UNIVERSIDADE CATÓLICA PORTUGUESA

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Interpretation of the beneficial owner concept in Tax Treaty practice and European Union Law

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Abstract

Despite its long history, the beneficial ownership concept has raised many controversies over the years and continues to be one of the most debated terms in international tax law, due to its ambiguous definition. The OECD Model and EU law do not provide a clear definition for the term and the lack of harmonization of the concept has led Courts to apply different interpretations according to their own perspectives.

The interconnection between the beneficial owner and abuse of rights has also been put on trial on several occasions, echoing the doubts surrounding the beneficial ownership term. The European Court of Justice recently issued two landmark decisions with important outcomes for the beneficial ownership concept and a new reading of the subject-to-tax clause, interpreted as requiring effective taxation.

Keywords: Beneficial Ownership; Double Taxation Conventions; General Anti-abuse Clauses; Danish Cases.

Resumo

Apesar da sua longa história o conceito de beneficiário efetivo tem levantado controvérsia e continua a ser dos conceitos mais discutidos em direito internacional fiscal, devido à sua definição ambígua. Quer o Modelo da OCDE, quer o direito da União Europeia não definem de forma inequívoca o conceito e a sua falta de harmonização leva os tribunais a aplicar interpretações diferentes e contraditórias.

A ligação entre o conceito de beneficiário efetivo e a sua ligação com a figura do abuso de direito foi já por diversas vezes abordada judicialmente, fazendo realçar as dúvidas quanto ao conceito. O Tribunal de Justiça da União Europeia emitiu recentemente duas importantes decisões judiciais com impacto para a definição do conceito de beneficiário efetivo, a sua conexão com o abuso de direito e uma nova leitura sugerindo que a cláusula de sujeição a imposto requer que este seja efetivamente tributado.

Palavras-chave: Beneficiário Efetivo; Convenções Sobre Dupla Tributação; Cláusulas Gerais Anti-abuso; Casos Dinamarqueses.

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List of Abbreviations

AG	Advocate General
Art.	Article
BEPS	Base Erosion and Profit Shifting
BO	Beneficial Ownership
DTC	Double taxation convention(s)
ECJ	European Court of Justice
e.g.	exempli gratia
EU	European Union
GAAR	General anti-avoidance rule
IBFD	International Bureau of Fiscal Documentation
IFA	International Fiscal Association
IRD	Interest and Royalties Directive 2003/49/EC
LOB	Limitation on benefits
MS	Member States
MLI	Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting
OECD	Organisation for Economic Co-operation and Development
OECD MC	OECD Model Tax Convention on Income and on Capital
para.	paragraph
PSD	Parent-Subsidiary Directive 2011/96/EU
PPT	Principal purpose test
VCLT	Vienna Convention of 23 May 1969 on the Law of Treaties

1. Introduction

Beneficial ownership is a concept used to determine if the recipient of dividend, interest or royalty payments is the beneficial owner and can be deemed entitled to a certain treaty benefit in connection to the payment. Despite all the scholarly attention, the definition of the term remains vague and ambiguous, leading courts to issue contradicting rulings as each jurisdiction applies its perspective creating great uncertainty. National tax authorities often challenge the application of treaty rights based on the non-fulfilment of the beneficial ownership, although there is no ordinary meaning agreed-upon of the concept.

The OECD Model and European Union Law do not share a clear interpretation of the concept. Notwithstanding, they provide guidance on a possible direction regarding a subject to tax clause that we will explore. The European Court of Justice in its recent rulings made an approximation of the beneficial ownership concept with abuse doctrines, interpreting the lack of beneficial owner status as an indication of abuse of rights.

This paper aims at fulfilling the concept of beneficial ownership starting by presenting a brief historical analysis highlighting the main questions raised over the years. To conclude this contribution, we will present a practical approach for beneficial ownership considering the different perspectives put forward by scholars and the recent cases on the term. with particular attention to the reading of the subject-to-tax clause concerning the interest income.

2. Preliminary Remarks

With the free movement of capitals, taxation of income will only be effective if there is cooperation towards transparency between States and taxpayers. The aim of this cooperation is essentially to identify the beneficial owner of income and tax accordingly.

Following the G20, OECD presented a Report with 15 actions, the Base Erosion and Profit Shifting (BEPS) Project designed to avoid double non-taxation through the introduction of domestic and international rules and instruments that address tax avoidance by preventing tax abuse. On the one hand, the BEPS ensures that profits are taxed where economic activities generating the profits are performed and value is created (state of source). On the other hand, if the source state does not want to tax the value, the

state of residence can apply a "switch-over" clause, or if the dividends are not distributed "controlled foreign companies" clauses can apply.

The BEPS project aims to tackle aggressive tax planning (tax erosion or tax abuse). BEPS Action 6 "Prevention of tax treaty abuse" tackles treaty abuse and clarifies that tax treaties aim to avoid double taxation and double non-taxation, setting a minimum standard[1]. Action 6 establishes recommendations to include in tax treaties, such as a limitation of benefits (LOB) rule and the inclusion of general anti-abuse rule (GAAR) based on a principal purpose test.

Limitation of benefits rules are specific anti-abuse rules designed to disapply treaty benefits in abusive situations, offering legal certainty due to its various tests. In substance, LOB clauses do not differ from the concept of beneficial ownership and its principles and raise less controversy in their application than beneficial ownership. However, LOB provisions diverge in concept from the BO as the tests thoroughly examine the nexus with the state of residence (legal nature of the entity, general activities) while the latter on the contrary weights the intensity of the ownership of the recipient over the income received.

The MLI is an international instrument that speeds the process of the implementation of BEPS measures as well as updating tax treaty measures into treaties already in place to counter tax avoidance.

In addition, the Principal Purposes Test (PPT) is a tool introduced in the OECD Model and the MLI that scans specific facts and circumstances to decide if the application of the Double Taxation Convention (DTC) benefits should apply to the case, intended to deal with conduit structures. The application of this GAAR means a treaty benefit should not be granted because it is reasonable to conclude that one of the principal purposes of the arrangement or transaction was to obtain that benefit. The PPT can be applied to the whole framework of conduit structure while the beneficial ownership aims to tackle the conduit issue in a broad manner regarding dividends, interest and royalties.

Depending on how we perceive the beneficial owner, the interaction that this concept has with the PPT may present different outcomes. Interpreting the beneficial

[1] OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances – Action 6*.

owner concept under a broad approach seems to overlap the PPT rule in conduit cases since the latter is a GAAR and the beneficial ownership a specific treaty abuse provision.

The BO concept may seem unnecessary since the PPT deals with conduit arrangements, and in its absence, we can apply LOB rules, however, neither of these two addresses agents and nominees. For this reason beneficial ownership is in our view still necessary.

3. Background and Development

The beneficial owner notion was imported from Common law into tax treaties and has originated many discussions in the last decades with its introduction in the Organization for Economic Co-operation and Development (OECD) Model Convention. In Common law countries, the beneficial owner concept is enclosed in a group of principles of allocation of income (relevant to define tax liability).

The concept was introduced in the OECD Model in 1977, in the dividends, interest and royalties articles[2], to clarify the meaning of the term "paid to", and then scattered to the Double Tax Conventions concluded between countries. Nevertheless, the meaning given to this concept was never harmonised or clearly defined, rising many interpretation disputes and problems, especially since many contracting states did not hold the term in their jurisdictions.

The application of the concept serves the purpose of limiting the taxing right of the state of source in addition to ensuring that business profits are subject to tax[3]. The concept is often considered by many scholars[4] as an important specific anti-abuse provision since it targets a specific form of treaty abuse, which is the interposition of a recipient who is obliged to pass the received income (leaving no doubt that the beneficial ownership limitation is not a broad anti-abuse provision). On the contrary, other authors such as David Oliver[5] perceive the concept of beneficial ownership as a "qualification for the benefit of the treaty" and an element of residence, regarding it as essential to determine the personal scope of a DTC. In our opinion, since the concept has

[2] OECD Model on Income and on Capital, Articles 10 (2), 11 (2) and 12 - Taxation on Dividends, Interest and Royalties.
[3] *Vide* OECD Model articles 10 (2), (4); 11 (2), (4) and 12 (1), (3).
[4] Such as De Broe and S. Gommers.
[5] In this sense also M. Lang; O. Gjems-Onstad and A. Meindl-Ringler.

repercussions reflecting on both purposes, as well as it suffers alterations from the evolution of the *status quo*, it seems to be less advantageous to choose one over the other as it serves both.

Nonetheless, choosing the approach of a narrow anti-avoidance rule for the BO excludes many conduit structures that would not be excluded under the interpretation of the concept as an attribution-of-income.

The concept of beneficial ownership was introduced to deal with treaty shopping situations where an intermediary resident (agent or nominee) who received the income had been interposed. In other words, the concept was meant to prevent that treaty benefits would apply in situations not intended by the treaty.

Depending on the structure of the funding of the interposed company or the choice of the Member State of establishment it can lead to a situation of lower or no tax applied. The introduction of BO clauses in international tax conventions is one of the most important instruments for contracting states to tackle treaty shopping. According to the 1977 OECD Commentary, treaty shopping can arise, irrespectively of the person's residence in a contracting state, with the creation of a legal entity in a state with the essential aim of obtaining a tax treaty that would not be available otherwise.

The OECD Conduits Report[6] stated that when the formal owner has very restricted power over the income received, i.e., when they are mere fiduciaries or administrators, they cannot be perceived as being the beneficial owner. It is now known and widely accepted that treaty benefits are not meant for agents or nominees of a contracting state that simply serve as a conduit to pass on to another person who will benefit from the income, since these intermediaries are not themselves subject to tax on the received income.

[6] In 1986, the CFA published the *Double Taxation and the Use of Conduit Companies Report,* adopted by the OECD Council, which embodied important remarks on the beneficial ownership concept.

3.1 The purpose behind the beneficial owner

The concept of beneficial ownership has relevance when attributing tax benefits (relief or exemption of taxation) to certain types of income, such as dividends, interest and royalties, being a needed condition to access them, when they are paid from one contracting state to another under a DTC.

There is no consensus on the definition of beneficial ownership in the international tax community and even though the OECD attempted to clarify it many times as will be discussed further it was never successful.

As we mentioned before, the aim of the OECD Model is to eliminate double taxation and, on the other side of the coin, states must not create opportunities for non-taxation (as it is advocated in the BEPS and established on DTCs). We believe that the underlying purpose is, ultimately, that tax is not avoided and is paid to one of the contracting States. More importantly than determining if the supposed beneficial owner has control over the income is, from an objective point of view, whether the tax was duly paid or not.

4. Interpretation of the beneficial owner

4.1 Value of the OECD Commentary

Due to the difficulties in the interpretation of the beneficial owner limitation, the OCDE launched a public discussion draft for commentators to give their proposals in 2011 and 2012, which contributed to the changes of the OECD Commentary update in 2014. In theory, states should apply the present version of the Commentary, which frequently rises discrepancies between the original meaning agreed upon and the current one.

The interpretation of the meaning of beneficial ownership in light of the changes that occurred, distinctively in 2014, is governed by the general international principles of interpretation, in the Vienna Convention on Law of Treaties (VCLT) that indicates treaty interpretation rules in the Articles 31 to 33.

Article 31(3) VCLT states that along with the context of a treaty we must contemplate “any subsequent agreement between the parties” and “subsequent practice”. Secondly, since Art. 32 allows the use of supplementary means of interpretation is the

Commentary a mere instrument for interpretation or should it have a more substantial weight?

There is no harmonization between the authors on what exact binding force the Commentary carries, although the vast majority agrees that they are relevant under the VCLT. In our understanding, considering it is an expression of the international tax community positioning and the *status quo,* the Commentary is undoubted of important value[7]. However, many other practical issues emerge from this position, such as the effect of the evolution of the actual meanings intended by the drafters – may even lead to contradictions in the intended meaning applied by the contracting states in the treaty (meaning at the time *versus* the current meaning).

In other words, the Commentary sheds light on the determination of the concept of beneficial ownership, at least as intended in the OECD view, which does not accommodate a broad approach.

On the one hand, the Commentary is not enforced with the same formal requirements as the actual Treaty, so it would be unwise to give it a compulsory role. On the other hand, contracting states may distance themselves and make reservations to the provisions.

4.1.1 Partial Conclusions

We believe the OECD still aspires to guarantee a consolidated definition of beneficial ownership orientated in the direction of policy measures[8]. This approach seems, in our opinion, wise since it considers a specific time and context, rather than adopting an impartial academic view to interpret the concept. The introduction of the concept of beneficial ownership in European directives offered (very needed) legal certainty, free of the exposed hazards the questionable value the Commentaries carry.

[7] The Commentary is a manifestation of the will and tendencies of the trending occurrences in international tax law, presenting an interpretation to the BO concept at a certain time, considering its evolution and adaption to new realities (31 (2) b) VCLT).
[8] In agreement with Felipe Vallada.

4.2 Domestic *versus* autonomous approach

Relevant questions were raised during the revision of proposals of the Working Party I on the beneficial ownership concept, namely the divergence between authors that supported the elimination of the domestic law reference and those who defended the applicability of the domestic law meaning should be addressed directly[9]. Another problem that we may encounter is having the domestic law applying further requirements to the beneficial ownership (e.g., demanding the distribution to occur with a certain temporal limitation or size). On the contrary, some commentators defend there should be an autonomous interpretation established on an international contextual meaning[10].

4.2.1 Partial Conclusions

It is our view that interpreting the beneficial ownership according to the domestic law of each jurisdiction would shrink the scope and reduce the technical meaning of the concept since many countries do not have the beneficial ownership concept implemented, causing the undesirable scenario of arbitrary decisions[11].

4.3 Legal versus economic approach

There is also no consensus if to determine the scope of the beneficial owner we must adopt a legal or, on the contrary, an economic approach (commonly associated with formal or factual factors respectively). The OECD Commentary apparently did not embody one approach, leaving it for the contracting states to set a position.

From the legal perspective, the beneficial owner is the person who is legally entitled to enjoy the income, interpreted according to a legal obligation deriving from either a contract or a legal provision.

Supporters of a formal definition defend that the concept of beneficial ownership was meant to be restricted for the cases of agent and nominees, as they were outlined in the OECD Commentary of 1977, to specify the meaning of "paid to". However, as De Broe stated this was only a negative definition for the concept, not limiting it strictly. We

[9] OECD Model: revised discussion draft on the meaning of "beneficial owner", *Autonomous versus domestic law meaning of the concept of "beneficial owner*".
[10]Interpretation followed in the case *Indofood Case*, Court of Appeal, 2 March 2006, *Indofood International Finance Ltd. v. JP Morgan Chase Bank NA*.
[11] The OECD later settled this dispute by favouring an international tax approach in the 2014 update.

believe agents and nominees were the only ones mentioned because it simply is not easy to find unanimity among the states and these were the institutes that all parties agreed to. It becomes, however, a context prone to treaty shopping[12], to adopt a more restrictive interpretation of the concept, since we neglect economic and material circumstances that could prevent those abuses.

Authors such as du Toit[13] advocate that conduits do not fulfil the beneficial ownership requirement only in situations where the company has a legal or contractual obligation to pay that received income.

To summarize, the legal approach has many advantages, such as providing security and certainty to the taxpayers, which are paramount values in stimulating international transactions but also faces the foregoing constraints.

From an economic perspective, the legal elements are still components used in the analysis, but we apply the tonic to the substance-related factors. This interpretation is frequently found in case law argumentation. One of the most recognized commentators in favour of the substance-over-form approach is Vogel, who defends that these components carry special importance when accessing the beneficial ownership of the income. The expression "for its own benefit" also implies there must be an economic benefit for the recipient of the payments. A problem this approach presents us is the risk of getting arbitrary decisions, without a rigorous set of criteria.

The question now is: did the OECD intend to adopt an approach that privileges a substance-over-form examination? Despite being defended by some authors[14], it does not seem that way: values such as legal security and certainty are crucial and so only a limited economic perspective would be feasible, making its application difficult since contracting states are not harmonized. The question we should now make is whether it is legitimate to embrace uncertainty in favour of fighting tax avoidance[15].

[12] By inserting a holding company into a structure with the only intention of obtaining a treaty benefit, granted to the intermediary resident who received the income.
[13] C. P. du Toit, in *Beneficial Ownership of Royalties in Bilateral Treaties*.
[14] Such as S. Jain, in *Effectiveness of the Beneficial Ownership Test in Conduit Company Cases*.
[15] As we will examine, in the *Danish cases* the ECJ adopted the economic approach.

4.3.1 Partial Conclusions: hybrid approach

Regarding that none of the exposed approaches have led to ideal solutions separately we believe the determination of the beneficial owner should contemplate the "targeted hybrid approach" proposed by Adrian Wardzynski. An approach combining the features of the two previously mentioned perspective that gathers the best of both worlds and is apparently welcomed on the Commentary update of 2014. The author calls this approach targeted since the main approach would be legal and only in certain cases of abuse we would resort to the factual circumstances. Essentially it perceives the beneficial owner with traits weighting on legal factors and with a required economic/substantial examination to avoid treaty shopping.

5. Beneficial Ownership in the OECD Model and Commentary

5.1 Evolution of the concept

The analysis of the scope of the beneficial owner requires us to briefly analyse its evolution in the OECD MC and the Commentaries after its introduction in 1977. The 2003 Commentary, stated that the beneficial ownership should not be read in a narrow technical sense but instead it should be perceived in the context of the Double Tax Convention intent and object, opening the way to a broader approach[16].

The revised draft of 2012 made alterations to Articles 10 and 11 for clarification purposes to make the language of these articles clearer but no substantial modifications. Conduit companies will be denied the beneficial owner qualification if they behave in the same way as an agent or nominee would behave, as a mere fiduciary or administrator on account of the person who will receive the benefit from the income. It is important to note that conduits do not fulfil the requirements for the beneficial owner status because of the flow of dividends from a subsidiary to a conduit and from the conduit to the parent (it is the parent that has the right to use and dispose of the income).

Whether the concept should have different meanings when regarding dividends, interest or royalties was questioned by drafters and the Working Party answered

[16] *OECD Model: Commentary* on Articles 10, 11 and 12 (2003) paras. 12, 8 and 4. In these passages, it is stated that when the recipient simply acts as a conduit for another person who benefits from the income, the recipient does not fall in the beneficial owner status. Furthermore, the taxing right of the state of source is still limited if an intermediary is interposed but the beneficial owner resides in the other contracting state.

negatively, stating that even though they constitute different institutes, the same principle should apply. We agree with this positioning as it would reveal an impracticable situation to define specific criteria for each instrument and gather consensus on the definition.

In the 2014 OECD Commentary, several clarifications were made addressing the beneficial ownership. We will highlight the principal ideas to retain from this instrument, starting with the clarification that the beneficial ownership concept does not refer to any technical meaning applicable under the domestic law of a specific jurisdiction, thus an international tax approach is preferred when interpreting[17].

As we can read from the summary of the comments, many authors alerted of two important aspects to consider among the finance industry: 1) financial institutions in their normal activity[18] and 2) the risk itself this field of business is associated with. We consider that these situations should be perceived as being under the scope of beneficial owners, as a safeguard, since their interest are primarily exposed and in peril. We agree with the commentators that supported the deletion of the word *full* in the phrase "full right to use and enjoy dividend", as it represented an exceedingly wide conjecture and could include legitimate cases (e.g., banks, holdings, unit trusts).

It is important to note the commentary on art. 10[19], as it provides fundamental clarification to the beneficial ownership. First, we have the cases where the recipient of the dividend, does not fall into the scope of the beneficial ownership: agent, nominee, fiduciary company and administrator, since the "right to use and enjoy" the income is restrained by a contractual or legal obligation to pass it (*on-payment obligation*). The logic for this is that frequently, intermediaries are not persons subject to tax for the received income.

Secondly, to demonstrate on-payment obligations authorities should resort to legal documents, however, they can also make use of facts and circumstances showing the recipient of the income does not have an unconstrained right to use and enjoy that income, in substance.

[17] *OECD Model: Commentary* on Article 10, 11 and 12 (2014) paras. 12.1, 9.1 and 4.
[18] "(…) hedging/managing/trading that risk as part of its normal business activities (…)", in OECD Model: revised discussion draft on tax treaty issues.
[19] Summary of the comments received on the para. 12.4 and explanations of the changes made, in OECD Model Tax Convention: revised discussion draft on tax treaty issues.

The expression "facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy"[20] requires further examination. There are two divergent doctrines to consider regarding this paragraph. One is that the OCDE contemplates the substance-over-form approach to determine the beneficial owner. The second is that facts and circumstances can be used *only* to prove the existence of an obligation, with an instrumental purpose of identifying a contractual or legal obligation to pass on the income. According to Daniel Gutmann, facts and circumstances should be instruments to demonstrate there is a legal obligation in question, so it does not collide with the beneficial ownership.

Another important aspect to analyse is the wording chosen in this paragraph, namely the word "clearly" that insinuates we must be in presence of an explicit situation, with more than enough factual elements to lead to a situation of abuse, that may differ from the conclusion the legal elements demonstrate in the case, meaning a heavier burden of proof for the economic factors. This level of certainty is only required for the substantial test and not for the legal requirements since the expression used in the text when referring to the latter is "will normally derive".

Paragraph 12.5 settles some debate around the juridical nature of the beneficial ownership recognizing the concept is not a broad anti-avoidance rule (at the very least it tackles some forms of tax avoidance).

In addition, the revised proposal reminds us that the concept of beneficial ownership was originally meant to clarify the expression "paid to" and does not regard the "ultimate effective control", i.e*.,* the actual ownership of shares of a company paying dividends[21]. In other words, it is established that the concept of beneficial ownership does not concern the owner of the asset originating the income. The BO aimed at uncovering the true link of those who had a void connection with the income, acting as intermediaries (agent or nominee), exposing the actual nexus between income and recipient.

The 2014 OECD Commentary also clarifies a few more questions that are worth mentioning: i) treaty benefits can be denied to the beneficial owner of the income based on another anti-avoidance rule; ii) beneficial ownership does not prevent other anti-abuse rules from being applied to tackle treaty shopping and iii) it is still possible to have

[20] *OECD Model: Commentary* on Article 10 (2014) para. 12.4.
[21] OECD Model: Commentary on Article 10 (2014) para. 12.6.

reduced taxation in the state of source when there is an interposition of an intermediary provided the beneficial owner of the income is resident in a contracting state[22].

The 2017 Commentary provides another clarification, stating that even though the concept of beneficial ownership deals with tax avoidance (through the interposition of a recipient who has an on-payment obligation), it does not cover all cases of abuse mentioned in other provisions. This means that the concept should not be expanded and reinforcing it is not a broad anti-avoidance rule.

The new preamble for 2017 makes an important reference to the problem of tax treaty shopping stating that contracting states are invited to eliminate double taxation in the taxes under agreement on the treaty, while not originating opportunities for non-taxation or reduced taxation[23]. It is also fundamental to remember that when interpreting treaty provisions and concepts, following with Article 31(2)(a) VCLT the preamble must be taken into consideration as an interpretation element.

The examination of the 2017 Commentaries requires us to look at paragraph 12.4 where a substance-over-form approach is endorsed since it is stated that there is no requirement to have a contractual or legal obligation for us to conclude we are in the presence of an on-payment obligation. Such obligation can exist and be demonstrated with facts and circumstances showing that "in substance, the recipient clearly does not have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person"[24].

5.2 Partial Conclusions

Under OECD Model and its Commentary, the beneficial ownership serves the purpose of restricting the right to tax on dividends, interest and royalties on the state of source while assuring appropriate taxation of business profits. The concept under the OECD perspective is not a narrow technical term and the 2014 changes indicate a broader approach of the term (even though that was not the intent originally). Nevertheless, it

[22] OECD Model: Commentary on Article 10 (2014) paras. 12.5-12.7.
[23] As para. 1 of the *OECD Model: Commentary* on Article 29 (2017) confirms the contracting states in the process of eliminating double taxation, the states must not create opportunities for non or reduced taxation either through tax evasion or avoidance, which includes treaty-shopping arrangements.
[24] *Idem on Article 10*, para. 12.4.

remains unclear whether the OECD was aiming for a substance-over-form approach or a "legal substance" analysis.

5.3 Fulfilling the concept

It is essential to take into account the Commentary on Art. 10 which mentions that since the Model does not set any subject-to-tax requirement in the State of residence to allow the relief of tax in the State of Source it is under the discretionary powers of the contracting states to decide if they want to establish such condition[25].

In our opinion, the comments on Art. 10 provide us with an important direction towards the fulfilment of the concept in light of the principles of non-double taxation as well as Single taxation (assuring the income is taxed). Considering these principles and that the DTC itself provides for withholding tax exemption in the State of Source if the entity does not pay tax accordingly in the State of residence no double taxation arises.

The OECD leaves, therefore, an open possibility for the beneficial owner status to be conditioned upon the dividends being subject to tax in the State of Residence, although leaving it for the contracting states to decide upon negotiations.

We believe that to solve the current issues with the definition of the term an objective solution, welcomed under the Commentary as we just observed, would be to examine if the interposed party who presents himself as the beneficial owner is effectively going to pay tax. If the dividends are subject to tax, then the main purpose underlying a Double Tax Convention is secured.

6. Beneficial Owner in European Union Tax Law

European Union tax law and international tax treaty law are not harmonized fields and so they do not share the same interpretation methods. The latter is bound by customary international law, codified as it is known in the Vienna Convention on the Law of Treaties, while EU law has its own principles.

[25] *Idem* on Article 10, para. 12.7 "It does not specify whether or not the relief in the State of source should be conditional upon the dividends being subject to tax in the State of residence. This question can be settled by bilateral negotiations."

Considering the lack of harmonization in the EU, it falls under the umbrella of the competences of Member States (MS) to legislate and determine the lines of their taxing system, as long as they do not breach the exercise of the EU fundamental freedoms. These freedoms should be available to the taxpayer even if a certain operation is made to save tax if they are genuine operations.

In the EU context, many financial transactions are taxed in a domestic context from tax authorities which may be exempted or relieved from those, in accordance with a Double Tax Convention or a community Directive.

The fact that the MS have different taxation rules and treaties concluded presents difficulties for the functioning of the internal market, which prompted the enactment of the Parent-Subsidiary Directive 2011/96/EU (PSD) and the Interest and Royalties Directive 2003/49/EC (IRD) regarding direct taxation on passive income[26].

Furthermore, even though we found a certain level of harmonization on anti-avoidance rules regarding corporate income taxation, with the implementation of the Anti-Tax Avoidance Directive 2016/1164, Member States are still free to regulate other ones.

The beneficial ownership term developed its (almost autonomous) path in the EU law, specifically whilst in the Interest and Royalties Directive being first included in 2003. This Directive, unlike the Parent-Subsidiary, contains an inclusion of the BO requirement. Both directives share the objective of achieving harmonization on direct taxation, abolishing double taxation on the economic operators of the internal market.

The IRD sets out an anti-abuse clause, permitting the MS to withdraw the Directive benefits or deny their application when the principal motive or one of the principal motives is tax evasion, tax avoidance or abuse – in such situations, we can also invoke the general EU law principle of the prohibition of abuse of rights.

According to the proposal for a Council Directive submitted by the European Commission[27], the beneficial ownership requirement was first mentioned without a reference to the OECD materials[28], stating the purpose of the concept is to assure that the

[26] Also, on double taxation the Merges and Acquisitions Directive 2009/133/EC.
[27] COM (98) 67 Adjusted proposal for a Council Directive on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.
[28] Contrary to other concepts that are referenced (e.g., interests and royalties).

withholding tax exemption is not obtained wrongfully with the interposing of an intermediary.

Nonetheless, it is very likely that the EU legislator was inspired by the OECD MC, on the making of the 1998 proposal to include the beneficial ownership limitation in the IRD. Since the Model was "the long-standing standard" aiming at the elimination of multiple taxation systems among signatory states, the IRD borrowed some definitions, thus the discrepancies accompanied, such as the questions raised by the beneficial owner limitation.

The scope of the IRD, under Article 1(1) regards the exemption of taxation on interest and royalty payments in their source Member State when the recipient is not the beneficial owner of the payment, applicable when in relation between companies and Permanent Establishments (PE) in two different Member States, as long as the beneficial owner of the income fulfils the requirements from Art. 3 of the Directive. The goal of this directive is to assure equal treatment of national and cross-border transactions between associated companies as well as the single taxation of interest and royalties. This means that the IRD aim is not only the elimination of double taxation operating between the different Member States but also to assure such operations are taxed in one of the Member States involved.

The IRD defines the beneficial owner status (for corporations)[29] in Art. 1(4): "a company of a Member State shall be treated as the beneficial owner of interest or royalties only if it receives those payments for its own benefit and not as an intermediary, such as an agent, trustee or authorised signatory, for some other person".

The beneficial ownership under the Article above is an actual objective condition for the qualification of residence of a company of a Member State to enjoy the exemption of withholding tax on interest and royalties. To fulfil the "intermediary", which is a negative requirement, there must be either an arrangement between entities (one being the beneficial owner and the other the direct recipient of the income willing to pass it to the first), or a legal obligation for the recipient to transfer to the beneficial owner.

[29] On the other hand, when it comes to PEs, in accordance with Article 1(5) IRD, the fulfilment of the BO rule happens when the interest or royalties are effectively connected to that PE and the payments are subject to taxation in the Member State.

Moreover, to fulfil the qualification of a company of a Member State, the company must be subject to taxation under that Member State (positive requirement), without being exempt (negative requirement), according to Articles 2(a)(iii) of the PSD and 3(a)(iii) of the IRD. In what concerns the subject to tax requirement for PEs it is required that the income must be imputed to a subject liable to tax, under the jurisdiction of a MS.

In favour of the economic approach, there is the requirement that the BO is the person who receives the income *for its own benefit*, leading us to the conclusion that there must be an economic benefit for the recipient. We must now question if receiving the said benefit would be sufficient to qualify the recipient as the beneficial owner right away.

There are also convincing arguments that favour a narrow and legal approach. For instance, the BO requirement highlights the legal qualification of the person receiving the income. In our opinion, this approach carries fragilities since the recipient that receives the payment in its own name and account will be qualified as the beneficial owner even if the recipient passes it on, almost completely, to another individual. For this reason, the ECJ has made clear that under the application of the PSD the minimum holding period is a requirement to be interpreted strictly. Does this mean the beneficial ownership limitation should also be interpreted strictly?

The European Commission published a report based on the case law of the ECJ clarifying that, under the scope of Art. 1 of the IRD, the beneficial owner concept aims to tackle artificial conduit arrangements[30].

There is no doubt, however, that the aim of the IRD is the elimination of double taxation on interest and royalty payments between associated companies in different Member States, as well as that the mentioned payments should be subject to taxation once in a Member State[31].

We must also acknowledge that the requirement of the beneficial ownership is itself a restriction for the applicability of the Directive benefits which if applied to a cross border transaction intra-EU may result in a restriction for the exercise of the fundamental

[30] Report from the Commission to the Council in alignment with Art. 8 of Directive 2003/49/EC on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.

[31] "It has been held, in this regard, that it is apparent from recitals 2 to 4 of Directive 2003/49 that the aim of the directive is that double taxation should be eliminated with respect to interest and royalty payments between associated companies of different Member States and that such payments should be subject to tax once in a single Member State" in joined cases C115-16 (IRD) para. 85.

EU freedoms, specifically freedom of establishment and freedom of capital movement. However, anti-avoidance rules restricting or making less favourable the exercise of EU freedoms are deemed justified if they are proportional.

Since the purpose of the BO limitation is to tackle abusive arrangements if we do not make an introspection on the artificiality of the arrangement itself, the result may be that a transaction that is not artificial, economically benefiting residents in third countries would be undermined.

7. Danish cases

7.1 Introduction

The European Court of Justice (ECJ) issued, on 26 February 2019, six cases in *T Denmark and Y Denmark* (joined cases C-116/16 and C-117/16, herein 'dividend cases') and in N Luxembourg I (joined cases C-115/16, C-118/16, C-119/16 and C-299/16, herein 'interest cases') interpreting for the first time the beneficial ownership limitation.

The decisions got known as the Danish Cases and regarded whether dividend and interest payments were exempt from withholding tax through the application of the IRD and the PSD made by a Danish company to a parent company resident in the EU which then passed on those payments.

The cases go back to 2010 when the Danish tax authorities challenged multinational and investment funds that made structures on their investments to apply the Directive, through intermediary holding companies in other Member States and obtain an exemption, acquiring a convenient tax route to then pass the income to third countries.

Regarding more specifically the interest cases, it was at stake interest paid by Danish companies to other related companies in the EU Member States who paid the interest to companies based outside the EU[32]. US corporations were the ultimate owners of groups of companies reorganizing their structure to introduce intermediate holdings in the EU, which in this case culminated in Danish companies paying dividends to EU holding companies intermediates (both in Cyprus and Luxembourg).

[32] We will focus our analysis on the IRD joined cases since the BO requirement is directly addressed in these rulings only and the PSD did not include a definition of the term.

It is important to note that the Danish jurisdiction did not contemplate the transposition of Article 5(2) of the IRD into domestic legislation for the Danish authorities to invoke a statutory provision and neither contained the concept of beneficial owner in Danish law.

Regarding the just mentioned article, it is worth mentioning that the Member States shall in a situation of evasion, avoidance or abuse, withdraw the benefits of the Directive or deny its application. In the same sense, it cannot be interpreted as excluding the application of the principle of EU law that abusive practices are prohibited, whereas the application of that principle is not subject to a requirement of transposition[33].

7.2 Main findings of the Court – Analysis and critics

The Court initiates the analysis affirming that the beneficial owner concept, regarding the interest, under the directive is not interpreted referring to domestic laws that have different scopes, settling down some controversy[34]. This is enough evidence to conclude that the ECJ supports an autonomous interpretation of the concept, which we defend as well.

The Danish tax authorities argued the structures abused the IRD and thus the EU companies who received the payments should be denied the application of the Directive. By inserting a conduit company with residence in another Member State, with the only purpose being the channelling of the income to non-EU countries, without paying withholding tax in Denmark, or any other Member State for that matter, the tax was avoided. One of the questions the national Danish court submits is whether a provision containing the beneficial ownership requirement in a DTC between Member States constitutes an agreement-based anti-abuse provision covered by Art. 5 of the IRD and Art. 1 of the PSD. The Court does not provide an answer, invoking the general principle that the EU cannot be relied on for abusive or fraudulent ends[35].

[33] In that sense, *Cussens and Others*, C-251/16, EU: C:2017:881, paras. 28 and 31 *ex vi* joined cases C115-16 (IRD) paras. 104-105.
[34] Joined cases C115-16 (IRD) para. 84.
[35] We call the attention of the reader to the importance of this question keeping in mind as we said earlier the PSD does not contain a beneficial owner rule. If the Court had answered positively the PSD would also be subject to the beneficial owner limitation.

In its rulings, the Court made references to the OECD MC, the commentaries and DTCs concluded by Denmark, concerning the concept of beneficial ownership. The court also concluded that some conduit companies are excluded from the beneficial owner concept that were included in the commentaries of 2003.

The fact that the OECD members are not necessarily the Member States of EU, presents in our understanding an obstacle to automatic assimilation of the OECD approach, despite our awareness that the EU legislator sought inspiration in it. Tackling the (lack of) democratic legitimacy argument brought by the applicants, AG Kokott affirms that the OECD MC shall not have a direct binding effect on the EU directive since they do not correspond to the views of the EU legislature, concluding for an independent and autonomous interpretation under EU law, despite the similarities it may transport[36].

The Court also mentioned that apparently, from the 1998 proposal, the IRD "draws upon Article 11 of the OECD 1996 Model Tax Convention and pursues the same objective, which is avoiding international double taxation", which means we must have both legal instruments in consideration while interpreting[37].

Stated differently, the OECD materials serve as a foundation for the fulfilment of the meaning of a pre-existent concept, not a new one[38]. The question now is to what exact extent does this relevance go. One possible conclusion from the Court's decision is that under EU law, we should interpret beneficial ownership according to the definition conveyed by the OECD since it has proven relevant in interpreting the IRD.

The ECJ affirms that following the development of the OECD Model it is translucid the beneficial owner concept *"excludes conduit companies and must be understood not in a narrow technical sense but as having a meaning that enables double taxation to be avoided and tax evasion and avoidance to be prevented*", i.e., the term must give effect to both objectives[39].

Furthermore, the ECJ defended that the beneficial owner of the interest is the entity who *actually* benefits from the interest paid to it, and not as an intermediary, being

[36] Opinion of AG Kokott, Case C-115/16, paras. 48-55; Joined cases C115-16 (IRD) para. 91.
[37] Joined cases C115-16 (IRD) para. 90.
[38] Although no reference is made in the 1998 Proposal to the BO concept of Article 11 from OECD MC, the Court concluded that the BO term appearing in DTCs (deriving from the Model plus its' amendments) and the Commentaries are relevant to interpret the beneficial ownership concept under the IRD.
[39] Joined cases C115-16 (IRD) para. 92.

established in a Member State and that the term refers to the economic reality, applying a teleological and a textual reading of the Directive[40].

The reasoning for the court's conclusion for the economic reality is on paragraphs 86 to 90 of the C-115/16, from where we highlight the argument that since there are different translations for the concept found around the European languages in which we find the references to the "ownership", the "entitlement to use" and the "end entitlement", the term cannot mean a formally identified recipient but instead means the one who benefits economically, as the common trait throughout the different languages.

Keeping in mind what we concluded earlier, concerning the 2014 update on the Commentary favouring a legal approach, it is not without astonishment that the Court reignites the debate, that was starting to see closure, in the opposite direction.

One important assertion made in the rulings is that if we were to allow financial arrangements where the sole purpose is obtaining a tax benefit, under the IRD, we would be defeating the directive's objectives, as well as undermining the economic cohesion and the effective functioning of the internal market by distorting the conditions of competition.[41] Notwithstanding, AG Kokott alerted the ECJ that we do not require the sole purpose of the arrangement to be exclusively the pursue of a tax advantage, as it is sufficient for the arrangement in place to be motivated by an essential aim of obtaining said benefit[42].

In this context, the ECJ made a brief note worth referring of the existent right of the taxpayer to pursue the most favourable tax regime, if it is not based on fraudulent or abusive designs[43]. On the other hand, the taxpayers attempted to invoke *Kofoed* (which regarded the application of case law based anti-avoidance doctrines), although unsuccessfully since the Member States must refuse to grant the advantage, following the general principle that abusive practices are prohibited[44].

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[40] Joined cases C115-16 (IRD) para. 88; De Broe, however, states that the Court is not convincing in its analysis, since we cannot "reasonably conclude on the basis of the aim, scope and some language versions of the IRD that an economic interpretation prevails" in *Current Tax Treaty Issues*.
[41] Joined cases C115-16 (IRD) para.107.
[42] AG Kokott Case C-115/16, para. 63.
[43] For this, the ECJ referred its' relevant case law, Joined cases C115-16 (IRD) para 109: *Cadbury Schweppes and Cadbury Schweppes Overseas; National Grid Indus* and *SECIL*.
[44] Joined cases C115-16 (IRD) paras. 117 and 120.

Now that we have reached this point in our analysis, it is pertinent to make one interesting observation: the ECJ does not make use of the 2014 update to the Commentary on its argumentation, instead, the court holds on to the 2003 Commentary, which was less clear. This presents some surprise as well as confusion as to why did not the court engage in a dynamic interpretation.

7.2.1 Partial Conclusions

The Court favoured the autonomous beneficial ownership term[45] and drew attention to the OECD's beneficial ownership term being *relevant* in the interpretation of the term under the IRD.

The taxpayer has a right to pursue the most favourable tax regime. To be in the presence of abuse it must be established that the main purpose of an arrangement was to obtain a tax benefit and that it frustrates the Directive objective and purpose.

The ECJ did not provide an answer for many technical and complex questions the case presented, one of them being a clear answer on the (lack of) transposition of the Directive's rules. The Court held that a specific domestic or agreement-based provision to implement Articles 1(2) PSD and 5 IRD is not necessary as Member States may rely on the (abstract) general principle that EU law cannot be relied on for abuse or fraudulent ends[46]. As scholars expose, the fact that a Member State did not transpose a directive is a manifestation of its sovereignty on tax policies, namely, to grant certain benefits under their jurisdiction[47]. The non-implementation of those norms is not irrelevant and carries consequences, according to the authors "cannot logically be subject to an unwritten EU general principle that prohibits abuse of EU (and not also domestic) law"[48]. Likewise, AG Kokott defended that a directive cannot be applied directly to create obligations for the taxpayer.

[45] Since the court does not present us with a precise meaning for beneficial ownership, the concept must be fulfilled on a case-by-case approach considering facts and circumstances.
[46] Joined cases C115-16 (IRD) paras. 95-120.
[47] W. Haslehner and Georg W. Kofler: "(…)There is indeed evidence that this was a very deliberate decision by the Danish legislator not to implement anti-abuse provisions".

7.3 General Principle of abuse of rights

The ECJ presents us with an analysis of its case law on the principle that EU law cannot be relied on for abusive or fraudulent ends and proceeds to display the elements that uncover a situation of abuse.

To delineate an abusive practice, we must assess if objective circumstances and a subjective element are met cumulatively. The first group mentioned refers to the analysis of facts that even though pointing to the formal observance of the norm, contradict the purpose of the norm (*ratio legis*). The second refers to the intention of obtaining a benefit through the artificial transaction created essentially for that purpose.

The Court provides us indicators that show the absence of a genuine economic activity of a conduit company (i.e., when the sole activity of the company is to receive interests or dividends and transfer them again to another company)[48]. The ECJ defines "artificial agreement" as i) a group of companies set up for reasons that do not reflect economic reality, ii) with a purely formal structure and iii) whose principal objective or one of its principal objectives is to obtain a tax advantage that is not intended by the aim of the applicable tax law[49]. With the interposition of the conduit entity in the group's structure the tax on the income is avoided.

On another note, it is interesting that elements typically applied to a BO analysis are displayed instead under the examination of the assessment of an artificial arrangement. Some clear examples are the cases where the interposed entity passes all or almost all of the interest or dividend shortly after its receipt, makes an insignificant amount of taxable profit or its inability to have an economic use of the income receive[50].

Having in mind the aim of the IRD, we believe that the level of connection between the intermediary and the state does not hold a higher importance than the manner the income is passed to the other entity, i.e., the circuit of the income and how much of it is conceived artificially[51].

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[48] The mentioned indicators to consider are "the management of the company, to its balance sheet, to the structure of its costs and to expenditure actually incurred, to the staff that it employs and to the premises and equipment that it has" in joined cases C115-16 (IRD) para. 131.
[49] Joined cases C115-16 (IRD) para. 127.
[50] Joined cases C115-16 (IRD) paras. 128, 130, 132.
[51] Regarding as to whether a conduit is artificial: "to what extent it receives the relevant item of income in an artificial fashion", Robert Danon in *Current Tax Treaty Issues*.

The Court does not examine the burden of proof for the beneficial owner requirement *per se* in the rulings, addressing the burden of proving the abuse of rights instead. The ECJ held that tax authorities can request evidence from the taxpayer "for a concrete assessment of the taxes and the duties" and if the taxpayers do not comply the benefit can even be refused on that basis[52].

In this regard, the ECJ declares that to deny a company the BO status of the interest tax authorities are not required to identify the entity of the beneficial owner of the income, as such tax may be unfeasible, but they have the tax of establishing the (supposed) BO is merely a conduit[53].

An issue encountered by this reasoning is that we may encounter third parties benefiting from the income economically without fulfilling the beneficial owner status, so tax authorities may be prone to deem it an abusive situation, following the Court's perspective[54].

In conclusion, there is an undeniable connection between the beneficial ownership term we have been examining and the abuse of EU rights in the Danish cases, the two terms are intertwined. The fact that the taxpayers pursue the most favourable tax regime cannot be regarded as a presumption of fraud or abuse. Notwithstanding, the general principle that abuse is prohibited is applicable when we are in the presence of an artificial arrangement and the taxpayer obtains a benefit in a manner not consistent with the objectives of the rule, jeopardizing its purpose[55].

8. Differences between OECD and the ECJ rulings

The principal discrepancies found in the ECJ decisions that differ from the OECD reside in the exclusion of the unconnected obligations from conduits – operated by the commentaries. Meanwhile, the court favours the economic approach, stating that the beneficial owner is the person who economically benefits from the interest payment and designates its use freely.

[52] Joined cases C115-16 (IRD) para 141.
[53] Joined cases C115-16 (IRD) paras. 142-145.
[54] For P. Hernandez adopting the court's reasoning would mean to trigger an automatic abuse analysis when beneficial owners are residents in third countries, based on the application of a broad meaning to the beneficial ownership concept as an abuse indicator.
[55] Joined cases C115-16 (IRD) paras. 102 and 109.

We can also assess that the Court favoured the economic interpretation of the beneficial ownership concept in the IRD cases from the reference to other languages meaning and their use in domestic jurisdictions, as the entity which benefits economically from the interest to support this approach, over the formal interpretation[56]. In fact, it operates a comparative analysis of the literal meanings of the term, consolidating a teleological interpretation with the different connotations the term carries in the different languages. For De Broe, this clarification is useful, as it serves the purpose of denying the beneficial ownership qualification to rude forms of conduit arrangement structures, although not sufficient to solve the existing interpretation issues[57]. The author makes an interesting point: if to access the qualification of the beneficial owner of the interest we check if the recipient paid it to a third party or not, then nearly no recipients will acquire the beneficial owner status.

The ECJ also indicated that even in the cases there is no on-payment obligation, it is possible that substantially the company does not have the right to use and enjoy the income. As we mentioned earlier, the ECJ overlooked the Commentaries updates of 2014 and 2017 concerning the cases when a conduit company, who does not have the economic benefit, can still be regarded as the beneficial owner of a payment, provided there is no obligation to pass on the income[58].

Although, even with an existent obligation to pass the income the recipient can be the beneficial owner if the obligation is not contingent on such payment, demonstrating a disconnection to the obligation, according to the OECD definition of beneficial ownership. According to J. Janssen and M. Garibay, for a conduit company to fulfil the beneficial owner status under the OECD perspective, it must have the capacity to terminate the relationship with the payee without depending on the receipt of the income.

While the OECD focuses on the connection of the obligation, the ECJ chose to focus the analysis on the core of the arrangement and whether it is artificial or genuine,

[56] Joined cases C115-16 (IRD) para. 89.
[57] The author presents an example of a company that right after receiving the income uses it to reimburse a loan, contracted with a financial institution; pay suppliers; employees or tax liabilities. One could say the company had no power to freely determine the destiny of the interest payment received. However, De Broe believes the company benefits economically earning the qualification of the beneficial owner.
[58] According to Baker, it is only when the recipient of income has a binding obligation to pay that particular income to another person that such recipient cannot be the BO. Also, in this sense, De Broe and Gommers.

based on the functionality it presents. In the ECJ's decisions, the concept of BO appears in connection with the abuse of law as we saw.

Showing abusive or fraudulent conducts will not be tolerated under EU Law, the ECJ applied the abuse of rights doctrine. In that sense, MS shall not be compliant and must disapply any benefits given to the taxpayer conceded under any directive or EU prerogative, despite having or not enacted anti-abuse measure, i.e., general or specific anti-avoidance rules – Denmark had not implemented Article 1(2) PSD and neither 5 IRD. Furthermore, the ECJ held that, according to settled case law, there is a general principle of EU law that it cannot be relied on for abusive or fraudulent ends and the principle also be complied by individuals (against a person) that involves EU law rules to obtain an advantage in a manner that is distorting the objectives of those rules[59].

There is still uncertainty on the application of ECJ beneficial ownership interpretation, outside the scope of the IRD, to other legal provisions. If we were to apply that same interpretation when DTCs refer to the beneficial owner, granting a benefit in situations regarded as abusive the EU Member States would need to disapply said benefits.

In the opposite direction of this line of thinking, we believe that the ECJs ruling should not interfere with rights given by DTCs or domestic law, since the basis for the Danish cases was the abuse of rights doctrine.

It is noteworthy that the AG affirmed the concept of the beneficial owner is to be interpreted autonomously and independently when applying the IRD from the OECD Model and the Commentaries, especially because since we are in the scope of EU law it must be in conformity with its own principles and primary law. In our opinion, the ECJ should have followed the same approach to end uncertainty in its interpretation, which seems to have the same final result.

Furthermore, AG Kokott stated that the beneficial owner is the one collecting payment in his own name and for his own account – thus excluding the authorized signatory (since they do not act in their own name) and the trustee (since it does not act

[59] Joined cases C115-16 (IRD) paras. 95 and 111.

for its own account)[60] – and adopted a more legalistic interpretation. AG Kokott upheld that the beneficial owner is the one who can claim the interest under private law[61].

It is important to note that, following the Court's doctrine, it is possible to apply the withholding tax exemption provided by the IRD to a company if the transferred item goes to the beneficial owner (as long as this second level beneficial owner is established in the EU and fulfils the requirements of the IRD)[62]. It is possible that the Court found its inspiration from the OECD Commentary, under which it is also conceivable to claim treaty benefits in situations where the beneficial owner receives the income from an intermediary, provided all conditions are met nonetheless[63].

We conclude that the ECJ adopts an interpretation of the beneficial owner concept much wider than the OECD MC and its Commentary because, on the one hand, the if defines it as the person who benefits economically and has the power to freely determine the use of the payment and, on the hand, the clear absence of a reference to the 2014 and 2017 versions of the Commentary in which a more narrow and legal approach would prevail.

9. Compatibility between EU tax law and international tax treaty law

An initial framing difference that we immediately come across when comparing the definition provided by EU law with the OECD materials is that the first distinguishes the concept on whether it is being applied to corporations or PEs – in Article 1(4) *versus* (5) – while the latter presents us only one definition.

The IRD beneficial owner concept (as applied to companies) and the OECD are very similar. Although, the OECD Commentary defines the term in a negative way, settling examples, whereas the IRD leaves an open definition of the subject who receives the payment for their own benefit as being the beneficial owner – positive requirement. In fact, the IRD provides some examples of intermediaries excluded, in a not exhaustive list – negative requirement.

[60] AG Kokott Case C-115/16, paras. 36-38.
[61] AG Kokott Case C-115/16, para. 54.
[62] Joined cases C115-16 (IRD) para. 94.
[63] *OECD Model: Commentary* on Article 11 (2017) para. 11.

Under the definition of the beneficial ownership term under the IRD, trustees are excluded from fulfilling the beneficial ownership status. However, it is possible for trustees to be qualified as the beneficial owner in some cases when we consider the OECD Commentary[64].

EU tax law and international tax law have each their own interpretation method. From one side, the interpretation of DTC is governed by customary international law, which is systematized in the Vienna Convention, as well as interpretation rules specifically drawn in the DTC[65]. On the other side, EU law has interpretative rules of its own, being the theological interpretation one of its highlights.

On a side note, we cannot proceed without mentioning that the European Commission published a report in 2009, clarifying that the beneficial ownership concept aims specifically at tackling artificial conduit arrangements while referring to the fundamental freedoms and tax abuse found in the case law of the ECJ. From here we see the first manifestations of the Commission implicitly stating the existence of a connection between beneficial ownership and the ECJ's case law on anti-abuse.

The focus of this analysis on the interpretation of the court, under the approach of the OECD, namely, how they interconnect and if they have a common ground.

When concerning bilateral double taxation treaties, the beneficial owner requirement aims for two objectives, as well as the IRD. The first is the determination of the personal scope of the DTC and the second to prevent treaty shopping (as an anti-avoidance rule would assisting the first aim mentioned).

Invoking Article 2(a) IRD, the Court defines interest as "income from debt-claims of every kind", making the beneficial owner the entity who receives interest which is, therefore, income[66] and Article 1(4) to state that a company of a Member State will be the beneficial owner if it receives the payments for its own benefit and not as an intermediary - agent, trustee or authorized signatory - confirming the need for an economic analysis.

[64] Namely, if the trustee does not proceed to the distribution of the income for a certain period, in accordance with *OECD Model: Commentary* on Article 10 (2017) para. 12.1.
[65] Article 3(2) OECD Model.
[66] Joined cases C115-16 (IRD) paras. 87 – 88; Also, in accordance with the judgment of 21 July 2011, Scheuten Solar Technology, C-397/09, EU:C:2011:499, para. 27.

The mentioned examples provided by the Directive of excluded intermediaries, however, interestingly diverge from the ones the OECD presents, as we have outlined already on this essay (agents and nominees).

It is also paramount to note that when asked by the national court if the interest's recipient may be denied the beneficial owner when, *in substance*, it does not have the right to use and enjoy the interest (although no contractual or legal obligation to pass the interest is found) the ECJ states that an assessment of the constituent elements of an abuse of rights under EU law is in place as we examined earlier.

To determine whether we are in the presence of a conduit company the ECJ suggests an economic (broad) analysis, which differs from the OECD limited approach. In the commentary of the OECD Model, it is important to keep in mind that concerning the purpose of obtaining a treaty benefit, it is sufficient that it was at least one of the principal purposes, without being necessary for it to be the sole or dominant purpose of the arrangement.

In the Danish cases, the court makes a crude interference with the discretionary powers of the Member States allowed by the PSD and the IRD, which only set a minimum harmonization.

Adopting a broad economic approach translates, however, in greater proximity of the beneficial owner rule to an anti-avoidance rule, as opposed to what the concept was originally introduced – the clarification of the term *paid to* in the OECD Commentary– more likely, as an attribution-of-income rule. Nevertheless, courts have been adopting an economic approach (i.e., substance-over-form) to fulfil the beneficial ownership and interpret it as a broad anti-avoidance rule.

In conclusion, there is no significant harmonization between EU tax law and international tax treaty law on what approach should be followed regarding the beneficial ownership and how to apply it. The absence of a common ground can create further problems regarding the obligations and compromises the EU Member States are bound under EU and, simultaneously, under international commitments and which one should prevail.

10. The Applicability of the ECJ's interpretation for the meaning of the beneficial ownership concept

10.1 Korean cases

The Korean Supreme Court (KSP) issued a ruling, in November 2018, that is useful to have in consideration in this examination. It regarded the beneficial ownership term in a DTC concluded between Hungary and Korea. According to the KSP, the Hungarian company fulfilled the beneficial ownership requirement under Article 10 of the DTC, since it was the person who enjoyed the benefits of the dividends paid by the Korean company, unconstrained by legal or contractual obligations to retransfer the income to another person[67]. The answer would have most certainly been justified along the lines of abuse of rights, applying the same ECJ's reasoning on the Danish cases.

10.2 Future applicability

It is worth reminding that the PSD did not include the beneficial ownership requirement for the tax withholding to take place, however, the ECJ inserted the beneficial owner term while applying the general principle of abuse of rights, which means it is now a condition as well for the exemption of the PSD to take place. The Danish cases served as an endorsement for the EU general principle of abuse of rights applied to harmonized jurisdictions within the Member States (safeguarding subjective rights).

The judgments provided useful enlightenment on the application of EU general principle regarding the abuse of rights on subjective rights. The ECJ did not address many questions of the Danish court as it was unnecessary: the application of the IRD and PSD benefits was denied under the general principle that abusive practices are prohibited under the scope of EU law[68].

In the assumption that ECJ did adopt a wider interpretation than the OECD did, it is now pertinent to question what approach should the courts take, following the Danish cases break through, while interpreting the beneficial ownership concept.

As we mentioned earlier, the ECJ failed to provide the national court with answers for complex matters (the beneficial ownership concept interpretation under the IRD and

[67] Supreme Court Decision 2018Du38376.
[68] Joined cases C115-16 (IRD) para. 96 and next.

prevention of tax avoidance with the application of case law doctrines or specific anti-avoidance clauses of tax treaties).

On the other side, while trying to fulfil the meaning of a treaty term, before further examination we must attend to Article 31 of the VCLT as it provides insight on the matter, establishing the "general rules of interpretation"[69]. Article 31(1)(c) of the VCLT provides clarification: we must consider external sources materials. Interpretation of international treaties should be made considering the normative system of the parties, which means they ought to be interpreted by reference to their legal systems, in a process of systemic integration with international public law.

We now face the dilemma of external sources having a determinant impact on the treaty interpretation, namely, in our case, the definition of the beneficial ownership concept as it is presented in the IRD. In our opinion, it has a necessary influence when the parties are the EU Member States, national courts are entitled (and maybe even demanded) to interpret the beneficial owner concept used in a treaty in accordance with the definition of the IRD, as well as the cases law relevant to the concept definition, namely the Danish cases[70].

The other way around is, however, arguable: is the EU law also relevant for the interpretation of treaties between one Member State and a third country – for De Broe the answer is negative.

In our opinion, it is irrelevant if the treaty was concluded before or after the IRD since Member States must pursue the meaning for beneficial ownership under the Directive since they are bound by the EU principles. Therefore, national courts must rule in accordance. with consistent interpretation in conformity with directive provisions, that fall on the same scope of the treaty, even referring to the Danish cases.

Given the debate is still going on, the Member States may feel inclined to deny the benefit of the Directive on the basis of the economic approach for the beneficial owner requirement being widely applied since a lot of cases can be excluded this way.

Some Member States have already upheld the ECJ's ruling on the Danish cases:

[69] The first paragraph does not help much our case, stating the treaty shall be interpreted in good faith, the second provides items to be taken into account regarding context.
[70] "If use of judicial decisions and teaching do lead to an identification of such rules, their use must be taken as acceptable in treaty interpretation." R. Gardiner – Treaty Interpretation (Oxford University Press 2008).

I. The Spanish Central Economic-Administrative Court decision of 8/10/2019[71];

II. France Conseil d'État decisions no. 423809 et al. of 5 June 2020;

III. Italy Corte di Cassazione decision no. 14756 of 10 July 2020;

IV. The Netherlands Hoge Raad decision no. 18/00219 of 10 January 2020;

V. Swiss Supreme Court decision 2C_354/2018 of 20 April 2020.

The High Court of Denmark ruled two of the PSD cases, C-116/16 T Danmark and C-117/16 Y Denmark Aps on 3 May 2021. In C-116/16, the High Court ruled in favour of the Tax Administration remarking the lack of documentation supporting the economic substance of the companies and the decisions behind the redistribution of the dividends.

On another note, C-117/16 was ruled partially[72] in favour of the taxpayer. The High Court stated that by disregarding the interposed entities the dividends distributed to the US ultimate parent company could still benefit from tax exemption, so there was no abuse of EU law. In fact, even though the BO of the dividends was a resident in a different country than the intermediaries it would still benefit from a DTC with Denmark, which means that tax at source would still not have been withheld.

In conclusion, the High Court operates a comparative analysis to deal with the cases of conduit companies by overlooking the interposed entities and determining if the beneficial owner above (if there is one) would still be entitled to the treaty/directive benefits in direct distribution.

11. Defining a practical scope for beneficial ownership

11.1 Legal certainty

The concept of beneficial ownership is often fulfilled by authors according to the link between the income and the recipient accessed under one determining element. Some authors resort to the *time* the income stays with the recipient before being passed on, other authors to the *intensity* of the control the recipient exercises on the income or the disposal powers the recipient shows.

[71] In these rulings, the court interpreted a Spanish cross-border exemption rule that provided withholding exception on interest for associated enterprises from the Member States as carrying the requirement for the beneficial ownership, despite it not being said in the rule.

[72] There were two groups of dividends causing different solutions applying to each.

As important as this discussion may be, this author proposes to view the BO concept in a practical manner, under the DTCs and EU principle of single taxation that has been gaining importance. Under this premise more importantly than determining if the beneficial owner *actually benefits* from the income under the perspective of academic theories proposed by different scholars is to ascertain if the owner paid tax once. The OECD materials, although not adopting this perspective, leave it as an option open to negotiation that we believe should be enforced, to bring legal clarity and needed certainty to the beneficial owner.

Nowadays there are numerous anti-abuse provisions that States can (or must) apply, as we mentioned earlier, which brings us to the important goal of achieving legal certainty for a taxpayer that plans his business.

11.2 Subject-to-tax test

The subject to tax test refers to a particular item of income, some authors defend it requires effective taxation while others just being within the scope of charge, without the need for effective taxation. Although the Directive does not stipulate an actual taxation requirement for the beneficial owner, the ECJ in the Danish cases interpreted Art. 3(a)(iii) IRD as meaning that the dividends must be effectively taxed without being exempt[73].

For certain instruments, such as dividends, interests and royalties, it would be required that the subject is liable-to-tax in the state of residence and the income subject to taxation. In other words, we would require liability-to-tax income derived from sources that are not in a contracting state to access treaty benefits for trusts, nominees and other intermediaries.

With a subject-to-tax requirement, the country of source would "abandon" its right to tax on the assumption the country of residence taxes the income. The IRD does not contemplate such taxation requirement (except in the cases of permanent establishments) regarding the beneficial owner status.

[73] Joined cases C115-16 (IRD) para. 147: "Third, it must be subject to one of the taxes listed in Article 3(a)(iii) of Directive 2003/49 without being exempt, or to a tax which is identical or substantially similar and which is imposed after the date of entry into force of the directive in addition to, or in place of, those existing taxes".

The Court took a different direction from the main perspective that had been in place, previously viewing the subject-to-tax test as a general liability of the subject and not the income.

For the IRD to be applicable we must be in the presence of a company of a Member State which requires the company to be subject to corporate taxes without being exempt. According to the Court's doctrine, this requirement refers to the treatment given to the company's income and not the company as a taxable person, which means it is an objective requirement and not a subjective requirement[74].

Finally, to support this position the Court states that if the passed interest is exempt from corporate income tax in Luxembourg (even though it is liable-to-tax) the company cannot qualify as a company of a Member State, failing the three prong-test established in Article 3(a)(iii) of the IRD. That is to say that the recipient must be taxed in its state of residence to be considered the beneficial owner[75].

On the contrary, companies with a zero-tax rate on their profits should be excluded from the application of the Directive since there is no risk of double taxation, which is what we are aiming to avoid in the first place.

Furthermore, the EU Commission has submitted proposals in 2003 and 2011 that point towards an objective reading of the subject-to-tax requirement for companies which would work in a similar way of the BO test for permanent establishments already set by Art. 1(5) IRD. Following this reasoning, we believe no minimum rate or effective taxation (in the strict sense) should be required, since a company may not pay tax in a fiscal year due to losses, without meaning it is exempt. It is conceivable that no tax liability arises when there are loss carry-forwards, credits, or deductions and the beneficial ownership is not jeopardised[76].

Despite the ongoing debate surrounding the BO, the term has proved useful to avoid abusive situations, as the case law demonstrated. Considering that courts and national authorities currently are using their best endeavours to determine if an individual is legally and economically the beneficial owner, applying different weights to the

[74] In this sense see also CFE, "Opinion Statement ECJ-TF 2/2019 on the CJEU decisions of 26 February 2019 in Cases C-15/16, C-118/16 and 299/16, N Luxemburg I et al, and cases C-116/16 and C-117/17, T Denmark et al., concerning the beneficial ownership requirement and the anti-abuse principle in the company tax directives".
[75] Joined cases C115-16 (IRD) paras. 150-152.
[76] For a similar position see CFE Opinion Statement, idem 74.

possible factors and different approaches, we believe the analysis needs to include the actual payment of tax accordingly from the beneficiary.

12. Final remarks

In this section we will point a few notes that deserve mentioning before concluding this essay. In our understanding, the IRD should serve as an interpretation rule for Tax Treaties concluded between Member States, when the OECD does not present a clear answer. Although, P. Hernandez adverts for the possibility of ending into circular reasoning, considering the cases where the ECJ refers to the Model when interpreting the Directive[77].

With its origin in the international legal instruments on prevention of crimes and cooperation and exchange of information in tax international law, the Directive of Administrative Cooperation 2011/16/EU[78] also contains a beneficial ownership requirement, although with a different meaning and context from the IRD and tax treaties that we analysed.

The beneficial owner is not adequate, nor it intends to, deal with other cases of treaty shopping rather than addressing some forms of tax avoidance, namely the interposition of a recipient to pass the income[79]. The BO limitation is also not suitable for tackling treaty abuse through other distributive rules, other than the channelling of dividends, interest and royalties where our analysis was concentrated (for example, it is not suitable for capital gains).

[77] The Commentary will be used to interpret the Directive, and the Directive will be used to interpret the Model, P. Hernandez, *Beneficial Ownership in Tax Law and Tax Treaties*.
[78] Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC.
[79] *OECD Model: Commentary* on Article 10 (2014) para. 12.5: "It does not deal with other cases of treaty shopping and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases".

13. Conclusion

We believe beneficial ownership is not the perfect tool to tackle abusive situations and treaty shopping however it has great utility in specific cases of abuse, specifically the interposition of a recipient to pass the income.

The concept should be interpreted autonomously and not at a domestic law level and be subject to a dynamic interpretation. It is now acknowledged that the recipient of the income must be perceived as the owner of the income regarding taxation by the residence state to fulfil the beneficial owner requirement.

The interpretation provided by the OECD to the term clarified in the Commentary weights substantially even in the centre of EU decisions, but not prevailing over European Union law principles. It is possible to conclude from here that it is implied the OECD has *de facto* legislative powers within the European Union, given the influence it has over the interpretation of the beneficial owner concept of the IRD itself.

Before the Danish cases, the interpretation of the concept of the beneficial owner under the IRD was a textbook discussion. The approach of the ECJ, insufficient and far from settling the debate provided us once more enlightenment on the general principle of abuse of rights and its expansion in EU tax law, as well as confirming the relevance of OECD materials while interpreting the concept.

These landmark rulings clarified that there is indeed a general principle on the prohibition of abuse in EU law and provided indicators to uncover situations of abuse of EU law; the principle of single taxation is reaffirmed as a paramount guiding principle and the reading of the subject-to-tax clause as regarding effective taxation the Member States will face more limitations establishing tax benefits.

In a post-BEPs era where there are many anti-abuse mechanisms in place the utility of the beneficial ownership is being questioned. It would be, in our opinion, constructive to make the concept applicable in a uniform and practical way settling many of the disputes found over the years with a subject-to-tax test.

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