a broad consensus on the fact that the intended legislation does not injure the international tax relations. In the event that there is no such consensus, the Committee considers that only

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renegotiation of the relevant tax treaties is acceptable.” The amendments to the commentaries that followed added nuances to this statement in some ways. Even so, there is now express permission for countries to use their domestic anti-avoidance provisions even if no specific article allowing the use has been inserted in a bilateral treaty. The 2003 commentary provides that there is no conflict between domestic anti-avoidance rules and tax treaties and that an abuse of a treaty is automatically an abuse of domestic law. Still, there is no consensus on this issue.65

There are minor issues related to the use of domestic tax avoidance mechanisms. For example, such use does not favour harmonization in the application of tax treaties, and it makes efforts to agree on treaty provisions somehow aimless since the same objectives can be achieved using domestic law. In addition, the purposes of taxation at the domestic and international levels may differ, and the difference may make the abusive element more difficult to prove. This study is more concerned with multilateral interests and favours norms that come from international jurisdictions.

Completing the Expression with a “Main Purpose” Test

This idea comes from the 2003 commentary, which proposed that states should insert a provision that restricts the availability of treaty benefits “if the transaction has been entered into for the main purpose of obtaining treaty relief.” UK tax treaties usually include such a provision.

65 De Broe, see footnote 44, p.85.
This is a solution for completing the “beneficial ownership” requirement that is more appropriate than the others since it furthers all the objectives of tax treaties. It also prevents the exact type of treaty shopping that is usually seen as harmful, i.e., when the establishment of an intermediary is done mainly for the purpose of benefiting from tax advantages. This solution also protects *bona fide* holding corporations and is in accordance with the principle that taxation is a consequence of an economic reality rather than a behaviour-guiding force. The beneficial ownership” concept is not corrupted and maintains its role of monitoring ownership attributes, not parties’ intentions. When this approach is applied, the concept also maintains its objective nature, since it could be used to tackle blatant cases of transparent entities set up in tax favourable jurisdictions. This approach seems to be an acceptable compromise that is close to the U.S. and UK ways of thinking about treaty abuse in general.

It should be noted that such a “main purpose” test is difficult to apply. One could argue that, in the end, a factual inquiry would be required, as would have occurred in the case of an extension of the strict interpretation of “beneficial ownership.” This argument is true, but the concept should not be denatured through such an inquiry. In this regard, *where* the factual analysis is done (from within the definition/from outside the definition), has more than negligible importance. The argument could also be advanced that, if a detailed analysis is conducted, taxpayers should have the right to know what is legal or not legal, and that LOB provisions better achieve that goal. This statement is also correct. However, the disadvantages of the LOB approach that have been mentioned above are also applicable in such a situation.
As for the purpose tests, there are several options and degrees of intention, ranging from “one of the purposes” to an “only purpose” test. This writer sees a kind of “but for” test as an option that is better than specific targeting of treaty shopping schemes: The test can be described as follows: “the fact that the tax benefits make the transaction worth proceeding.” Using this test, tax administrations could ensure that nontax considerations are sufficiently significant by themselves to make the taxpayer proceed with the establishment of an intermediary, and that, in such a case, advantageous taxation would be a mere consequence of true and bona fide legal transactions. However, since this writer favours a minimum standard that could be acceptable by numerous countries, the adoption a “main purpose” degree of intention is proposed. One frequently finds such a test in tax legislation, and the assumption can be made that this test has been interpreted numerous times by courts. However, the objective of this study is not to explore the intricacies of such a test. Some analysis will nonetheless be undertaken here.

An American commentator states that there are five formulations used in purpose tests: “1) The classification of the actions rests on the actor’s state of mind; 2) The classification ignores the state of mind of the particular actor and considers what would be the state of mind of an average or typical person under similar circumstances; 3) The classification of the action turns on its actual outcome or aftermath; 4) The action is to be classified by judging whether it is more closely with one activity or another, or more closely fits one function as compared to others; 5) The conclusively presumes a classification based on the mere occurrence of the act.”

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Even though the purpose of this study is not to suggest any procedural intricacies in a court proceeding involving beneficial ownership, this writer suggests that the factual analysis should rest on the state of mind of a reasonable taxpayer placed in the same circumstances. This interpretation obviously makes the evidence burden less onerous for the administrative body involved.

Several options exist for integration of the input of a “main purpose” test. If the assumption is made that the inherent “abuse of rights” doctrine does exist in customary international law, one could see the test as a way of integrating a substance-over-form principle applicable to cases of treaty shopping. In fact, a domestic abuse of rights doctrine has been interpreted in that fashion in a French case, which determined that “the arrangement was entered into for the sole purpose of obtaining benefits provided by the France-United Kingdom treaty.” In a more appropriately decided Swiss case, it was first determined that the taxpayer was not the beneficial owner, but that treaty relief was nonetheless to be denied under a domestic abuse of rights doctrine. One convincing argument with an inherent abuse of rights doctrine input is that the principle is already “there” (assuming it exists), and that there is no need to amend treaties to apply it. Another option would be the incorporation of a specific stipulation providing for a “main purpose” test, as is the case in UK tax treaties.

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CONCLUSION

Part I explained the study’s framework. Part II provided explanations of basic notions about tax treaties that are needed to understand the remaining parts of the thesis. Part II set out an overview of the history of double taxation conventions, identified the main interpretation issues, and explained the uncertainty with regard to application of the OECD commentaries in the interpretative process. An analysis of the purposes of treaties and an examination of the policy rationale for action preventing the improper use of tax treaties were undertaken. Part III came to the conclusion that, based on its definition, “shopping” a treaty tends to create negative consequences when it is done for the main purpose of avoiding taxes and that improper use of tax treaties in general involves both an objective and subjective element. Part IV explained the context surrounding the “beneficial ownership” provision and emphasized the need for a new international meaning. Part V described the possible interpretations that have been proposed in the literature and by courts. Part VI outlined the main conclusions of the thesis. A preliminary conclusion is that the concept of “beneficial ownership” cannot be used to tackle some direct conduit schemes that are seen as treaty shopping without attracting negative consequences. The meaning of the term therefore should have some extension beyond its strict interpretation, but it is not appropriate to provide the term with an extended definition. Moreover, under a strict interpretation, too many treaty shopping schemes are left unchallenged. For that reason, a recommendation was made for the adoption of a substance-over-form requirement to the effect that tax advantages should not be the main purpose of a given transaction. In this way, the strict interpretation of “beneficial ownership” would serve as a filter, and the main purpose test would play the role of an ultimate protector.