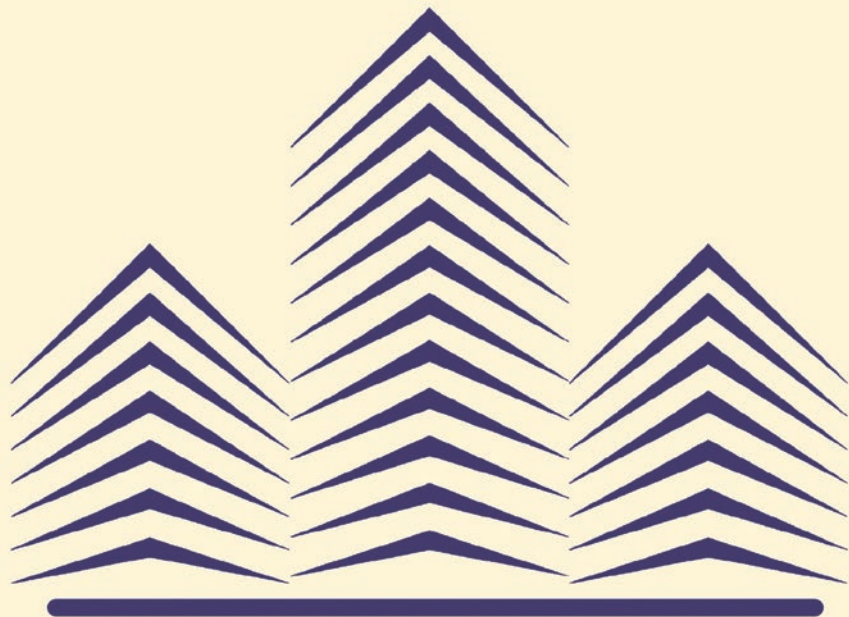


Effectiveness of the Beneficial Ownership Test in Conduit Company Cases

Saurabh Jain



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Effectiveness of the Beneficial Ownership Test in Conduit Company Cases

Why this book?

Since the introduction of the term “beneficial owner” to the OECD Model Tax Convention in 1977, courts and the OECD have struggled to interpret the term, and to use it as a test for deciding conduit company cases.

This book examines the conflict between the general policy of double tax treaties embodied in the beneficial ownership requirement and the concept of corporations. The work highlights the shortcomings of surrogate tests with the help of analyses of reported conduit company cases. It offers an alternative approach for interpreting and applying the beneficial ownership test. It contains a critique of the work of the OECD Committee on Fiscal Affairs before the insertion of the term, and suggests appropriate amendments to relevant parts of the official Commentary on the OECD Model Tax Convention.

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Chapter 2

Confusions of the Legalistic Approach

2.1. Introduction

Double tax conventions are diplomatic agreements of a fiscal nature. They should be construed in a substantive economic sense, in order to ensure that treaty benefits are available only to residents of the contracting states. From a substantive economic point of view, companies are legal fictions that shareholders use in order to derive income. It follows that theoretically from an economic perspective, income tax should be imposed at the level of shareholders, not at the level of corporations. Contrary to this implication, the OECD has decided to recognize companies for treaty purposes. The OECD's decision seems pragmatic because it is hard to operate income tax treaties unless companies are recognized. This decision causes the OECD Model to operate simultaneously in two contradictory manners. On one hand, the Model operates in a substantive economic sense to ensure that its benefits are limited to residents of the contracting states. On the other, it recognizes companies for tax purposes, which is impossible from the substantive economic point of view.

The contradictory manner of functioning of the OECD Model causes problems in the interpretation and application of articles 10, 11 and 12, which provide for a reduction in withholding tax on passive income. Residents of a non-contracting state can improperly obtain benefits of the reduction by interposing a company as the recipient of passive income in a contracting state. As discussed in section 1.7., such companies are commonly known as "conduit companies". Articles 10(2), 11(2), and 12(1) of the OECD Model require the recipient of passive income to be the beneficial owner of that income.

Theoretically, conduit companies should never be entitled to treaty benefits because their shareholders, who enjoy passive income in an economic sense, are residents of a non-contracting state. However, the OECD's Conduit Companies Report and the official commentary on the Model assume that at least in some situations conduit companies *can* be considered beneficial owners of passive income. The assumption is a logical impossibility that makes it difficult to interpret and apply the beneficial ownership concept.

This chapter examines in detail the point mentioned in chapter 1, which is that the beneficial ownership concept cannot logically be applied as a test to conduit company cases. To illustrate the point, it explains the application of the beneficial ownership concept in trust law and in the OECD Model. It also discusses the legal and economic perspectives of the application of income tax law to corporations.

2.2. Interpretation of double tax conventions

Treaties should be construed liberally rather than in the strict legalistic manner by which domestic statutes are generally interpreted.³³ As an international treaty, a double tax convention should also be subjected to liberal interpretation.³⁴ The interpretation of a double tax convention is governed by public international law and specifically by article 31(1) of the Vienna Convention on the Law of Treaties,³⁵ which provides that treaties should be interpreted in the context of their object and purpose.³⁶

Double tax conventions are bilateral agreements entered into with the general economic objective of mitigating double taxation. To achieve this objective, the contracting states agree to restrict their substantive tax law reciprocally. That is, a double tax convention forms an independent mechanism to avoid double taxation only between its contracting states.³⁷

A resident of a third state can improperly obtain benefits that a double tax agreement provides to residents of its contracting states, by interposing a person or a conduit entity in one of the contracting states. For this reason, another purpose of a double tax convention is to prevent its improper use by

33. See generally UK: *Fothergill v. Monarch Airlines Ltd* (1980), AC 251.

34. CA: *Gladden Estate v. Minister of National Revenue* (1985), 1 CTC 163, 166.

35. UN: *Vienna Convention of the Law of Treaties* art. 31(1) (23 May 1969), *Treaties IBFD* [hereinafter *Vienna Convention*]. UK: EWCA, 2 MAR. 2006, *Indofood International Finance Limited v. JPMorgan Chase Bank NA, London Branch*, 158, at para. 24, *Tax Treaty Case Law IBFD*. CH: FCATM, *Re V SA* (2001), 4 ITLR 191, at 208. See P. Baker, *Double Taxation Conventions and International Tax Law* at 21 (2nd ed., Sweet and Maxwell 1994).

36. Art. 31(1) *Vienna Convention*. It states: "A treaty shall be interpreted in good faith 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."

37. K. Vogel, *Double Taxation Conventions: A Commentary to the OECD-, UN-, US-Model Conventions for the Avoidance of Double Taxation of Income and Capital with particular reference to German Treaty Practice* at 19 (Kluwer Law and Taxation Publishers 1990). See D.A. Ward, *Principles to be Applied in Interpreting Tax Treaties*, 25 *Canadian Tax Journal* 263, at 265 (1977).

limiting its benefits to residents of its contracting states. The Swiss Federal Commission of Appeal in Tax Matters in *Re V SA*,³⁸ explained:³⁹

... double taxation conventions ... are primarily intended to avoid international double taxation ... However, only international double taxation of residents of a contracting state are covered by these conventions ... double taxation conventions do not have as their object to permit persons who are not residents of a contracting state to benefit from the advantages of the convention ...

The context of the object and purpose of limiting the benefits requires double tax agreements to be interpreted in an *economic* sense. The Austrian Supreme Administrative Court in *N AG v. Regional Tax Officer for Upper Austria*⁴⁰ expressed the same opinion. As will be discussed in section 2.7., the *N AG* case concerned the Austria-Switzerland double tax treaty of 30 January 1974,⁴¹ which did not have an anti-abuse clause. The court observed:⁴²

If a double taxation convention contains provisions which bear on the *economic aspects* of tax questions and the attribution of assets, these provisions must be applied. The absence of such provisions in a convention – as in the case of this [double tax convention] – does not, however, justify the conclusion that the convention permits the use of nominee arrangements to obtain treaty benefits or the abuse of the forms and institutions of civil law. Such a conclusion would be incompatible with the *goal and purpose* of the convention, to assign taxing rights between the two states according to objective criteria. Where a treaty does not contain specific provisions on an *economic approach* and attribution of *economic interests* a state accordingly has the right to protect itself against an unjustified exploitation of the tax benefits provided for in the convention.

The observation confirms that because a double tax convention is an agreement between two countries, one of its objects and purposes is to limit its benefits to residents of the contracting states. For this reason, regardless of whether its provisions contain specific anti-abuse clauses, a treaty should be interpreted in a substantive economic sense in order to prevent residents of non-contracting states from improperly obtaining tax benefits it provides.

As discussed earlier, this book concerns provisions that deal with the double taxation of passive income, which are generally based on articles 10, 11 and 12 of the OECD Model. They mitigate double taxation by limiting the right

38. *Re V SA* (2001).

39. *Ibid.*, at 210.

40. AT: SAC, *N AG v. Regional Tax Officer for Upper Austria* (2000), 2 ITLR 884.

41. *Convention between the Swiss Confederation and the Republic of Austria for The Avoidance of Double Taxation with Respect to Taxes on Income and on Capital* (30 Jan. 1974), Treaties IBFD [hereinafter *Switz.-Austria Tax Treaty*].

42. *N AG* (2000), at 900 (emphasis added).

to tax of the state where passive income originates, which will be referred to as the source state. In order to ensure that the benefit of the withholding tax reduction is limited to residents of the contracting states, articles 10, 11 and 12 of the OECD Model require the recipient to be the “beneficial owner” of income. In the context of the object and purpose of double tax agreements, the term “beneficial owner” should logically connote that the immediate recipient must be the owner in a *substantive economic* sense. The official commentaries on articles 10, 11 and 12 of the OECD Model support this argument.

2.3. Beneficial ownership test in the OECD Model

In 1977, the OECD Model adopted the notion of beneficial ownership as a test to determine whether a party is entitled to treaty benefits. The official commentaries on articles 10, 11, and 12 of the OECD Model state that the object of introducing the beneficial ownership requirement was “to clarify”:

- (1) the meaning of the words “paid ... to a resident of a contracting state” in articles 10(1)⁴³ and 11(1);⁴⁴ and,
- (2) how article 12 applies in relation to payments made to intermediaries.⁴⁵

According to the official commentary, the requirement:⁴⁶

makes it plain that the state of source is not obliged to give up taxing rights over passive income merely because that income was immediately received by a resident of the other contracting state.

This statement is essentially a reiteration of the policy of limiting benefits of the convention to residents of contracting states. The use of phrases “to clarify” and “makes it plain” shows that the term “beneficial owner” simply emphasizes the policy. Because the purpose is entrenched in double tax treaties, it would have produced the same result in the absence of the term “beneficial owner”.⁴⁷ *Aiken Industries Inc v. Commissioner of Internal*

43. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 10* 187 at para. 12 (22 July 2010), Models IBFD.

44. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 11* 211 at para. 9 (22 July 2010), Models IBFD.

45. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 12* 220 at para. 4 (22 July 2010), Models IBFD.

46. Para. 12 *OECD Model: Commentary on Article 10* (2010). Para. 9 *OECD Model: Commentary on Article 11* (2010). Para. 4 *OECD Model: Commentary on Article 12* (2010) (emphasis added).

47. See also Vogel, *supra* n. 37, at 459.

*Revenue*⁴⁸ helps to illustrate this point. That case was decided before the term “beneficial owner” was introduced to the OECD Model.

2.4. Aiken Industries Inc v. Commissioner of Internal Revenue

Ecuadorian Corp Ltd, a resident of the Bahamas, which will be referred to as Ecuadorian Ltd, wholly owned Aiken Industries, a US resident corporation. Aiken Industries took over the ownership as well as the relevant rights and obligations of Mechanical Products Inc, another US resident corporation, which will be referred to as Mechanical Inc. Mechanical Inc was initially involved in the disputed transaction. Aiken Industries became the party in this action as a consequence of its takeover of Mechanical Inc. Ecuadorian Ltd also held all the shares of CCN, a resident of Ecuador, which, in turn, wholly owned Industrias, a Honduran corporation.

Ecuadorian Ltd made a loan to Mechanical Inc on a promissory note. Since there was no double tax treaty between the United States and the Bahamas, Mechanical Inc would have to deduct US domestic withholding tax on interest payments to Ecuadorian Ltd. Ecuadorian Ltd interposed Industrias in the transaction and transferred Mechanical Inc’s promissory note to Industrias in consideration of a debt outstanding. The effect of the transaction was as if back-to-back loans were made from Ecuadorian Ltd to Industrias and subsequently from Industrias to Mechanical Inc.

The transaction was designed to take advantage of the US withholding tax exemption under article IX of the US-Honduras double tax treaty of 26 June 1956.⁴⁹ Accordingly, Mechanical Inc withheld no tax on the interest payments. The Commissioner of Internal Revenue determined deficiencies in withholding tax.

The Commissioner alleged before the United States Tax Court that the existence of Industrias as a corporation should be disregarded for tax purposes because Ecuadorian Ltd was the true owner and the recipient of the interest. Aiken Industries responded that Industrias complied with the definition

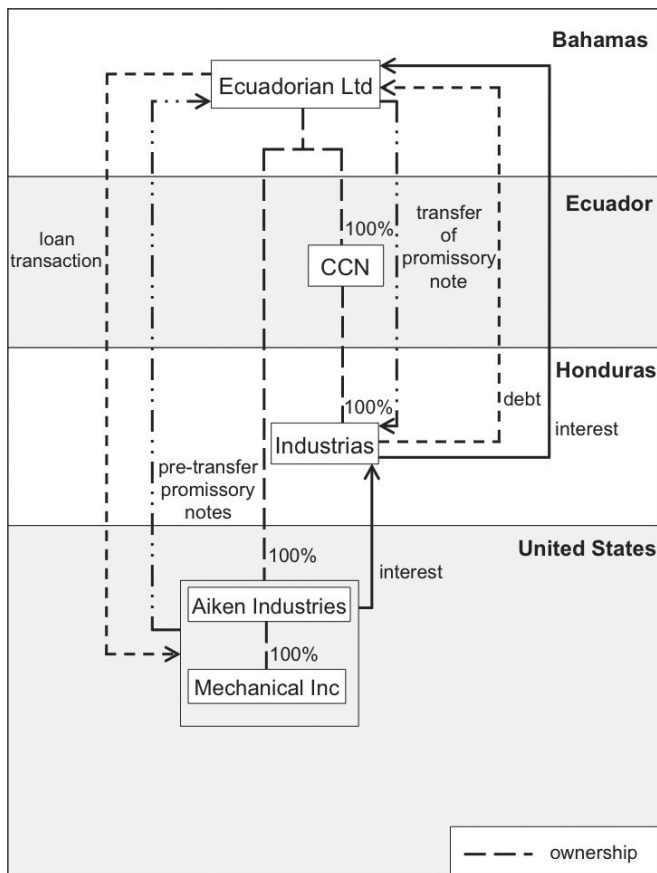
48. US: TC, 5 AUG. 1971, 56 925, *Aiken Industries Inc. v. Commissioner of Internal Revenue*, Tax Treaty Case Law IBFD.

49. *Convention for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, the United States-Honduras* (25 June 1956), Treaties IBFD [hereinafter *US-Hond. Tax Treaty*]. The convention was terminated on 31 December 1966.

Chapter 2 - Confusions of the Legalistic Approach

of a corporation under article II of the treaty,⁵⁰ and therefore could not be disregarded. It contended that Industrias received the income as a “Honduran enterprise”, and therefore the interest payments should be exempt from withholding tax under the treaty.

Figure 2.1: *Aiken Industries*



50. Art. II *US-Hond. Tax Treaty*. Article II(g) stated: “The term “Honduran enterprise” means an industrial or commercial or agricultural enterprise or undertaking carried on by a resident of Honduras (including an individual in his individual capacity or as a member of a partnership) or a fiduciary of Honduras or by a Honduran corporation or other entity; the term “Honduran corporation or other entity” means a corporation or other entity formed or organized in Honduras or under the laws of Honduras.”

The court had to decide whether the treaty was applicable to the facts and circumstances of the case in order to exempt Mechanical Inc from the requirement to deduct withholding tax from its interest payment to Industries. The court held that the interest payments were not exempt from the US withholding tax.

2.5. *Aiken Industries: The interpretation of the term “beneficial owner”*

When the United States Tax Court decided the *Aiken Industries* case, neither article IX of the US-Honduras double tax treaty nor article 11 of the OECD Model used the term “beneficial owner”. The relevant part of article IX of the US-Honduras double tax treaty stated:⁵¹

Interest on ... notes ... from sources within one of the contracting States received by a resident, corporation or other entity of the other contracting State not having a permanent establishment ... shall be exempt from tax by such former State.

The court interpreted the words “received by” in article IX according to the language and context of the treaty, and observed:⁵²

As [utilized] in the context of article IX, 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 words “received by a resident ... of the other contracting State” in the US-Honduras double tax treaty and “paid ... to a resident of a Contract State” in the OECD Model point to the same person, who is the immediate recipient of the passive income.⁵³ In this context, the foregoing interpretation becomes relevant to the approach that, according to the official commentary, the term “beneficial owner” was introduced to clarify.⁵⁴ The foregoing observation of the court, in fact, illuminates the approach. The court essentially followed the object and purpose of the treaty to limit its benefits to the contracting states.

51. Art. IX *US-Hond. Tax Treaty*.

52. *Ibid.*, at 933 (emphasis added).

53. See also S. van Weeghel, *The Improper Use of Tax Treaties: With Particular Reference to the Netherlands and the United States* at 89 (Kluwer Law International 1998).

54. Commentaries on articles 10, 11 and 12 of the OECD Model.

Because the court used the phrase “complete dominion and control”, the observation implies that in order to qualify for the reduction of withholding tax, the recipient of passive income should be a person who owns passive income in a substantive economic sense. Following the object and purpose of limiting treaty benefit, it found:⁵⁵

Industrias was merely a conduit for the passage of interest payments from [Mechanical Inc] to [Ecuadorian Ltd]. Industrias had no actual *beneficial interest* in the interest payments it received, and *in substance*, [Mechanical Inc] was paying the interest to [Ecuadorian Ltd] which “received” the interest within the meaning of article IX.

The court used the term “beneficial interest”, which is simply a linguistic variation of the concept of beneficial ownership. Thus, the observation shows that the court read the beneficial ownership requirement into the provision. The court’s use of the term “beneficial interest” suggests *substantive economic* ownership.

The Austrian Supreme Administrative Court in *N AG v. Regional Tax Officer for Upper Austria*⁵⁶ adopted a similar approach. The *N AG* case was decided after the term “beneficial owner” was introduced to the OECD Model.

2.6. *N AG v. Regional Tax Officer for Upper Austria*

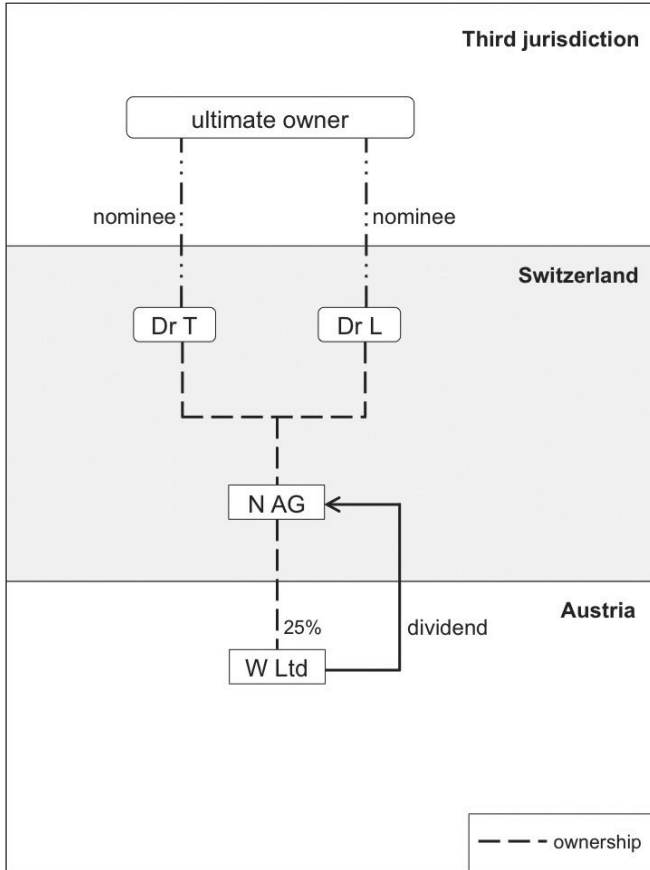
N AG, a Swiss corporation, was one of the shareholders of *W Ltd*, an Austrian company. *W Ltd* paid a dividend to *N AG* and deducted Austrian withholding tax from the payment. *N AG* applied to the Austrian tax authorities for a refund of withholding tax under article 28(2) of the Austria-Switzerland double tax treaty of 30 January 1974.⁵⁷ The Austrian tax authority refused the refund to *N AG*. The tax authority had evidence that the shareholders of *N AG*, *Dr T* and *Dr L*, who were Swiss residents, were merely nominees for the ultimate owners, who were not resident in Switzerland. Thus, according to the tax authority, *N AG* was a conduit company. *N AG* produced a residency certificate from the Swiss Tax Administration that certified that *N AG* did not pass on the treaty-favoured profits to others who were not entitled to the benefit of the Austria-Switzerland double tax treaty. However, the Austrian tax authority did not regard the certificate as conclusive.

55. *Aiken Industries* (1971), at 934 (emphasis added).

56. AT: SAC, *N AG v Regional Tax Officer for Upper Austria* (2000), 2 ITLR 884.

57. Art. 28(2) *Switz.-Austria Tax Treaty*. It states: “... the tax withheld by way of deduction (at the source) shall be refunded upon request, providing this Agreement restricts the levying of such tax ...”.

Figure 2.2: N AG v. Regional Tax Office for Upper Austria



The issue before the Austrian Supreme Administrative Court was whether the Austrian tax authority was entitled to investigate whether N AG had been interposed only to extract benefits under the treaty because the “real economic owners”⁵⁸ of the income would not have been able to claim tax relief. The court decided in favour of the tax authority.

58. N AG (2000), at 900.

2.7. The *NAG* case: The interpretation of the term “beneficial owner”

Although article 28(2) of the Austria-Switzerland double tax treaty of 30 January 1974⁵⁹ did not use the word “beneficial owner”, the court observed:⁶⁰

... the *pre-requisite* for the repayment of withholding tax was inter alia that the recipient of the dividends should be the *beneficial owner* of the investments which gave rise to the dividends.

It is clear that as with the United States Tax Court in *Aiken Industries*,⁶¹ the Austrian Supreme Administrative Court read the beneficial ownership requirement into a provision that did not use the term “beneficial owner”.

In the light of the court’s observation quoted in section 2.2., it is obvious that the court considered article 28(2) to be a “provision on an *economic approach* and attribution of *economic interests*”.⁶² That is, it accorded an economic effect to the term “beneficial owner”.

Aiken Industries and the *NAG* case confirm that in the language and context of double tax treaties in general, and the OECD Model in particular, the term “beneficial owner” means a person who has the substantive economic ownership of passive income.

2.8. “Beneficial owner”: Ordinary meaning

The documents concerning the work of the OECD Committee on Fiscal Affairs with respect to articles 10, 11 and 12 before the insertion of the term “beneficial owner” show that according to the United Kingdom delegation:⁶³

59. Art. 28(2) *Switz.-Austria Tax Treaty*. It states: “... the tax withheld by way of deduction (at the source) shall be refunded upon request, providing this Agreement restricts the levying of such tax ...”.

60. *NAG* (2000), at 899 (emphasis added).

61. *Aiken Industries* (1971), at 934 (emphasis added).

62. *NAG* (2000), at 900 (emphasis added).

63. OECD Committee on Fiscal Affairs, *Note on the Discussion of the First Report of Working Party No. 27 of the Fiscal Committee on Interest and Royalties during the 31st Session of the Fiscal Committee held from 10th to 13th June, 1969* at 6, DAF/FC/69.10, 4 July 1969, <www.taxtreatieshistory.org>. OECD Committee on Fiscal Affairs, *Preliminary Report on Suggested Amendments to Articles 11 and 12 of the Draft Convention, relating to Interest and Royalties Respectively* at 14, FC/WP27 (68) 1, 30 December 1968, <www.taxtreatieshistory.org>.

... Articles 10, 11 and 12 were defective in that they would apply to dividends, interest and royalties paid to an agent or a nominee with a legal right to the income.

A remedy that the delegation suggested was that the articles should be applied only to passive income paid to the “beneficial owner”. Delegates for Switzerland and the United States supported the suggestion. The committee was of the opinion that it was evident that relief in a source state was available only if the recipient of passive income was “actually resident in the other contracting state”⁶⁴ and was the “true recipient”⁶⁵ of the income. Nevertheless, it decided to insert the term “beneficial owner” in articles 10, 11 and 12.

In the light of the United Kingdom delegation’s concern, the committee’s decision suggests that it acknowledged that sometimes courts tend to interpret tax treaties in a strict legalistic manner. A legalistic interpretation would lead them to base their decisions on formal ownership. However, because this approach would contradict the object and purpose of double tax conventions, the committee decided to insert an expression that calls for an economic approach.

Article 31(1) of the Vienna Convention states:⁶⁶

A treaty shall be interpreted in good faith 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.

A possible reason why the committee adopted the term “beneficial owner” is that the ordinary meaning of the word “beneficial” accurately captures the economic approach. In the term “beneficial owner” the use of “beneficial” means that the owner is entitled to enjoy the property. Words such as “real”, “ultimate” or “true” might have been alternatives; however, they do not necessarily express their economic consequences.

In the *Re V SA* case,⁶⁷ the Swiss Federal Commission of Appeal in Tax Matters also referred to the ordinary meaning of the terms “*bénéficiaire effectif*” and “*bénéficiaire*” and interpreted them in an economic sense. When translated from French they mean “effective beneficiary” or “beneficial owner”, and “beneficiary” respectively.

64. OECD, *Preliminary Report*, *supra* n. 63.

65. *Ibid.*

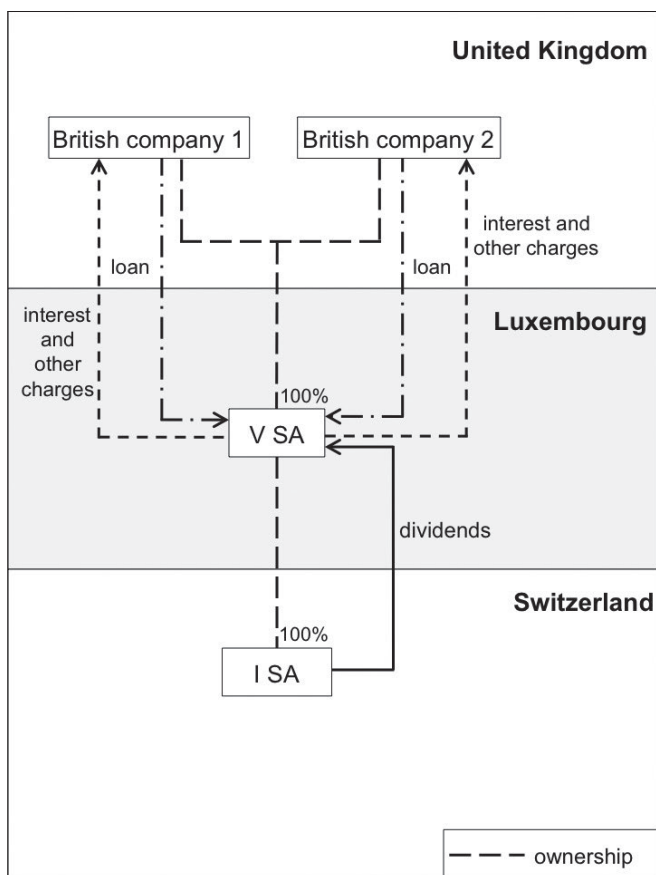
66. Art. 31(1) *Vienna Convention* (emphasis added).

67. *Re V SA* (2001).

2.9. The *Re V SA* case

Two British companies incorporated V SA in Luxembourg. V SA acquired all the capital in I SA, a Swiss company, with the help of a loan from the British companies. I SA made separate dividend payments to V SA in the first and second year of its incorporation. It deducted Swiss withholding tax on the payments.

Figure 2.3: *Re V SA*



Article 10(2)(a) of the Switzerland-Luxembourg double tax treaty of 21 January 1993 states:⁶⁸

- a) ... dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the recipient is the *effective beneficiary* of the dividends the tax so charged shall not exceed:
 - i) 5 percent of the gross amount of the dividends if the *effective beneficiary* is a company (other than a partnership) which holds directly at least 25 percent of the capital of the company paying the dividends;

Whereas, article 10(2)(b) states:⁶⁹

Notwithstanding the provisions of [clause] (i) of sub-paragraph a), the dividends are exempt in the Contracting State of which the company paying the dividends is a resident, if the *beneficiary* is a company (other than a partnership) which is a resident of the other Contracting State and which holds, directly for an uninterrupted period of two years preceding the date of payment of such dividends, at least 25 percent of the capital of the company paying the dividends

Accordingly, V SA applied to the Swiss Tax Administration for partial and full reimbursements of withholding tax on the first and second dividend payments respectively.

On the demand of the Swiss Tax Administration, V SA submitted its statutory documents and annual accounts only for the year it received the first dividend payment. It did not reply to the question of whether it received the benefit of dividend payments. The administration denied refunds. The Federal Commission of Appeal in Tax Matters confirmed the administration’s decision.

2.10. Re V SA: Ordinary meaning of “beneficial ownership”

The word “effective” did not accompany “beneficiary” in subparagraph (b), as it did in subparagraph (a). For this reason, the Swiss Federal Commission determined “whether the term “beneficiary” must be interpreted in the same sense as “effective beneficiary [beneficial owner]” or whether it refers

68. *Convention between the Swiss Confederation and the Grand Duchy of Luxembourg for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital* art. 10(2)(a) (21 Jan. 1993), Treaties IBFD [hereinafter *Switz.-Lux. Tax Treaty*] (emphasis added).

69. *Ibid.*, art. 10(2)(b) (emphasis added).

exclusively to the direct formal shareholder.”⁷⁰ Referring to article 31 of the Vienna Convention, the commission observed:⁷¹

Double taxation conventions must first be interpreted in accordance with the ordinary meaning given to the terms employed ...

A beneficiary is the person ‘who receives a benefit, an advantage, etc’ ... The beneficiary is thus the person who can actually benefit from a payment, and not one who receives it subject to an obligation to transfer it to a third person. Thus, a company which transferred to a third person dividends received without being able actually to dispose of them cannot be considered as the ‘beneficiary’. The notion of ‘beneficiary’ envisages, therefore, according to the ordinary meaning to be attributed to this term, one who effectively receives a payment and can dispose of it. This definition overlaps with that of the ‘effective beneficiary [beneficial owner]’ which envisages the person who profits economically from income, and does not apply to conduit companies placed as intermediaries between the payer of income and the person who ultimately receives it ...

... the requirement of an effective beneficiary is implicit in double taxation conventions and does not require an express reference ...

... it follows from the sense of the word beneficiary that one cannot stop at the purely formal shareholder of a company, but rather it is necessary to research who is the person who can in reality and effectively benefit from the payment of income.

The Swiss Federal Commission noted that V SA provided incomplete information. V SA’s annual accounts showed that it paid the entire income it received as dividends from I SA by way of interest and other charges to the British companies. The commission also pointed out that V SA’s only significant asset was its holding in I SA. Considering these facts in the light of the ordinary meaning of the term “beneficiary”, the commission found that V SA was “manifestly only a conduit company”⁷² that could not be considered as the beneficiary of the dividends.

The commission’s approach corresponds to the line of the argument in section 2.8. The ordinary meaning of the terms “*bénéficiaire*” and “*bénéficiaire effectif*” led the commission to interpret them in an economic sense. Because the term “*bénéficiaire effectif*” is the French equivalent of the term “beneficial owner”, the observation also shows that the ordinary meaning of the term “beneficial owner” reflects economic consequences.

70. *Re V SA* (2001), at 208.

71. *Ibid.*, at 209.

72. *Re V SA* (2001), at 210.

As with *Aiken Industries*⁷³ and the *NAG* case,⁷⁴ the commission considered the beneficial ownership requirement inherent in double tax treaties. In the context of the ordinary meaning of the terms “effective beneficiary” and “beneficial owner”, the role played by words “effective” and “beneficial” are comparable. As with the OECD Committee on Fiscal Affairs, the negotiators of the Swiss-Luxembourg double tax treaty used “effective” to show that the immediate recipient should own passive income in a substantive economic sense. This may be the reason for using the word “effective” with “beneficiary” in subparagraph (a) so that the word “beneficial” could be read in the same light.

2.11. “Beneficial owner”: Legal meaning

The discipline of trust in English law also uses the concept of beneficial ownership. “Beneficial owner” is a term of art under English law.⁷⁵ The concept of beneficial ownership originated in equity, a branch of English law separate from common law. Equity uses the concept of beneficial owner in the context of the trust. Whereas common law adopts the position that ownership cannot be divided,⁷⁶ equity allows the division of ownership into legal ownership of the trustee and equitable or beneficial ownership of the beneficiary. Other common law countries follow English law and use the term “beneficial owner” in the same sense in their domestic law. The English law meaning strongly influences the meaning of the concept in the OECD Model.

Because most civil law countries⁷⁷ do not use the term beneficial owner in their domestic tax law, the debate over the meaning of the term in the OECD Model essentially revolves around two questions. First, whether contracting states should refer to their domestic law under article 3(2) of the OECD Model for interpreting the term “beneficial owner” or whether the context

73. *Aiken Industries* (1971).

74. *NAG* (2000).

75. UK: *Ayrest (Inspector of Taxes) v. C & K (Construction) Ltd* [1975], 2 All ER 537 at 540. See Baker, *supra* n.35, at 229.

76. Avery Jones et al., *supra* n. 13.

77. Belgium and the Netherlands use terms equivalent to beneficial owner. In the Netherlands, article 1(1) of the Dividend Tax Act of 1969 uses the term “*uiteindelijk gerechtigde*”, which means ultimately entitled. Article 198(1)(11) of the Belgian Income Tax Code uses terms “*uiteindelijk gerechtigde*” or “*bénéficiaire effectif*”. See H. Pijl, *The Definition of “Beneficial Ownership” under Dutch Law*, 54 Bull. Intl. Taxn. 6, 256 at 258 (2000), Journals IBFD. See W. Eynatten et al., *The Concept of ‘Beneficial Ownership’ under Belgian Tax Law: Legal Interpretation is Maintained*, 31 Intertax 523, at 524 (2003).

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