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CONCEPT OF BENEFICIAL OWNERSHIP

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Your global tax partner

CONTENT

GLOSSARY

Abbreviation	Full form
OECD	Organization for economic co-operation and development
AY	Assessment year
SAT	China's state administration of taxation
HK	Hong Kong
COD	Certificate of domicile
DGT	Director General of Taxes of Indonesia
FTS	Fees for technical services

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BENEFICIAL OWNERSHIP - MEANING

OWNERSHIP - MEANING

Definition of ownership

- **Black's Law Dictionary - Eighth Edition**

  "One who has the right to possess, use, and convey something; a person in whom one or more interests are vested"

- **Supreme Court, Swadesh Ranjan Sinha vs Haradeb Banerjee, AIR 1992 SC 1590]**

  "'Ownership' is a bundle of rights attached with a property"

Types of ownership

Ownership could be of different types such as 'beneficial owner', 'legal owner' or 'registered owner' having different implications.

- **Legal owner**: One who holds legal title to property
- **Registered owner**: One in whose name the asset is registered
- **Beneficial owner**: One who ultimately enjoys the income on the asset and also controls such income receipts and the asset itself

CONCEPT OF BENEFICIAL OWNER

In the absence of the precise and clear definition, the term '**Beneficial ownership**' has always been subject matter of litigation. As per legal dictionaries, the term is defined as under:

Black's Law
"One recognized in equity as the owner of something because use and title belong to that person even though legal title belongs to someone else"

Law Lexicon
"One who, though not having apparent legal little, is in equity entitled to enjoy the advantage of ownership"

Klaus Vogel
"Beneficial owner is a person who is free to decide whether or not the capital or other assets should be used or made available for use by others (i.e., the right over capital), ow how the yields from them should be used (i.e., the right over income), or both"

Webster's
"One who is entitled to receive the income of an estate without its title, custody, or control"

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BENEFICIAL OWNERSHIP - INTERNATIONAL CONCEPTS

OECD (1/3)

- Treaty benefit to the residents of a contracting state only if they are the '**Beneficial owners**' of income in the nature of dividends, interest, royalties and FTS i.e. passive income. Illustrative phraseology [Articles 10, 11 and 12 of the OECD Model Convention of 2010]:

  *"Such interest may also be taxed in the Source state and according to the laws of that State, but if the **beneficial owner** of the interest **is a resident** of the other Contracting State, the tax so charged shall not exceed 10 percent of the gross amount of the interest"*

- OECD commentary recognizes the concept of '**Beneficial owner**' as a measure used to counter '**Tax avoidance**'

- OECD commentary provides that the term '**Beneficial owner**' should not be interpreted in a narrow technical sense

- '**Beneficial owner**' should be understood in the context and in light of the object and purposes of the tax treaties, including avoiding double taxation and the prevention of fiscal evasion and avoidance

OECD (2/3)

- OECD commentary states that **receipt of income in the capacity of an agent or a nominee** does not give rise to double taxation since the income is not liable to tax in the hands of the agent or nominee in the country of residence, and thus relief from source country taxation shall not be allowed in such cases

- Conduit companies set up as intermediaries receiving income on behalf of other persons who in fact receive the benefit of the income concerned, should also be denied tax treaty relief for not being the beneficial owner of the income

- Concept based on the principle of **substance over form**

OECD (3/3)

2014 Update to OECD

- The term '**beneficial owner**' was added to address potential difficulties arising from the use of words "paid . . . to a resident of the other contracting state", and it was intended to be interpreted in this context and not to refer to any technical meaning provided under the domestic law of a specific country
- An **agent or nominee or a conduit company** acting as a fiduciary or administrator on behalf of interested parties would normally not be regarded as a beneficial owner
- An **obligation to pass the payment** to another person might be derived from relevant legal documents or on the basis of facts and circumstances
- Where the recipient of a income does have the right to use and enjoy the income unconstrained by a contractual or legal obligation to pass on the payment received to another person, the recipient is the '**beneficial owner**'
- In case of **abuse of treaty provisions**, the limitation of tax should not be granted even if the recipient of the income is considered to be the 'beneficial owner' of that income
- The meaning of the term 'beneficial owner' **must be distinguished from the meaning ascribed to it in the context of other instruments** that concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets

UN AND US CONVENTION

- The UN and US model convention also use the beneficial ownership concept, without defining the term
- However, the technical explanation to the US model provides that the term **'beneficial owner' would have the meaning as under the internal law of the country imposing tax**, i.e. the beneficial owner of the relevant income would be the person to which the income is attributable under the laws of the source state

KLAUS VOGEL

Klaus Vogel defines a beneficial owner as **one who is free to decide**:

- whether or not the capital or assets should be used or made available for use by others; or
- how the yields therefrom should be used; or
- both

CHINA (1/3)

- **Notice 601** issued by the SAT on October 27, 2009 provides guidance on interpretation of the term 'beneficial ownership' in the context of the China's tax treaties. It defines the term 'beneficial owner' as a **person who has the 'ownership' and 'control right' over the income, rights or property based on which the income is derived**
- '**Beneficial owner**' to generally engage in substantive operational activities and can be an individual, a company or any other entity; 'agents' and 'conduit companies' specifically excluded
- '**Conduit company**' defined as a company established for escaping or decreasing taxes, or transferring or accumulating profits, established only for satisfying the organizational form required under the law and not engaging in any substantive operational activities such as manufacturing, distribution or management
- **Determination of 'beneficial owner' to reckon the purpose of the tax treaties, i.e.,**
  - avoiding double taxation and preventing tax evasion and omission;
  - to follow the principle of 'substance' over 'form'; and
  - to analyze and judge based on the facts of each case

Circular 30 dated June 29, 2012 allows safe harbor for companies listed in the treaty partner country or 100 percent subsidiaries of such listed companies against the "adverse factors test" prescribed in Notice 601

CHINA (2/3)

Adverse elements to an applicant's identification as 'beneficial owner' under Notice 601

- Obligation to distribute or assign all or majority (e.g. more than 60 percent) of the **proceeds** within a specified time limit (e.g. within 12 months after receiving) to a third country resident
- No or little **operational activities** other than holding the property or rights based on which the income is derived
- Existence of **small or few assets**, scale or staffing, which barely match the amount of income
- **No or little rights to control or dispose off** the income or the property or rights based on which the income is derived
- Bears **no or little risks**
- The contracting country does **not tax or exempts from tax, or tax at an extremely low effective tax rate**
- Besides the loan contract based on which interests accrue and are paid, the applicant has **other similar loan or deposit contracts** in respect of amount, interest rate and execution date **with a third party**
- Besides the transfer contracts of copyright, patent or technology based on which loyalties generate or are paid, the applicant has **other transfer contracts** in respect of right to use or ownership of copyright, patent or technology **with a third party**

CHINA (3/3)

Circular 165 issued by the SAT on April 12, 2013 provides clarification on interpretation of the term 'beneficial owner in context of dividends under the China's tax treaty with HK. Circular 165 confirms the position put forward in Circular 601 and Circular 30, and lays down the following principles:

- Consider '**totality of facts**' on a case-to-case basis
- Beneficial owner status **should not be adversely affected** where a **HK resident does not make any distributions of dividend to a non-HK resident**
- A **single project holding company** may be regarded as adverse to an applicant's identification as 'beneficial owner', although solely by this item itself will not deny tax treaty benefits, due to the BO shall be comprehensively analyzed and determined pursuant to various criteria
- Assets should not be equated with the registered capital of the HK resident; while assessing whether HK resident's staffing level is commensurate with its income, the responsibilities and nature of the staff should also be considered
- Following **aspects to be considered for** determining the rights of control and disposal:
  - Whether the **Articles of Association** of the HK resident grant such rights?
  - Whether such **right has been previously exercised** by the HK resident?
  - Whether the **exercise of such rights is voluntary** (which will be evidenced by the resolutions passed at the Board meetings or general meetings)?

INDONESIA (1/4)

In 2009 and 2010, the DGT had issued regulations number PER-61/PJ/2009 and PER-62/PJ/2009 dated November 5, 2009 which had been amended by PER-24/PJ/2010 and PER-25/PJ/2010 dated April 30, 2010 ('DGT Regulations'), providing guidance on the implementation of tax treaties and the prevention of tax treaty abuse. In these two regulations, the following principles emerge:

- **Grant of tax treaty benefits**, only where:
  - The recipient of the income is **not a domestic Indonesian tax payer**;
  - The **administrative requirements to apply** the treaty provisions have been fulfilled; and
  - The foreign taxpayer is the **beneficial owner** of the income sourced from Indonesia
- **Requirement for seeking treaty benefits** by any person shall be to provide a COD in a prescribed form, ie:
  - Form DGT -1 for general foreign taxpayers;
  - Form DGT 2 for:
    - foreign taxpayers that receive or earn income through a custodian from transfer of shares / bonds on Indonesian capital markets except for interest and dividend;
    - foreign bank taxpayer; or
    - foreign pension fund

INDONESIA (2/4)

- In case there is a **difference between the legal form of a structure / scheme and its economic substance**, the tax treatment will be based on the economic substance
- **Treaty abuse will be deemed to exist** in cases where:
  - A transaction **has no economic substance** and is arranged solely to obtain treaty benefits;
  - A transaction has a structure / scheme whose **legal form differs from its economic substance**, which is solely for the purpose of obtaining treaty benefits;
  - The **recipient of the income is not the beneficial owner** of the economic benefits of the income; agents, nominees and conduit companies are precluded from qualifying as 'beneficial owners'
- The '**beneficial owner**' test is to be applied only in respect of income for which the relevant treaty article contains a beneficial owner requirement

INDONESIA (3/4)

Treaty abuse shall not be deemed to exist in case the income recipient is:

- An **individual** who does not act as an agent or nominee;
- An **institution** specifically identified in the treaty or one that has been jointly approved between the countries
- A **foreign taxpayer that receives or earns income through a custodian** from transfer of shares/bonds traded or reported in a capital market in Indonesia except for, interest and dividend and provided that the foreign taxpayer does not act as an agent or nominee;
- A **public listed company** the shares of which are being traded regularly.
- A **pension fund** which was established following the regulation in the treaty partner and a taxpayer in the treaty partner.
- A **bank**; **or**
- A **company** that meets the following requirements:
  - The establishment of the company and the transaction is **not structured solely for the purpose of obtaining treaty benefits**;
  - The **business activities are managed by the company's own management, which has adequate authority to execute** the transaction;
  - The company **has employees and engages in an active business**; active business interpreted with reference to the costs incurred, business efforts and significant activities undertaken to continue as a going concern;

INDONESIA (4/4)

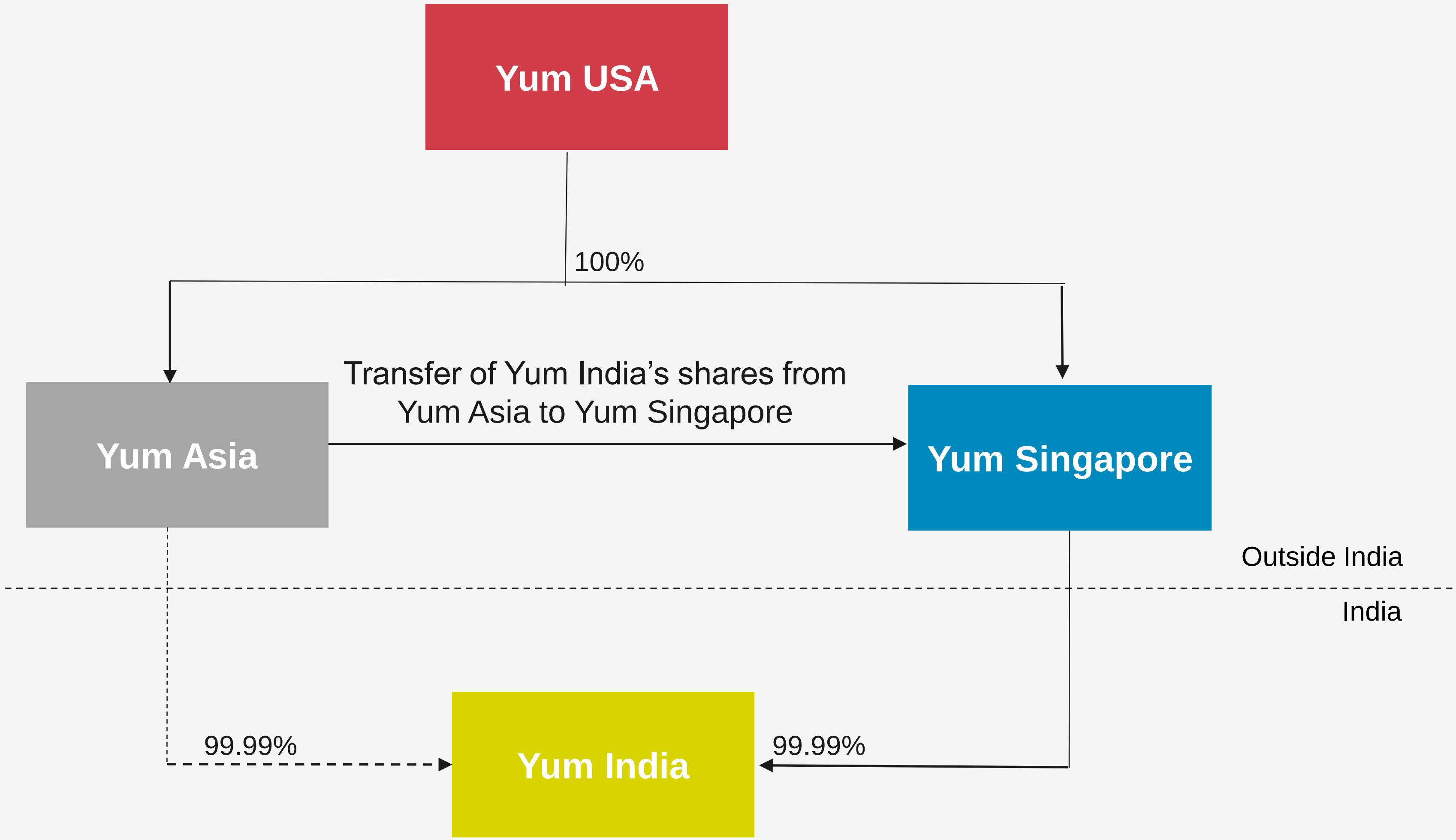
- The Indonesian-sourced income of the company is **subject to tax in its country of residence**; and
- **50 percent or more of the company's total income is not used to fulfill obligations to other parties such as interest, royalty or other fees**

- **Consequences of treaty abuse**: In case the Indonesian tax authority determine that a tax treaty has been abused, then:
  - The tax treaty **benefits could not be applied**; and
  - **No refund of overpaid income tax** would be allowed to be claimed by the offshore taxpayer
- In case the Indonesian tax authority determine that the **foreign taxpayer is not the beneficial owner of the income sourced from Indonesia or that a tax treaty has been abused**, then the payment of income sourced from the Indonesian taxpayer is subject to tax per Article 26 of the Income Tax Law at the rate of 20 percent

Participants may provide update for respective jurisdiction

INDIAN CASE STUDIES

CASE STUDY - 1 (1/3)



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CASE STUDY - 1 (2/3)

Facts

- Yum Restaurants (India) Private Limited (‘Yum India’), is a part of Yum Restaurants Group with its ultimate holding company being Yum! Brands Inc. USA (‘Yum USA’)
- 99.99% of shares of Yum India were initially held by Yum Restaurants Asia Private Limited ('Yum Asia')
- After 28th November 2008, the shares were held by Yum! Asia Franchise Pte. Ltd. Singapore ('Yum Singapore') pursuant to a restructuring within the group
- Yum India had accumulated business losses up to AY 2007-08 and had claimed a set-off of the brought forward losses in Ay 2009-10 which was disallowed by the tax authorities under Section 79 of the Act

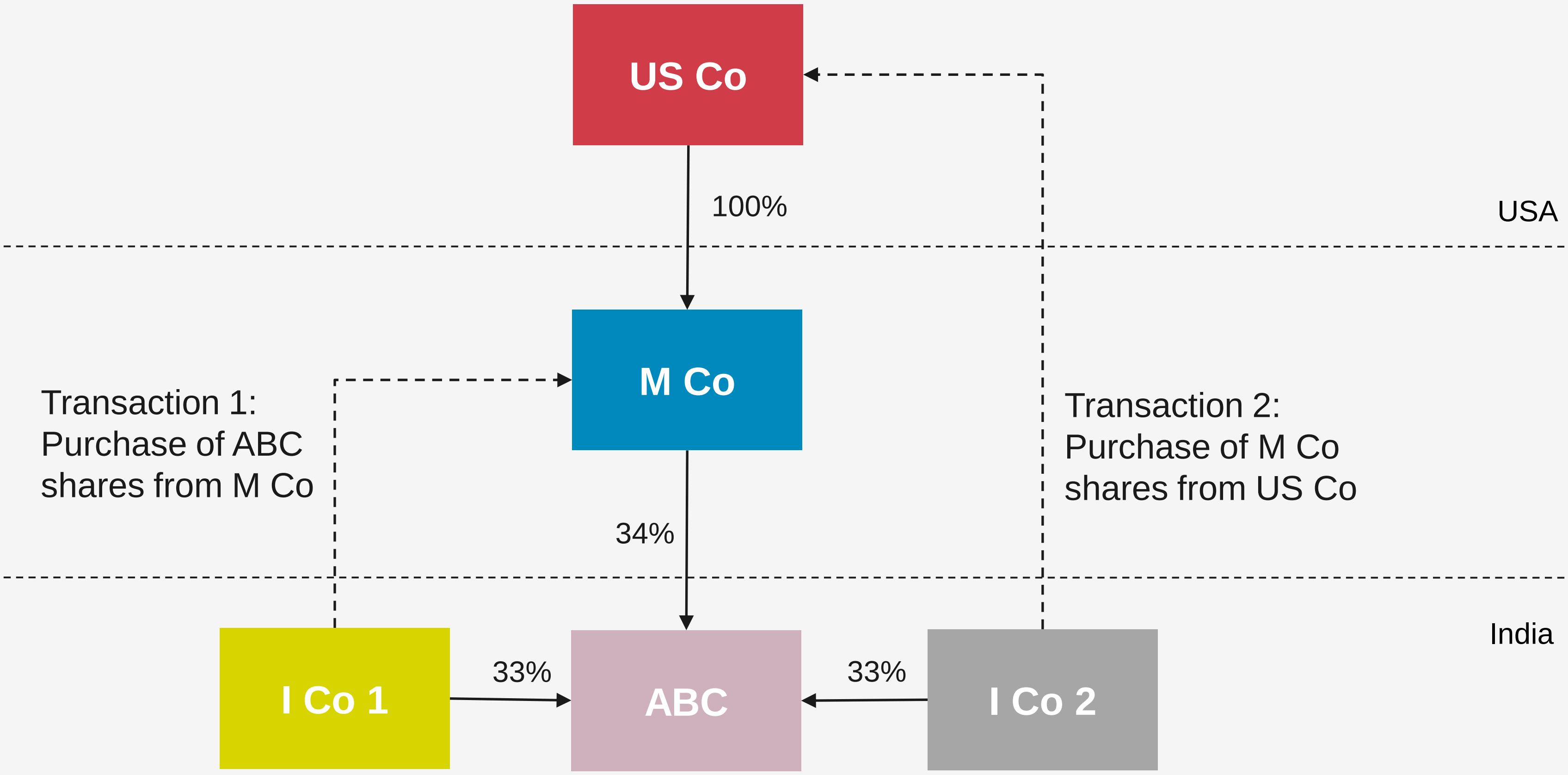
Principle

Section 79 of the Act restricts carry forward and set off of losses in hands of a closely held company, if shares of such company carrying at least 51% of voting power are not <u>beneficially held</u> by persons who beneficially held such shares on the last day of the previous year in which the loss was incurred

Issue under consideration

Who is the beneficial owner of the shares held in Yum India: Yum Asia or the ultimate holding company, Yum USA?

CASE STUDY - 2 (1/3)



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CASE STUDY - 2 (2/3)

Facts

- ABC Co, a company incorporated in India, was held by three shareholders ICo 1, ICo 2 and M Co; where ICo 1 and ICo 2 are Indian companies and M Co is a Mauritius based company
- M Co is a wholly owned subsidiary of US Co, a company incorporated in United States (‘US’)
- The Joint Venture Agreement (‘JVA’) entered for establishing ABC was executed by US Co; US Co had an option to hold shares in ABC through a permitted transferee; M Co was designated as the permitted transferee
  - **Transaction 1**: ICo 1 acquired shares in the ABC from M Co a Mauritius based company
  - **Transaction 2**: Post Transaction 1, ICo 2 acquired shares of M Co from its US Co
- ICo 2 did not withhold tax on the payment made to US Co based on the argument that the transaction is of sale of Mauritius company shares being effected between two non-residents and hence, not liable to tax in India
- Indian Revenue authorities contended that M Co was not the beneficial owner of the shares in ABC and it was really US Co that beneficially held the shares in ABC
- It was therefore argued that both the sale of shares under Transaction 1 and Transaction 2 are chargeable to tax in India as the real transfer was the transfer of the shares in ABC by US Co

CASE STUDY - 3 (1/2)

Facts

- KSPG Netherlands Holding BV ('KSPG Netherlands'), incorporated in Netherlands, had its registered office in Amsterdam
- Pieburg India ('PG India') was a private limited company incorporated in India and was the wholly owned subsidiary of KSPG Netherlands
- Kolbenschmidt Pieburg AG was the ultimate holding company in Germany
- Benefits of the India-Netherlands tax treaty ('treaty') were claimed for the capital gains earned by KSPG Netherlands on transfer of shares in PG India to another non-resident
- Under Article 13(5) of the treaty, where the recipient is the beneficial owner, the gains from the alienation of any property (which includes shares) are liable to be taxed only in the State of which the alienator is resident

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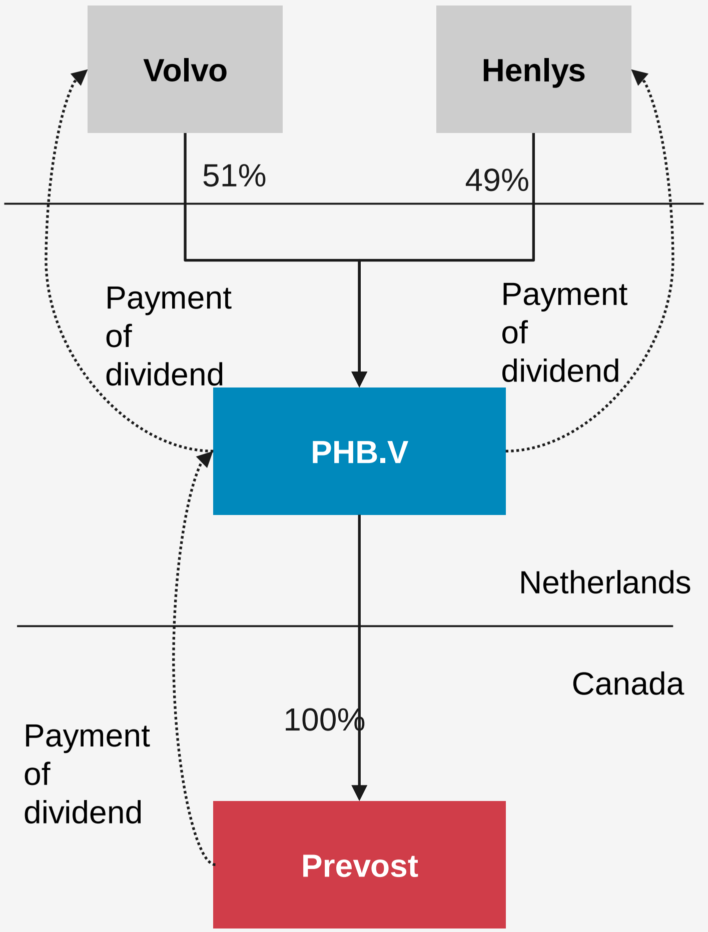
INTERNATIONAL CASE STUDIES

CASE STUDY - 4 (1/4)

Facts

- The shareholders of Prevost transferred their shareholding to PHB.V, a Netherlands resident company which was owned by Volvo and Henlys
- Shareholders agreement provided that at least 80 % profits of Prevost, PHB.V and their subsidiaries to be distributed to Volvo and Henlys
- Dividends were distributed by PHB.V in accordance with the above agreement
- Prevost applied a beneficial withholding rate of 5 percent under the Canadian Dutch treaty on dividend payments made to PHB.V
- During the year under appeal, PHB.V had no employees in Netherlands nor did it have any investments other than the shares in Prevost
- Further, PHB.V from time to time represented that the beneficial owners of the shares of Prevost were Volvo and Henlys in the KYC documentation provided to its bankers



CASE STUDY - 4 (2/4)

Principle

- Under Netherlands-Canada tax treaty, the source state can subject the dividends to withholding tax, however, if the recipient is the beneficial owner, tax shall not exceed 5 percent, domestic rate of tax for withholding of dividends being 25 percent under Canadian tax law
- The tax authorities argued that the treaty provisions did not apply as PHB.V. was not the beneficial owner of the dividends; Volvo and Henlys beneficially owned the dividends

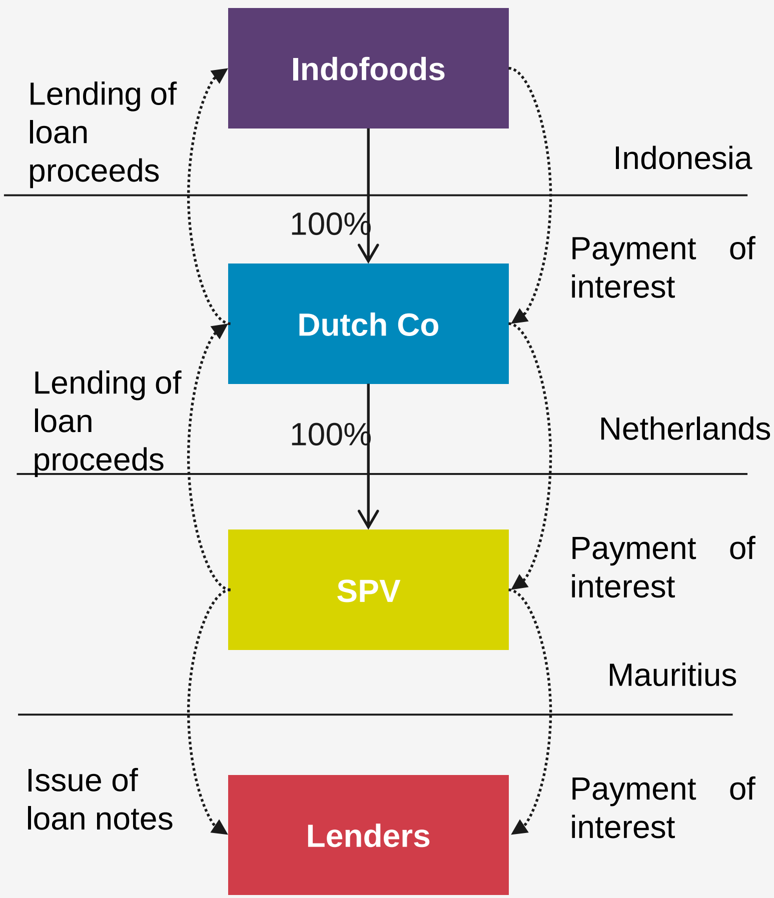
Issue under consideration

Whether PHB.V or its shareholders being Volvo and Henlys were the beneficial owner of the dividends under the Netherlands-Canada tax treaty?

CASE STUDY - 5 (1/3)

Facts

- Indofoods, an Indonesian resident company set up a SPV, resident in Mauritius which issued loan notes to the lenders and subsequently lent the proceeds to Indofoods. This allowed access to a reduced withholding tax rate of 10 percent under the Mauritius-Indonesia tax treaty
- Under the terms of the loan issue, the SPV could redeem the notes early if the withholding tax exceeded 10 percent, consequently, due to the revocation of the Mauritius-Indonesia tax treaty, the SPV sought to redeem the note
- However, the holders resisted the redemption arguing that a Netherlands company ('Dutch Co') interposed between the parent and the SPV would benefit from a 10 percent rate of withholding tax under the Netherlands-Indonesia tax treaty



CASE STUDY - 5 (2/3)

Principle

- Under the Netherlands-Indonesia tax treaty, the source state can subject the dividends to withholding tax, however, if the recipient is the beneficial owner, tax shall not exceed 10 percent, domestic rate of tax for withholding of dividends paid to non-residents being 20 percent under Indonesian tax law

Issue under consideration

- Whether Dutch Co would be ‘beneficial owner’ of the interest payable by the parent guarantor under the Netherlands-Indonesia tax treaty?
- Whether or not Dutch Co would be ‘resident’ in Netherlands under the Netherlands-Indonesia tax treaty?

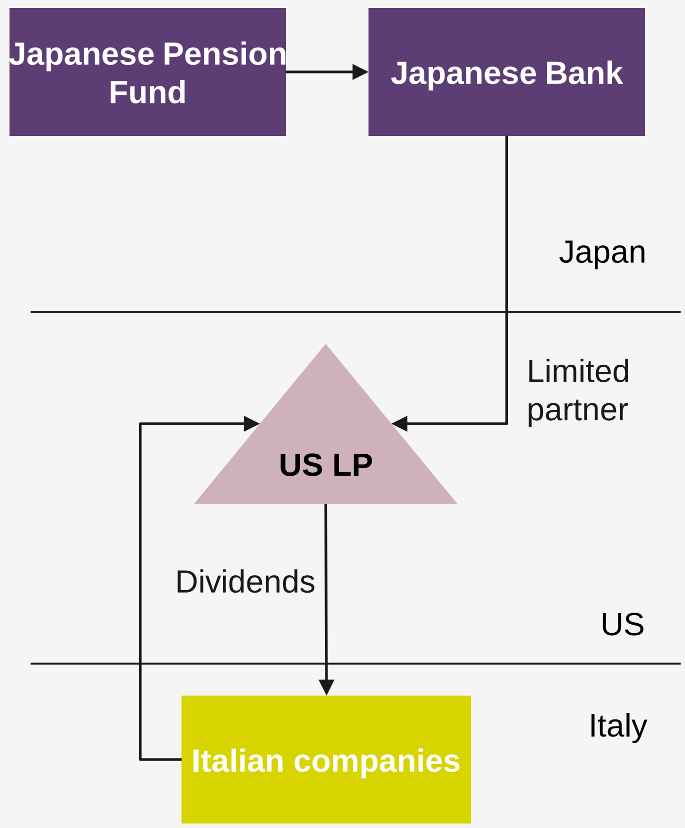
CASE STUDY - 5 (1/2)

Facts

- Funds of a Japanese Pension Fund (‘the Fund’) were managed by a Japanese Bank (‘the Bank’)
- The fund acquired participation in a US limited partnership (US LP) which was held by the bank, acting as an agent of the fund
- US LP purchased shares in Italian companies. Dividends paid by the Italian companies were subject to a high domestic withholding tax
- The fund claimed a reduced dividend withholding rate under the Italy-Japan tax treaty (‘treaty’), which did not contain a beneficial ownership clause for dividends
- The tax court of first instance held in favour of the fund. However, on second instance reversed the decision and ruled in favour of tax authorities

Issue under consideration

Whether treaty benefits, with respect to dividends, could be granted to the fund or to the bank?



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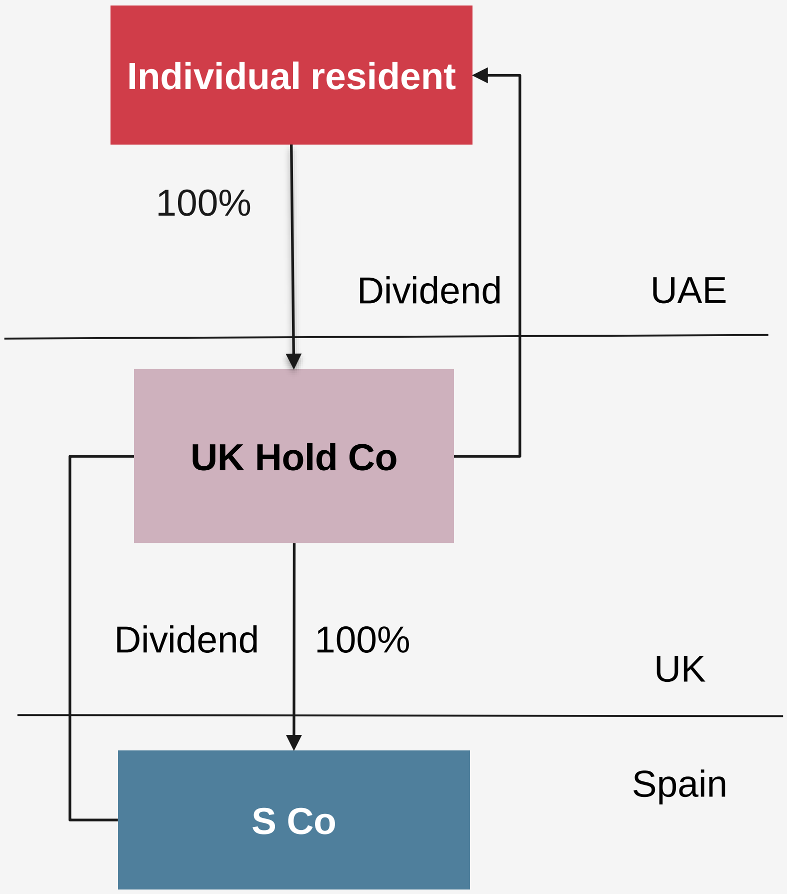
CASE STUDY - 7 (1/2)

Facts

- Spanish resident company ('S Co') was wholly owned by its UK parent company ('UK Hold Co')
- Shares and voting rights of UK Hold Co were in turn held by an individual resident in the United Arab Emirates ('UAE')
- S Co distributed dividend to its UK Hold Co which subsequently distributed dividend to its UAE shareholder
- Benefits of the zero rate under the Parent-Subsidiary Directive were claimed for the dividend distributed by S Co to its UK Hold Co
- The tax authorities contended that withholding tax rate of 10 percent under Article 10 of the Spain-United Kingdom tax treaty be imposed on the dividend distribution

Issue under consideration

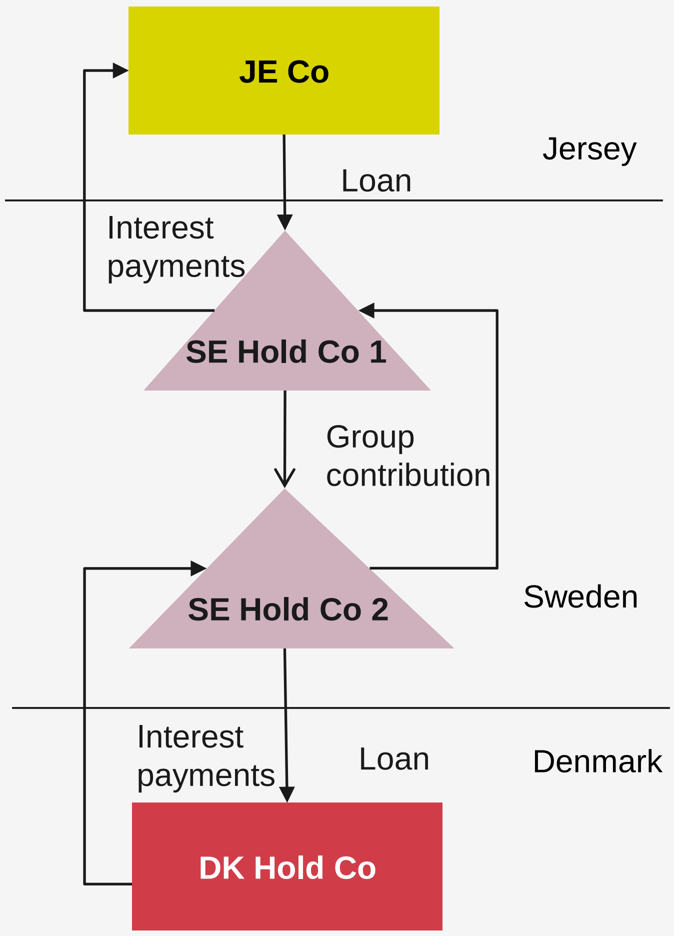
Who is the beneficial owner of the shares held in S Co: UK Hold Co or the ultimate individual resident of UAE?



CASE STUDY - 8 (1/3)

Facts

- G1 Ltd, a company resident in Jersey ('JE Co'), acquired a Danish holding company ('DK Hold Co') through two holding companies resident in Sweden ('SE Hold Co 1' and 'SE Hold Co 2')
- SE Hold Co 1 was the parent company of SE Hold Co 2
- Swedish holding companies did not carry out real business activities except for the holding of the shares of SE Hold Co 2 and DK Hold Co respectively
- On the date of acquisition, loan was granted by JE Co to SE Hold Co 1 and by SE Hold Co 2 to DK Hold Co with same face values and interest rates
- DK Hold Co paid interest to SE Hold Co 2 which the latter subsequently transferred to SE Hold Co 1 as group contribution. SE Hold Co 1 subsequently paid interest to JE Co
- Danish tax authorities required DK Hold Co to withhold tax on interest payments



CASE STUDY - 8 (2/3)

Principle

- Under Danish law, interest on controlled debt (ie debt by companies that directly or indirectly own more than 50 percent of the shares or the voting power of the debtor company) paid to non-resident companies were subject to withholding tax
- However, withholding tax was not levied if the withholding taxation was reduced or abolished by a tax treaty or by an applicable European Union (‘EU’) directive
- Under Article 11(1) of the Nordic convention, interest paid to a recipient in the other contracting state was exclusively taxable in the recipient's residence state provided that the interest was paid to the beneficial owner of the interest

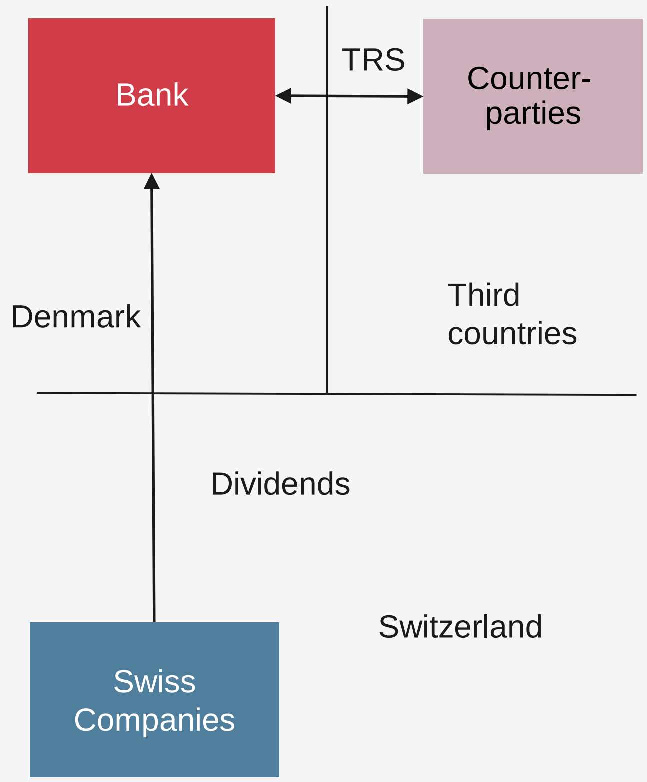
Issue under consideration

Who is the beneficial owner of the interest received from DK Hold Co: SE Hold Co 2 or SE Hold Co 1 or JE Co ?

CASE STUDY - 9 (1/2)

Facts

- Danish Bank entered into several Total Return Swaps (involving shares in Swiss companies) with counterparties in the EU and the US
- As a hedge, Danish Bank acquired the corresponding amount of the underlying Swiss shares
- Swiss domestic tax law - 35 percent Dividend Withholding Tax (‘DWT’)
- Switzerland / Denmark treaty (at the relevant time), Article 10:
  - Nil DWT;
  - No ‘beneficial ownership’ condition
- Argued by Swiss tax authorities: Nil DWT rate should not apply because
  - Danish Bank not ‘beneficial owner’ of dividends (and ‘beneficial ownership condition should be read into Article 10);
  - Danish Bank committed treaty abuse



CASE STUDY - 9 (2/2)

Issue under consideration

Whether Danish Bank is the beneficial owner of the shares held in the Swiss Companies?

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WAY FORWARD

WAY FORWARD

- The concept of beneficial owner is important to curb the practice of treaty shopping.

- The concept of beneficial ownership remains a debatable issue and thus following aspects needs to be considered:
  - Domestic law meaning or international meaning?
  - How to find International Fiscal Meaning? (one would faced with a bewildering array of views and different approaches of the court may make providing such meaning challenging).
  - Legal or practical determination?
  - Anti-Avoidance rules or the common law approach?

ANNEXURE - 1

- **Article 26 (1a) of Republic of Indonesia Law No 36/2008** on Income Tax which took effect on January 1, 2009 stipulates that the country of domicile of a foreign taxpayer other than those carrying on business or conducting business activity through a permanent establishment in Indonesia as intended in paragraph (1) shall be the country of residence or domicile of the foreign taxpayer that actually received the benefits of the income (beneficial owner)
- The elucidation of the said article states that the country of domicile of the foreign taxpayer other than those carrying on business or conducting business activity through permanent establishment in Indonesia that receives income from Indonesia shall be determined based on the residence or domicile of the taxpayer that actually receives the benefit of the income (beneficial owner)
- Accordingly, **the country of domicile shall not only be determined based on the Certificate of Domicile, but also on the residence or domicile of the beneficial owner of the said income**
- In the event that the beneficial owner is an individual, the country of domicile shall be the country where the individual resides or lives, whereas if the **beneficial owner is a corporate entity, then the country of domicile shall be the country where**:
  - the owner or more than fifty percent (50 percent) of shareholders both individually and jointly resides; or
  - where the effective management of the company is located”

THANK YOU

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