

MESA DE DEBATES DO IBDT DE 06/10/2011

Integrantes da Mesa:

Dr. Ricardo Mariz de Oliveira

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Dr. Salvador Cândido Brandão

Prof. Kees van Raad

Sr. Presidente Ricardo Mariz de Oliveira: Bom dia a todos. Vamos dar início a esta reunião.

Eu queria antes de passar a palavra a alguém, aqui para Pequeno Expediente, comunicar, para os que não sabem ainda, que a nossa conselheira, associada e conselheira Maria Teresa Martinez, conselheira do Carf, foi agraciada com um prêmio que existe lá, uma medalha e um diploma. Como conselheira, vamos chamar aqui de modelo, mas é o destaque na 3ª Seção do Carf. Cada seção agraciou um dos conselheiros, sempre um conselheiro antigo com muita dedicação, muita participação. E a Maria Teresa, para nossa satisfação, foi na 3ª Seção, a agraciada, com todo o merecimento para quem milita lá sabe disso. Ela não está aqui hoje, porque nós gostaríamos de fazer uma homenagem interna, nossa aqui, um cumprimento para ela, mas eu transmito posteriormente, se estiverem de acordo.

Queria convidar o Prof. João Dárcio Olímpio para sentar-se à mesa. Faça o favor.

Prof. João Dárcio é nosso grande colaborador também, professor nos nossos cursos, e hoje está aqui nos visitando, espero que venha sempre João. [risos]

Alguma comunicação? Não? Então vamos diretamente ao Prof. Van Raad, que está aqui conosco para falar sobre 'Beneficiário Efetivo'.

Já foi noticiado também, todos sabem que após esta reunião, às 10h15 na faculdade, ele também participará de um evento, falará, dentre outros temas, sobre o caso Volvo, que é um caso que está em grande destaque, de forma que será uma reunião muito interessante.

Sr. Presidente Ricardo Mariz de Oliveira: Professor Kees van Raad, we are very pleased to have you with us. And we are anxious to hear what you have to say to us. Thank you for your presence.

Prof. Kees van Raad: Well, we will discuss today a bit about beneficial ownership, which is a notion, as we all know, that was introduced in the OECD model in 1997. And what people who haven't studied the topic much may readily believe that this was a notion that was introduced based on the UK tax law. It sounds very sort of British and it sounds very much like it's from Trust Law. And it's correct, it's from Trust Law; but surprisingly, in the 1960s and the 1970s, and also earlier, this term was never used by the UK in respect of tax law, but only in the Trust meaning. And it's very unclear -- that may be surprising -- it's very unclear why exactly they decided in the 1960s UK to use this term. Before it was introduced in 1977 in the OECD model, which you can see on this list, it was used in three treaties included by the United Kingdom: A treaty with the United States; a treaty with Canada; and a treaty with the Netherlands. And in those treaties, there was in the official explanation given by the countries involved, there was no explanation whatsoever for what the term meant.

Some research has been done recently by Doctor Jones into the background of the discussions with the OECD at that time, because they did start discussing it in the late 1960s and then decided in the early 1970s to incorporate it.

Apparently, they were worried about the case where income for which the source country is supposed to give a withholding tax reduction whether that income would be received by a party that is not subject to tax in respect of that income. And it was initially suggested from the UK side that they would include in the treaty a liable to tax requirement for the recipient. So, it was originally suggested that Article 10, 11 and 12 would be changed in such a way that the source country would need to reduce the withholding tax only in instances where the recipient would be liable to tax in respect of the income received.

And then it was decided not to use the words liable to tax because they were afraid that, by using those words, it would be impossible for tax-free entities, like pension funds, which in many countries, as such, are not liable to tax. But in the case of dividends, interest and royalties received by pension funds, the withholding tax would not be applied because the pension fund is not liable to tax. But the pension fund could be, in the perception of the UK, the beneficial owner of the income, a term again derived from trust law.

So, there was some discussion, but it was not perfectly clear what they exactly meant with beneficial ownership in tax law because, as we know now in trust law, it does have a different meaning.

Anyway, it was included in the 1960s in these treaties, it was included in 1977 in the OECD model and the commentary with pretty little explanation. The 1977 commentary, in 1986, nine years later, the OECD released a report, which is well known as the Conduit Report. It was sort of a report dealing with tax haven

structures. The conduit, as we all know, is an entity being used as a flow-through entity; an entity that is used for back-to-back structures.

And in the Conduit Report, a much broader interpretation was given to the term beneficial ownership than the explanation in 1977. But that was only in a report, and a report is not part of the commentary. It was sort of interesting to read, but the OECD member states were not bound by this broader meaning given to the term until 2003 when the essence of the Conduit Report was included in the commentary of Article 10, 11 and 12. So, the original explanation of beneficial ownership in 1977 was changed, was expanded in 2003. And then this year, 2011, April OECD released a discussion draft and suggested a further explanation of the topic.

Let me tell you a bit about the status of the discussion draft. A long, long time ago, I started my career myself with the government in Holland and during part of my career went to the OECD for all sorts of meetings. And at that time all the meetings and all of the discussions of the OECD were very secret. And there as never anything released. As we know, we had the 1977 model and we didn't hear a thing until 1992 when we had the next model. So, in those 15 years, you had no clue about what was happening.

But 15 years ago, the OECD changed their way of operating. What they do now, every time when you are dealing with new topics, with new developments, they publish a discussion draft. And not simply to be sort of open, but also to have the benefit of obtaining, on the basis of the discussion draft, comments from people in practice. Beneficial ownership is something which is extremely important in practice, particularly in the financial world with hedging transactions where you have income coming in and income going out that's connected. So, OECD, of course, is an organization of governments, so they may not have the full insight in all of the complexities that may arise in tax practice.

So, to their great advantage -- and to our advantage -- things are published these days. So, the discussion draft that was published in April of this year was specifically meant, and expressly meant to get comments from the outside world. And about 40 parties sent in comments. In August, the OECD published these comments. They're on the website. Everybody can read them.

So, what we have now is a draft report, which we will discuss in a minute of April, the draft changes in the commentary and what we have also are these comments and what we probably will have later this year or next spring most likely an updated draft. I'm sure the OECD will very carefully study the comments and may release, on the basis of the comments, an amended draft. It's certainly possible, and as it happened with other topics earlier, that later the OECD may release a third draft or maybe even a fourth draft. If the topic is very sort of sensitive, OECD is very careful to get all the input they can get to make the new text as clear and as helpful as possible.

If we look at the current OECD model text, Article 10, paragraph 1 and 2. Paragraph 1 simply says that dividends that are paid by a company which is a resident of one country and received by a shareholder in the other country, that the other country may tax the dividends.

And then the second paragraph goes on and discusses the taxing rights of the source state. And it's not often done, but it's useful to read the second paragraph actually in two parts. The first part says that the dividends may be taxed in the source country, the country where the company is paying the dividend is a resident, and then it says, according to the laws of that state. And if we stop there, it basically says that under this treaty rule that the dividend being paid by a company which is the resident of one country to a shareholder in the other country, the first country, the source country, may tax the dividend according to its own laws.

So, if the source country is the United States and the withholding tax rates in the United States are 30%, the United States may apply 30%. That is what the treaty says.

And then you have a second rule, and the second rule is an exception. And the exception says, in case the recipient is the beneficial owner of the dividend, the source state must reduce the withholding tax down to 5%, 15%, whatever the treaty says. But again, the first rule is that if the recipient is not the beneficial owner, then the source country can simply apply its ordinary tax rates and the resident's country is required under Article 23, relief of double taxation, to give a credit for unreduced withholding tax, which is quite surprising.

The term beneficial ownership is a treaty term. Whether a dividend that is paid by a company in one country to a recipient in the other country, whether the other country is going to tax that dividend to that recipient or not tax it to the recipient because they believe the recipient is simply an agent, is something of the domestic law of the country of the recipient. That is not a treaty issue. Domestic law will determine whether a particular income is income of the recipient or whether the recipient simply received the income for another party.

Apparently, in 1977, when they drafted this language, the OECD had in its mind, and it's also confirmed by some text in the commentary, that if the recipient is a beneficial owner of the dividend, interest, whatever, in that case, the resident's country will tax it to that person; and, when the recipient is not the beneficial owner, that the country of the recipient will not tax it to that person. So, the OECD sort of assumed that their notion of beneficial ownership is identical to the domestic rules of countries whether or not a dividend is going to be taxed to the recipient or to another person. Of course, that is not OECD's business, and of course OECD has 30-some countries, and it would be extremely accidental if of all those countries' domestic law rules as to whether a dividend being paid is going to be attributed to a person on exactly the same criterion in all those countries.

So, it may very well happen, and it's certainly true for Holland, that a dividend may be received by a person who is taxed for that income, but under the treaty is not the beneficial owner; and it may be possible that a dividend is received by a person who is not taxed for that income and still, under the treaty rules, he is the beneficial owner. So, there is no identity, necessarily, between the concept of beneficial ownership and the domestic rules under which income may or may not be taxed to the recipient.

Let me take the simple case of a dividend being received by a minor child, yet also the rules domestically whether income of minor children is taxed to those children or taxed to the parents or taxed to whoever, OECD says that this is domestic law, so it may vary greatly from state to state.

By the way, if there are questions among you, you don't have to wait, as far as I'm concerned to the end, you know. If you want a clarification, I will be happy to give it right away. So, just raise your hand and ask your question.

Well, in the initial commentary of 1977, the explanation was extremely limited. It only said that the source state doesn't need to reduce the withholding tax when the payment is received by an intermediary, such as an agent or nominee. Well, many countries -- and Holland was one of them -- was sort of surprised by this final language because, in our perception -- and I don't know how here in Brazil you look at this language -- in our perception, this income is received by an agent, and the very term agent indicates that such a person is not acting for him or herself but is acting for another person, we would say if the income is received by an agent, of course the income is not taxed to the agent because the agent is simply receiving something for another person. So, what are you talking about? Why do you need a concept like beneficial ownership simply to deal with agency situations?

Later I learned that a UK law that may be different. Under UK law, it's possible that an agent will receive income for another person but still based on a direct right the agent may have himself to claim the income. So, this is clearly a difference in domestic law among the states. In some states, it's necessary to have this; and in other states, it is not necessary to have it. It does show the original, very narrow meaning of the notion. It just refers to cases where the income is paid to a person who is clearly designated to be an agent or nominee.

If you go back for a second to Article 10, the real problem that they tried to solve in 1977 by adding the beneficial ownership requirement is in the word paid. Look at Article 10, paragraph 1, second word. This says dividends are paid. You may never have done that, but it is sort of interesting to go through all of the articles of Chapter 3, what we call the income distributive articles, Articles 6 - 21, and see which verb is being used to make the connection between the income and the taxpayer.

If you look at Article like Article 15, discussing employment income. It says employment income derived by a resident. So, the verb to make the connection between the income and the taxpayer is, income is derived by that person.

In Article 7 discussing business profit, it says profit of a person. So, a term derived and a term of is a term with a very broad meaning. This prevents a specific legal meaning. The term paid, on the contrary, does have a specific legal meaning. So, the issue really was, if in the OECD model, Articles 10, 11 and 12, the verb would not have been paid, which is a narrow legal term, and if income like in the UK situation is effectively and legally paid to an agent, you cannot simply give an interpretation to the term paid that you should read it as being paid to another person. No, paid is paid and it's perfectly clear to whom the income is paid.

If it would have said, dividends derived by a shareholder, then it's possible to interpret and give a much wider meaning to that term. So, effectively, the term beneficial owner was used to repair something that also could have been prepared, probably much more effectively, by replacing the term paid by income being derived by. Because everything that wants to do with the beneficial ownership concept could have been done by derived by. And I'm pretty sure the OECD right now very much regrets that they didn't do that. Because the whole discussion on beneficial ownership has really exploded. What we have seen in the past decade is that countries included in their domestic tax law very broad definitions of beneficial ownership, as broad as would make provisions like limitation on benefits that we see in many treaties of the United States and also sometimes in other treaties, would make a notion like elimination of benefits unnecessary because the whole thing was already solved by beneficial ownership. This is exactly something that the OECD never wanted. And the challenge now is to get this whole wrong development back to its original reach.

UK people typically describe the need for beneficial ownership as a need to keep what they call custodians out as beneficiaries of the lower treaty rate. But it really dealt with cases where income was paid through a person who was clearly designated as a person acting for another one. And this whole conduit business and what you see in treaty versions prepared by countries like China and Korea and Indonesia would go far too far. And that's one of the reasons why the OECD decided a few years ago to take up again the topic of beneficial ownership to get it back to its original scope and intention.

Well, this is some language from this 1986 report. And this language shows at the bottom that they really tried to widen the scope by including in the cases where the person is not the beneficial owner and the conduit company that has -- look at the very bottom -- very narrow powers which render the conduit country a mere fiduciary or an administrator. Well, it was far from clear where the exact line should be drawn between conduit companies that would qualify as beneficial owners and other ones that have only very narrow powers. They clearly refer to back-to-back situations without making it clear where to draw the line.

Commentary in 2003 effectively incorporated in the commentary the findings of the 1983 conduit report. And here this Section 12-1 is a good illustration of the wrong thinking on the side of OECD. If you look at the second sentence there, it says, basically, there was no problem if you denied, reduced withholding to people like agents or nominees or conduit companies because, it says, there is not going to be any double taxation because the recipient will not be treated in his country of residence as the owner of the income. The recipient will not be taxed for the income in his country of residence. Well, how can the OECD say that? OECD doesn't have knowledge of the domestic tax law of all of its member states. It suggests here that all the countries that are OECD member states will, in case the recipient is not the beneficial owner, not tax that income. But that, again, as I explained earlier, is a matter of the domestic tax law. It is nothing of treaty law. So, the OECD simply cannot say that, but that's apparently their idea. Their idea is, if the recipient is not taxed for the income, then he is not the beneficial owner. That makes sense. But you cannot make that tax connection between a treaty rule and a domestic law rule. Domestic law is not controlled in this respect by treaty, of course.

Well, let me go a little faster because otherwise I may run out of time. It's important to understand that at the same time in 2003 when the commentary was updated, that they also in Article 1 expanded the commentary with a lot of rules regarding conduit companies. And they described in which cases treaties should not be applied in instances where conduit companies would receive such income. Well, the very fact that in 2003 they both expanded the definition of beneficial ownership in Article 10, 11 and 12 and gave a much broader discussion on public companies in Article 1 makes clear that the OECD never intended that the beneficial ownership concept of Article 10, 11 and 12 would be a solution to any type of treaty shopping situation. By putting all this language and this is only just a very brief overview, putting all this language, including a text of a limitation of benefits provision in the commentary on Article 1, they made clear that for a lot of types of treaty shopping situations, you cannot use beneficial ownership, you must make use of special clauses based on the suggestions laid down in the commentary on Article 1.

So, the OECD tried to show already at that time that the scope of application of beneficial ownership should be considered quite narrow. If you want to go beyond that in order to fight perceived abuses of tax treaties, you have got to resort to different means.

It's interesting in the meantime to see how some of the countries defined in their treaties specifically the notion of beneficial ownership. If you look at the German-US treaty, they wrote in the protocol that a beneficial owner is the person to whom the income is attributable for tax purposes under the laws of the source state.

If we take a dividend being paid by a US company to a German shareholder. So, under this rule of the treaty, it says United States is required to give a reduction

of its withholding tax if the shareholder who is a German resident is going to be taxed for that income in Germany. So, here they specifically did make the connection between beneficial ownership and the shareholder being taxed on the income received. Something the OECD has in mind in very general terms, here between the two countries, they specifically included it here. So, here there is identity being the treaty criterion of beneficial ownership and the domestic law rule whether or not the income is taxed to the recipient.

It also shows how impractical this works in practice because, again, the United States is the country where the company paying the dividend is residing, the country from which the company is making a dividend payment to the German shareholder and then it says that the German shareholder is entitled to tax rate reduction in the United States if the United States determines that the German shareholder is in Germany subject to tax withholding on the dividend.

So, the United States doesn't know the shareholder, of course, and will have to send an information request to Germany asking who is that shareholder and what is his tax position. And then the United States, in its own right, will decide whether the shareholder qualifies as a beneficial owner. It would be very impractical in every instance. The source state needs the cooperation of the residence state in order to determine who is the shareholder and does the shareholder meet the requirements for being a beneficial owner.

To look at another German treaty during the period, a treaty between Germany and Italy, it goes beyond that. There it says that whether a recipient is a beneficial owner must be determined under the law of both the source state and the state where the recipient resides. So, that's quite difficult, administratively very cumbersome to make that particular determination. That must be made on a dividend by dividend basis. So, how they ever considered this could work in practice is really beyond my understanding.

In the text explanation to the current U.S. model, it's perfectly clear that in the United State's view, the meaning of beneficial ownership is something that is determined under the domestic law of the source country. The United States never believed in a broader treaty meaning of that term, which of course is very impractical. Because, if the United States as a source country is going to make its domestic law definition controlling for treaty application, then all the countries in the world are going to do that, that is not going to create much harmony because domestic law will, of course, vary from country to country.

So, the only thing that can work is having a uniform treaty meaning. The United States has always been resisting that.

Also, a country like the Netherlands, ten years ago, included in its dividend tax act a very particular definition of beneficial ownership, also with the purpose to use that definition in the absence of a real definition in the treaty, to use the domestic law definition for treaty purposes. So, another illustration that countries will do anything they want themselves to apply the treaties, based on

their domestic tax law. And, of course, treaties should be applied in as efficiently uniform and harmonized way; and this is not going to be helpful.

There were four cases that I would like to briefly discuss with you, which are focused truly on beneficial ownership. There were not decisions on point. There are quite a few additional decisions that deal with cases where the recipient may for anti-abuse reasons or for trust law reasons not be considered the true recipient. But only in these cases the term beneficial ownership is specifically used and explained.

The decision of almost 20 years ago, a pretty straight forward case where a shareholder of Royal Dutch Shell was a resident of a country that had a treaty with Holland in which Holland was permitted to apply a dividend withholding of 15%. They couldn't credit the withholding tax, so he engaged in the transaction under which he would keep the shares but sell the dividend coupons to a person who resided in a country that had a duty with Holland that would reduce the Dutch withholding rate to 5%.

So, by selling the dividend coupons and having the dividend received not by a person in the 15% treaty country but in a 5% treaty country, the two parties in the transaction split the benefit, the withholding tax rate difference, and the dividend was received effectively by this person who had purchased the dividend coupons. And the Dutch authorities said, well, you are not the beneficial owner because the shares are still in the hands of a person who lives in a country who has a treaty with a higher withholding tax rate. Then the Court said, sorry, if I read Article 10, it says the beneficial owner of the dividend. It doesn't say the beneficial owner of the shares but of the dividend. And the dividends were sold unconditionally. The person buying the dividends could do with the coupons whatever he wanted. And the Court said, sorry, if you mean something else, you better change the language of the treaty. That is not up to us.

So, the Court confirmed that, indeed, you can trade different dividend coupons and have the coupon actually owned by a person in a treaty country that has a low rate in the treaty than the source treaty.

In the Indofood case, some of you may be familiar with this case. It was a pretty striking decision involving a true back to back structure. The Indofood company wanted to float bonds in the UK market and J.P. Morgan acted as trustee for the future note holders. Indofood did not issue the bonds directly because, if the bonds had been issued directly, they would have been subject to 20% withholding tax. At that time Indonesia had a tax treaty with Mauritius, a tax haven, although it's far from clear whether Indonesia was fully aware of this particular status of Mauritius, which is surprising. Mauritius is a huge country, but many of these sort of developing countries in international tax law matters are pretty primitive in their understanding and knowledge of international tax law things.

So, anyway, this treaty was there and having the notes issued not directly by Indofood to the note holders but at first the note holders buy notes from finance, the subsidiary. Finance was going to forward the funds to Indofood. So, Indofood would pay under the Indonesia-Mauritius treaty a lower withholding tax rate, 10%, and the loan instrument said within 48 hours would pay on the interest received from Indonesia to the note holders in the U.K.

So, it was a pretty blatant back to back structure. As I said, the interest had to be paid within 48 hours. The interest was paid on exactly the same amount received. There was no margin kept in finance. No single attempt was made to give finance even the appearance of having any substance. There was no substance and it was blatantly, you know, a back to back structure.

When Indonesia understood how things worked, they terminated the treaty with Mauritius. So, this termination took place during the period in which this loan was still going on. So, as a result of the termination, the withholding tax rate would increase from 10% to 20%. Of course, Indofood didn't want to pay 20% because it was typically a structure under which an increase in withholding tax would be for the account of the issuer, Indofood; not for the note holder in the U.K.

So, under the rules of the loan instrument, it was possible for Indofood to pay back the loan if the tax circumstances changed substantially. Here Indofood said they changed substantially because the withholding tax rate was 10% and now it's going to be 20%. So, I'm going to pay back the loan. And Indofood was very happy to pay back the loan because, when the loan was issued, it carried an interest rate of over 10%. It was something like 11%. And in the meantime, interest rates had come down. So, Indofood was very interested in paying back the loan and issuing a new loan for a lower percentage.

J. P. Morgan was not so interested in having the loan paid back because, you know, they would rather hold onto the higher interest rate. The loan instrument said you can pay back the loan earlier unless there is an alternative available under which you can keep the tax circumstances the same. And J. P. Morgan contacted a Dutch law firm. As you may know, I am counsel of to this firm. I was not involved in this case, but I was receiving from J. P. Morgan the question. Can you think of putting instead of the Mauritius company, for example, a Dutch intermediary company that has enough substance that it will be recognized by Indonesia as the beneficial owner because under the Indonesia-Dutch treaty, you also get 10%.

So, if such a Dutch company, instead of the Mauritius company, would be possible, then Indofood could not ask to pay back the loan earlier and they would be required to pay the 11%.

So, the case went to a commercial court in the U.K. to see whether this solution of having a Dutch company instead of a Mauritius would work. And the basic question for the U.K. judge was, if this case would go to court in Indonesia,

would a Dutch company instead of a Mauritius company -- would an Indonesian court recognize the Dutch company as the beneficial owner. So, quite strangely, a U.K. court had to determine whether, if the went to an Indonesian court, Indonesia would recognize the company as the beneficial owner.

Well, the fact was that there was no single decision on Indonesian beneficial ownership. So, how could a U.K. court decide what an Indonesian court should have decided if the case would have gone to Indonesia? Pretty impossible. So, as a matter of fact, the judge in the U.K., of course, said -- well, the judge himself talked about the case. And the High Court Judge felt that the Dutch company would work, and on appeal, the Court of Appeal felt it would not work. So, in the end, it did not work. And I think it's a correct decision. If I had been the judge in such a case -- as you may know, I'm also a tax judge in Holland for tax matters -- I would say this is such a blatant back to back thing. You know, you can play tricks, but if you're going to play your tricks, you know, you've got to be a little more sophisticated than such a cheap thing as they did here. You have to hire good tax counsel, not, you know, just anybody who volunteers to take care of it.

Anyway, a few years later, we had the second case and this is a very important case. It's also been a case helpful, I think, for the OECD to suggest a clearer definition of beneficial ownership. What is this case? This is a case where right from the beginning, the Canadian company at the bottom was a company manufacturing buses. The company was going to be acquired by two foreign companies, a Swedish one, Volvo, another Volvo case, and a U.K. company. And the U.K. company and the Swedish company were going to acquire the Canadian company. But right from the beginning, they quite smartly decided not to acquire directly but to acquire through a Dutch company. Obviously, the Dutch company was put there for tax reasons. But, of course, they explained it as business reasons, and they had some business reasons.

Canada was very much aware of the fact that if the Swedish and U.K. company would have purchased the Canadian company directly, the dividends would be subject to 15% in the the case of Swedish dividends and 10% in the case of the U.K. dividends. And by having the Dutch company in between the dividends, the withholding tax in Canada was reduced to 5% and then the Dutch company paying the dividends on to Sweden and U.K. under the European Union parent-subsidiary directive at 0%. So, it was neither 15% nor 10%, it was now 5% and 0%. So, obvious saving.

The question is Holland the beneficial owner of the dividends received from Canada? The Canadian tax authority said no way. And they explained that the Swedish and the U.K. shareholders had concluded a shareholders' agreement and the shareholders' agreement said that they would vote together at the shareholder meetings of the Dutch company that 80% of the dividends received by the Dutch company would be paid on to the shareholders. So, they had claimed in the agreement that there would be a flow-through of at least 80% of the dividends received. And Canada said, look there, flow-through of 80%.

In Canada, in tax cases, you often see that they call in witnesses. And the court heard a witness which was produced by the shareholders, and the witness was a professor at the University of Amsterdam in Holland in company law. And he testified that under Dutch company law, if the shareholders make an agreement to have the company pay on dividends, that such an agreement is not binding on the company directly. Of course, the shareholders, if they vote for having 80% or more paid out and the company refuses -- and under the Dutch law, the company has its own legal responsibility to act to the advantage of the company itself, which is not necessarily the benefit of the shareholders. The company can deny such a request by the shareholders. You cannot force the company to do that.

What the shareholders can do, of course, is to have a vote of confidence against the Board and they can dismiss the Board and they can appoint another Board that may do it. But they cannot force the company directly to do what they want it to do.

And on the basis of that, the Canadian tax court said, this is not a flow through because it's simply not fully controlled. The company can always decide not to pay out the 80%, what the shareholders want. It's also a pretty risky case. It was one of those cases where the tax planning, I think, was done okay but, as in many cases as in all of us who are in tax practice know, sometimes clients are not as careful to implement in practice what you, as tax advisers, may tell them to do.

This client was extremely careless because the Swedish shareholder was established later frequently held the treasurer of the Canadian company and told the treasurer that he should make some dividend payments directly to the Swedish shareholder, which is not really helpful if you want to establish that the Dutch company is, you know, a true company with substance and so on. And those dividend payments were made later in the accounting, which, you know, the adjustments were made, of course, that the dividends were not paid from Canada to Sweden but first to the Dutch company, blah, blah, blah, blah.

But this came all out in court, and it's a bit surprising that the court said, well, that's just accounting. I think it was just the reality and the other thing was pretty different.

Anyway, so this was a case not really back to back, and therefore the court said no, the Dutch company is the beneficial owner. The case went on appeal and the Canadian Court of Appeal confirmed the decision of the lower court. So, this was a sign to the authorities that things would not always go as easy as in the Indofood case.

This is a case that isn't decided yet. This is a case still pending. And we are really looking forward to this judgment because it's, again, a pretty blatant back to back case. Let's see how it works. Here you see Velcro, a Canadian company making those fasteners, you know, that you use for your shoes and your jackets,

these Velcro things. And the initial property rights were transferred by Velcro Canada a long time ago to a Dutch company, the company at the bottom. The company at the bottom had licensed back the patents to help Canada, so Velcro was paying a royalty to the Dutch company.

Later, another Dutch company was created, the top company, and the license was transferred to the top company and the lower Dutch company was converted into an Antilles company. Under Dutch law, a company can be converted into a company of the Antilles, which, as you may know, is part of the Kingdom of the Netherlands, sort of a Commonwealth situation the Antilles and the European part of Holland are still part of a sovereign state. And the Dutch company at the bottom there sort of disappeared because it was converted into the Antilles company on the right-hand side. So, after this restructuring, the royalties by Velcro Canada, the yellow, were paid to the Dutch company, and that Dutch company -- it's hard to understand because the facts are not fully known because the case isn't decided yet and the documents are not of public record. This is what I read in a tax periodical. I understand that pretty much the same amount of the royalties received by the green company from Canada were paid on without any change in amount and right away to the intended company.

And the question of course is: Is Canada going to apply a 25% withholding tax or is it going to be reduced to 0% under the treaties? The question is whether the top company is the beneficial owner.

What's interesting is that this goes to the same court that decided the earlier decision, so this is an opportunity for the court to say this prior one is okay, but this is perhaps not okay. So, we are still waiting. The case has been in court for quite a while and everyone is looking forward to the outcome.

The big question is, of course, may countries indeed from their domestic tax law give a definition of beneficial ownership that is going to work under the treaty? And any term which is not really defined, and the explanation in the OECD commentary is not a real definition. This is sort of a description.

You say that the undefined term of beneficial owner has a domestic law meaning or do you have to recognize, as Article 3 (2), do you have to recognize that there is a treaty context that is different? Can you distill from the OECD commentary that not domestic law, but a treaty notion of beneficial ownership should be applied? As I said earlier, the United States very strongly resisted that there should be a single treaty notion. The United States always preferred that it should be a right on the side of the source country to apply its domestic law.

Let me skip this and let me do well, this may be interesting briefly. What you see increasingly in treaties, and this recent treaty between Hong Kong and Indonesia is an illustration of that. Last year at the Congress in Rome, one of the main topics for discussion was tax avoidance for the treaties. Countries used to fight tax avoidance with their domestic tax law that may contain concepts, such as broad anti-avoidance rules and other things, or do something specific in the

treaty. Well, pretty much the outcome was either you include in the treaty a particular treaty rule, which is anti-avoidance. Here Article 11 says, the reduction of withholding tax rate does not apply with the main purpose or main purposes of persons involved is the reduction of withholding tax. So, a main purpose test.

They also do in this treaty in one of the last articles is lay down a specific reference to domestic rules. Many countries apply domestic rules against treaty abuse without having such a rule in the treaty. What they cleverly did here in this treaty is simply refer in the treaty to such domestic rules and, as a result, those domestic rules are a part of the treaty and can be applied. So, that's sort of the preferred approach.

Okay, we have arrived now at the draft of April of this year, and what we see in this draft -- what you see on the slide is three reasons why it was an appropriate point in time for the OECD to issue this draft. The first reason became actively clear that the guidance laid down in the 2003 commentary was insufficient to help countries solve their issues.

Secondly, countries use increasingly their own domestic law definitions of beneficial ownership, resulting in a very widely divergent application of treaties with this requirement around the world.

And, thirdly, some countries -- and I mentioned them already: China, Indonesia, Korea -- use the beneficial ownership requirement as a very broad weapon against treaty shopping, and OECD never meant that. As we discussed earlier in 2003 they explained in the commentary in Article 1 that, if you want to have a broad approach available to yourself regarding treaty shopping, you have got to include in your treaty limitation of beneficial provisions, a similar instrument. Don't do it through beneficial ownership. Those countries did. OECD thought it was exactly what they should avoid to continue.

Of course, I don't work with the government anymore. I have not been participating in those meetings with OECD over the past few years, but I'm pretty sure that in the preparation of what was published in April of this year, the OECD had to make a choice between two approaches to continue. Either they could on the basis of how serious things were happening in practice, they could put all these practical cases, with a full description of the case, in the OECD commentary and on the case-by-case basis determine whether that case was a case where the recipient was a beneficial owner or not. And by working with these cases in the same way as the United States regulations often do, by having examples, you can make more clear sometimes than with general language what's qualifying and what's not qualifying.

I think in the end OECD decided not to do that because I think they were afraid that if they would give many examples and indicate on an example-by-example basis what is okay and what is not okay, they would effectively create a manual for tax advisers and they thought that was not the thing to do for the OECD. So

they decided in the end to still produce general language. Let's take a look at that general language.

The term beneficial owner was not intended to refer to any technical meaning that it had under the domestic law of any specific country. On this Section 12 (1), this new section, they quite clearly say there is no point using domestic law. In the first place, when the term was introduced in 1977, there was no single country in the world in its domestic law using this notion. So, there is no original domestic law meaning of that notion. And everything the countries have been doing since that time is writing down what they feel it should mean. No way.

So, they simply say it doesn't work. And then in order to pacify the United States, they have added this last sentence, they say this does not mean that the domestic law meaning of beneficial owner is irrelevant. No, it is relevant but only to the extent it's the same as what is written down in the commentary.

Well, that's not very helpful; but, apparently, the United States felt this was very nice to include. So, also the United States has accepted now that their domestic law meaning does not apply unless it happens to coincide with the meaning that the OECD produced.

The OECD stressed again the situation that we have since 2003 that basically there are three types of persons who are not beneficial owners: The earlier than nominee '77 and then in 2003 conduit companies that act as administrators. So, conduit companies in blatant back to back situations.

In Section 12.4, the OECD tries to give a definition of what is a beneficial owner, but surprisingly they first give a definition of what is not a beneficial owner and that is followed by a definition of what is a beneficial owner. The two things are pretty similar, so let's take a look at the second one.

It says the recipient of a dividend is a beneficial owner of the dividend when the recipient has the full right to use and enjoy the dividend unconstrained by an obligation to pass the payment received to another person. This is the core sentence.

And the core sentence, of course, raises questions. The first question is, it says, the shareholders have the full right to use and enjoy the dividend. And then it says, this right may not be constrained by an obligation to pass the payment received to another person.

What is not so clear is whether if there is another constraint on that full right other than what is indicated here, a contractual, legal obligation to pass the dividend received to another person. Assume that you have made a pledge of shares to a bank, as a result of which you do not have the full right anymore, without the income, the dividend passing necessarily to another person. Does that mean that you have sort of two requirements? Does it say there may be no single restriction, including no constraint by an obligation to pass the payment, or do you have to read them together? Do they say your right may be restricted,

but not restricted by an obligation to pass the payment received to another person? So, the combination in the language of full right and then unconstrained is unclear.

Second, it says obligation to pass the payment received. Well, under Article 10 you receive a dividend. If the dividend recipient passes the full amount received in the form of an interest payment to another party, can you say I did not pass the payment received to another party; I simply paid something else to another party? Does the payment received, does that refer also to the nature of what was received? In other words, if you receive a dividend, you must pay out a dividend in order not to be a beneficial owner; and as soon as you pay out something else, if you receive as an individual a dividend, as an individual you cannot pay a dividend as such to another person. So does that mean that if you pay an amount equal to the dividend received, but in another form like alimony, maybe you entered into a divorce arrangement with your former spouse under which you must pass particular payments received on to the other person as alimony, is it okay under this language because you don't pass the dividend as such to the other party? Not so clear.

What if you receive dividends amounting to a hundred and you pay twenty on to the other party and the remaining eighty you pay ten years later? The problem is a timeframe for determining whether the payment has been passed to another person. First, any payment received by a company will, at the very end, be paid to another person. I mean, companies are simply creations of the mind, right? Nobody has ever seen a company. We sort of, you know, we have agreed that we work with companies. But in the end, everything will end up in the hands of individuals. So, passing the payment, what sort of time restrictions will be there?

This shows, you know -- first, I think that the clarification is helpful. I think that the clarification makes it perfectly clear that the OECD wants to use back to back criterion to determine whether the recipient is the beneficial owner or not. But of course quite a few questions remain.

There is one point that I forgot to include in a slide, and let me tell that right away. Within Section 12.5 that deals with the issue how wide is the scope of application of beneficial ownership. And let me read from Section 12.5 to you. It says, there are many ways of addressing conduit companies, more generally, treaty shopping situations. These ways include specific treaty anti-abuse provisions, general anti-abuse provisions and substance over form or economic substance approaches. While the concept of beneficial owner gives you some forms of tax avoidance, it is not a general approach to any sort of treaty shopping situations and, therefore, the other approaches used under Article 1 should be used in those cases.

So, this language laid down in 12.5 makes it absolutely clear that the approach taken by countries such as China and Indonesia and Korea are not approaches that are compatible with the course decided by the OECD in this particular update of April 2011.

There is one treaty thing in the commentary, so let me go back for a second to the language in 12.4. So, your beneficial owner has the full right to the dividend and it should not be constrained by an obligation, how do you establish whether there is an obligation? Normally, the existence of an obligation will derive from the relevant legal documents. But the government tax authorities may also construe the existence of an obligation on the basis of facts and circumstances.

It does not say that the government may on the basis of facts and circumstances try to demonstrate in general that the recipient is not the beneficial owner. It may use those facts to show that there is an obligation. If the obligation is not clear from a contract, a document, it may be clear from circumstances. That's risky, of course.

Finally, in 12.4, it says, it's basically a confirmation of this earlier Dutch decision majority, Royal Dutch Shell, beneficial ownership of dividends and shares is separate. You can be the beneficial owner of dividends without being the beneficial owner of the shares.

Okay so far?

Sr. Presidente Ricardo Mariz de Oliveira: Yes, thank you very much. Very good. Are there any questions?

Ninguém tem nenhuma pergunta a fazer? Pode fazer em português. [ininteligível].

Sr. Luís Eduardo Schoueri: I would just like to know whether you are aware of the fact in this comment that Brazilian law recently has introduced a concept of beneficial ownership for thin capitalization purposes. I can see that you are aware of this and perhaps you can bring some comments to say what is the relevance of such an internal concept of beneficial ownership for the Brazilian treaties?

Prof. Kees van Raad: Well, the answer simply is it's irrelevant. (Laughter). Why? Because, again, this is another attempt to use a domestic idea for treaty purposes. And although Brazil is not a member state yet of the OECD, Brazil is one of the countries that's accepted the invitation of the OECD to publish the viewpoints of the commentary. As far as I know, Brazil did not make in its viewpoint on the commentary any reservation in this respect. So, I'm afraid that the domestic definition is sort of interesting to read but just for scholarly purposes, there is no practical meaning.

Sr. Luís Eduardo Schoueri: If I may say just for the purpose of consideration, as you know Article 3.2 refers to internal law. Perhaps if you read our text of this law, which is tax law -- not tax treaty law but internal tax law -- the concept is really very near from the one of OECD. I mean, the wording here is even more strict than OECD because it refers to companies constituted with the purpose of saving taxes and, moreover, that values were received on its own account and not as an agent, fiduciary administrator or mandatory. It means it is quite according to the OECD. I would give some relevance to this and say, well, this is good news

because you can refer to internal law and within the context of the treaty, this internal definition could be applied.

I don't have the English translation right here, but what I understand from the Portuguese text is that it not only refers to this agency thing but it adds something else; and that something else is not -- it tends to say that moreover a company will not be the beneficial owners if it was constituted with the purpose of saving taxes and moreover it is the agents alone. So, I mean it is an even stricter definition and not the opposite.

I mean, for you not to consider a company a beneficial owner, you need a double test: First, if the company has another purpose, it's already not for it to be the beneficial owner. Moreover, so I mean it's a stricter definition and I would say within the context of the treaties, it's a very positive definition.

Prof. Kees van Raad: Okay, well in that case, I probably could consider the -- let me read again this. The last sentence, it does not mean that the domestic law meaning is irrelevant. No, it's relevant when it's consistent with the general guidance provided in this commentary. So, based on your further explanation, I think I agree that, under this language, the Brazilians, a more strict criterion could be accepted for treaty purposes.

Sr. Presidente Ricardo Mariz de Oliveira: Bianco.

Sr. João Francisco Bianco: You mentioned in the beginning that Article 1 dealing with treaty shopping issues has nothing to do with the definition of beneficial ownership. To what extent is the internal Brazilian law defining beneficial ownership related to tax planning issues, what could influence the definition of beneficial ownership for tax purposes?

And besides that, this definition of beneficial ownership under the Brazilian internal law deals with the deductibility of payments made to known residents. It has nothing to do with the interpretation of tax treaties. So, to what extent this definition could be used to influence the application of tax treaties, that's the point.

May I add this case from a general perspective: Assuming you apply Article 3.2. Article 3.2 says tax laws of the applying country. Now, you're saying we have a tax law. It is a tax law. We have a concept in the tax law, but this law does not specifically refer to a payment abroad. Is this relevant or relevant enough to have the concept within the tax law of the paying country?

I mean the context where the concept arises or is it sufficient for you to say this is tax law? Within Brazilian tax law there is a concept of beneficial ownership. The concept is compatible with OECD. It's even more strict so it means you have another requirement for you to say this is not a beneficial owner. And this should be applied anyway. Okay, this is for thin capitalization. But it says beneficial owner, it defines beneficial owner. It says agent. It says fiduciary. It's very similar to what you've got in the OECD commentaries. I would dare to say there is some

kind of inspiration in this, even. But it's stricter because it says if the company already existed, so it's already enough for you to say this is a beneficial ownership.

So, for you not to be a beneficial ownership, the company must have been created with the purpose of saving taxes and moreover must be the agent and so on and so on.

May I try to translate very quickly the Brazilian wording here. So, it is considered beneficial owner the company not incorporated with the only or main objective of tax planning. So, the company that is not incorporated with the main objective of tax planning, that derives those values on its own account and not as agent or fiduciary manager who has the power of telling on account of third parties.

Prof. Kees van Raad: So, are you saying that the concept laid down in Brazilian domestic law narrows the availability of beneficial ownership to a party as compared to the treaty situation? So, opposite to what it says.

Sr. João Francisco Bianco: No. What I am trying to say is that the definition here is applicable clearly to conduit companies. They are clearly incorporated with the objective of tax planning. And so I don't see any incompatibility between the Brazilian internal tax law and the tax treaties.

Sr. Luís Eduardo Schoueri: João, assuming that is the case, you have a company that is an agent, clearly an agent. But it's not a company which was created for being an agent. It's a company which existed, let's say Ford. The Ford Indonesia which exists and which produces cars and so on and in one specific operation would act as an agent. According to Brazilian law through this article, would you apply the article or not? I say you would not apply this article because Ford was not constituted with the main purpose of saving taxes, which is one of the two requirements. Although it is the agent in the concrete operation, the tax law is very clear to say it is a person constituted with the sole or main objective of tax saving, which is not the case.

Prof. Kees van Raad: So that means in clear agency situations where the OECD would not allow the recipient to be the beneficial owner, you would, for purposes of your domestic law, do that.

Sr. Luís Eduardo Schoueri: For the purposes of this article.

Orador não Identificado (01:17:08): In the case about tax policy, I would like to know your opinion if the international fiscal meaning for beneficial ownership is desirable and achievable, taking into account many different jurisdictions worldwide.

Prof. Kees van Raad: Well, it's obvious that beneficial ownership is a very important criterion for tax treaties, you know, whether or not the source country will be required to reduce its withholding tax. And I simply cannot see how it's possible under -- if a country is going to apply its domestic law notion, it means if one country which is the source country with dividends going also to different

countries, then depending on the treaty, the recipients which are in exactly the same position in different countries, but because the countries concerned have different domestic law notions, that in some cases the source country may not give the reduction and in other cases it must give the reduction simply because the laws of those countries are different.

I find it policy-wise very difficult to accept. That's the reason why I think OECD should try to create uniformity also to keep sort of an international treaty grip on how this works. If you leave it to domestic law, countries can go pretty wild without any possibility of the OECD to sort of intervene. And you may end up with treaty practices that vary from country to country greatly, which I think is, from a global tax treaty perspective, undesirable.

Sr. João Francisco Bianco (01:19:22): The French version of the OECD model refers to beneficial effective as corresponding to the wording beneficial ownership. Here in Brazil, our treaties use the same French criteria. Do you see any difference between beneficial ownership and beneficial effective? Is there any conceptual difference between these two expressions?

Prof. Kees van Raad: Well, earlier I referred to the time I worked in the Holland Ministry of Finance. It was in the 1970s. One of the things I had to learn in the early '70s was to sort of improve my French because all of the discussions in the OECD were in French at that time. And so although the term beneficial ownership came from the U.K., the whole thing was discussed within the OECD on the basis of the French Term beneficial effective. And it certainly acknowledged that beneficial owner as it is understood in the U.K. and the way this term is understood in French-speaking countries is quite different. The term beneficial effective is a much more -- it's not a legal term. And with beneficial owner, you have always this link to trust law from where the term was originally used.

So, people like Doctor Jones, himself, he prefers the term the equivalent of effective beneficiary rather than the beneficial owner. So, in the Prevost case, which was a Canadian case, the court actually, at some length -- because in Canada both languages are equally authentic. And in Canadian domestic law, they also use this term the court at some length analyzed both the English language and the French language expression, and clearly preferred the French language expression. In Canada, it has a sort of non-legal -- it doesn't have an original legal meaning. It is something that you look, who is the true guy who receives it, which is not necessarily the definition of beneficial owner.

So, is there any writing here in Brazil on the difference between your Portuguese term and the English term? Or is that not really explored?

Sr. Luís Eduardo Schoueri: Right now, I would ask you and perhaps you could mention that, well, treaties unfortunately -- I mean, unfortunately OECD itself is not supposed to write treaties and treaties are written and signed by countries and are approved by parliaments according to the wording they use. And so what

is your experience, concrete experience with this question of languages in concrete cases? I mean, for instance, in Germany you would have it different, which is a third expression which has more to do with the use and not the diffusion of the good. And do you know cases where these differences in language were considered and sometimes saying, although we know OECD would have both French and English versions, since the parties signed the treaty in English the French version could be irrelevant for that treaty or would the French version always be relevant despite the fact that the parties never dealt in French?

Prof. Kees van Raad: No, I am not aware of any court decision that addresses the issue as squarely as you suggest now. I mean the decision most on point is this Prevost discussion where the tax court looked and analyzed carefully the two languages.

You must not overestimate what your judiciary does. Even in countries where treaties are taken very serious, courts are not sort of academic research institutions where they do that sort of analysis. So, I was very pleased to see it in the Canadian decision, but I don't expect that many courts would go that far.

In general, I would say that since the OECD is still officially bi-lingual, I mean the very reason that's the reason why the OECD treaty book that we produce in Leiden, we have the whole commentary in English in large print and in French in small print so you can always check. So, in case of doubt, I think it's mandatory that you check the French language as well.

So, in this case, it came out that beneficial effective and beneficial owner are, you know, distinct terms. But if you read the commentary carefully on points that may come up in cases that you are dealing with, you quite frequently may find that the French language is more precise than the English language in that respect.

Sr. João Francisco Bianco: But what you're telling us, which is for me -- I had never heard of this, that the negotiation within OECD is made in French and not in English. Because this is the relevant course to try to find -- what should have the bold letters and which should be the smaller ones? You said you have the big printing in English and the small in French. And perhaps the opposite could be more correct or more faithful.

Prof. Kees van Raad: Well, technically both languages are equally authentic. The point is that most people will only read the English, and my suggestion is do check the French, if necessary. In practice most people are incapable of reading French properly, so I mean if I put the thing in large print and the English is in small print, I have to sell also reading glasses with it so everybody can read the commentary recently.

Sr. Daniel Castro: Professor, my name is Daniel Castor. I have a question. How does the work in the case of beneficial owner when you have the recipient is a partnership. Let's say Brazil paying to another country which has the partnership concept, how do you see the application of this provision?

Prof. Kees van Raad: Well, it's interesting that you raise this issue because, in the reactions from practice reported by the OECD in August, quite a few people mentioned the partnership issue. Because with a partnership report, we know how to deal with partnerships and transparent by one country and not transparent by the other country. As a matter of fact, if the partnership is treated in the country where the partnership is created as an entity under the rules of the partnership report, the income is going to be taxed to the partnership. And, in that case, I would say, you know, irrespective of how the source country looks at the partnership as being transparent, if the country with the partnership itself will treat the partnership as the recipient entity, there is no question about the beneficial owner because, then, it's clear that the country is going to tax the income to the partnership.

So, the source country must sort of accept the recipient country's viewpoint as to whether the partnership is transparent. If it is not transparent, then the partnership is a beneficial owner, I would say.

Sr. Daniel Castro: I am asking this because in Brazil we don't have this concept so far. So, we have this practical problem where you have this treatment, especially with partnerships. So, we have a kind of conflict between the source country and the recipient country and who is the beneficial owner and so on. So, maybe you can go to the residence rules to determine if the beneficial owner is also a resident or not.

Prof. Kees van Raad: Is the partnership report sort of accepted here in Brazil? Or is this another thing Brazil sort of takes its own view?

Sr. Presidente Ricardo Mariz de Oliveira: I am almost sure that in the commentary, the position of Brazil, Brazil has some comment on partnerships. It's clear in Article 1. I just see it there. But Brazil has stated its position here.

Prof. Kees van Raad: Okay. So, what the OECD concludes may not be shared, as I understand now, by Brazil in that respect.

Sr. Presidente Ricardo Mariz de Oliveira: Another question? Okay, let's finish our meeting today. We thank Professor Case for his delivery and for everybody here in the room. It's good to have you with us. I hope to see you again very soon.

Sr. Presidente Ricardo Mariz de Oliveira: Obrigado a todos.

E eu até com relação a beneficiário proprietário, falando em português. E eu queria que vocês lessem o art. 167, § 1º, inciso I do Código Civil.

FIM

Eu, Randall A. Czerenda, estenotipista, declaro que este documento, segundo minhas maiores habilidades, é fiel ao áudio fornecido. Revisado por ACV.

Texto sem revisão dos autores.

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