The Concept of a Beneficial Owner in the Application of Finnish Tax Treaties

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1 Introduction

In international tax law it is an established standpoint that tax treaty provisions are to have preference over the rules of domestic tax law. Simultaneously it is on the level of tax treaty interpretation often emphasized that tax treaty provisions generally should not hinder the combat against tax avoidance and evasion.

As domestic provisions under Finnish law cannot override treaty stipulations, there always remains some need to include specific rules against the abuse of tax treaties. In this respect Finland mainly resorts to solutions offered by the OECD model convention, but has also included some special provisions in its tax treaties.

One feature in the model convention designed to limit the improper use of tax treaties is the requirement of *beneficial ownership* with respect to dividends, interest and royalties for reduced treaty rates to apply. This vehicle is below dealt with from a Finnish perspective and in the light of Finnish treaty practice.

2 Limitation of Benefits in Finnish Treaty Practice

Presently Finland is having a tax treaty network comprising one multilateral treaty concluded among he Nordic counties and about 60 bilateral treaties. This network of treaties on income and capital covers most important trading partners, but includes also exotic countries with mainly symbolic importance. The oldest treaty in force is the one with Egypt and this originates from 1965.

The decisive factor determining access to treaty protection is residence in one or both of the contracting states. Due to the structure of the Finnish tax system, dual residence of companies is, however, rare.[1] European Community law may

[1] As Finland under its domestic law adheres to *place of registration* as the decisive factor for the residence of companies, corporate entities registered abroad are not regarded as Finnish, but dual

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at instances extend treaty benefits to be granted to parties not so provided for in the applicable treaty.[2]

In some situations Finland has desired to specifically exclude *certain persons* doubtlessly resident in a contracting state entirely from the scope of a tax treaty. The traditional example of this is exclusion in article 29 of holding companies established under the 1929 legislation from the scope of the treaty with Luxembourg.

In other cases Finland has elected to have certain persons prevented from being entitled to treaty benefits with respect to *certain items* of income only. An example of this is article 6 in the tax treaty with the United Kingdom according to which treaty benefits in Finland do not apply to persons resident in the United Kingdom, who (being non-domiciled there) are taxed on a remittance basis, i.e. unless they actually remit the item to the United Kingdom for taxation.

Furthermore, Finland has also pursued to include in its treaties a possibility to *globally* tax its citizens who are *moving abroad* for some time.[3] Without an express treaty provision with respect hereto, the effects of Finnish domestic tax law would be precluded once residence on a treaty level is established in the other state. Such provisions are included in the treaties with e.g. Estonia, Germany, Luxembourg, Switzerland and the United States.

In other respects Finland has usually been inclined to follow the OECD model convention in the form it has been available when the respective tax treaty has been concluded or amended.

3 The Beneficial Ownership Requirement in the OECD Model Convention

During the past decades the OECD model convention has gradually undergone change in order to better restrain the improper use of tax treaties concluded based upon the model.

After the update in 1995 of articles 10 and 11 relating to the reduction of withholding tax rates on dividends and interest, as well as article 12 relating to elimination of withholding tax on royalties,[4] treaty benefits shall expressly be available only if the *beneficial owner* of the item is a *resident* of the other contracting state. The current wording of articles 10, 11 and 12 show some dominantly technical variation.[5]

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residence can occur when a Finnish company is simultaneously treated as resident elsewhere.

2 Ryynänen, Olli, *Om behovet att ändra vår inkomstskattelagstiftning mot bakgrunden av EG-domstolens rättspraxis*, Tidskrift utgiven av Juridiska Föreningen i Finland 2002, at 170.

3 With respect to *individuals* dual residence is often established as Finland regards its citizens as being resident in Finland during three full calendar years after their leave, unless they can prove not to have had substantial ties to Finland during that time.

4 Article 10(2) stipulates a reduction of the statutory withholding tax rate on dividends to 5 % in the case of a company with a direct holding of at least 25 %, and 15 % in other cases, whereas article 11(2) indicates a maximum withholding tax rate of 10 % on interest. Article 12(1) lays down the principle of exclusive taxation in the state of residence of the owner of the royalty, which has lead to many deviations from this in bilateral treaties.

5 Article 10(1) speaks of dividends *paid* by a resident in a contracting state to a resident of the

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The beneficial ownership test was introduced in the 1977 version of the model convention. The wordings of articles 10, 11 and 12, which were later clarified, may previously have given the wrong notion that reduced treaty rates were applied only when an item was *directly* paid to and received by the beneficial owner of the dividend, interest or royalty.[6]

In the 1963 version of the OECD draft convention articles 10, 11 and 12 only addressed dividends, interest and royalties being *paid to* a resident of the other contracting state.[7]

Upon introduction into the model convention in 1977 the concept of a beneficial owner was not defined and the convention commentary is still very sparse explaining its meaning. This is somewhat surprising as the concept directly decides the allocation of the right to tax dividends, interest and royalties between the contracting states. The concept was, however, used before that time by the United Kingdom in its treaty practice.

The question of how the beneficial ownership requirement is to be interpreted also occurs with respect to tax treaties built upon the United Nations and United States model conventions, because they follow the same structure.

4 The Impact of the Beneficial Ownership Test on the Finnish Tax System

With respect to Finland the reduction of withholding taxes by way of treaty provisions is fully relevant as to dividends and royalties, but not for *interest*. This is due to the fact that interest received by non-residents is taxed to Finland only if the interest is effectively connected to a permanent establishment located here. This is an explicit choice of the legislator as taxing interest to Finland would only lead to a corresponding adjustment in the interest level, as provided for in tax clauses of all properly drafted international loan agreements.[8]

An exception to this tax treatment is provided for in section 9(2) of the Income Tax Law relating to amounts paid as interest to related persons on

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other contracting state, whereas article 11(1) addresses interest *arising* in a contracting state and *paid* to a resident of the other state.

Articles 10(2) and 11(2) both require the *beneficial owner* of the dividend or interest to be a *resident* of the other contracting state for reduced treaty rates to apply.

Article 12(1) stipulates that royalties *arising* in a contracting state and *beneficially owned* by a resident of the other contracting state shall be taxable only in the state of residence.

6 Articles 10(2) and 11(2) provided that “the *recipient* is the beneficial owner” of the dividends and interest, whereas article 12(1) spoke of royalties arising in a contracting state and *paid to* a resident of the other state being taxed only in the latter state “if such resident is the beneficial owner of the royalties”.

7 Articles 10(1) and 11(1) spoke of dividends and interest *paid to* a resident of the other contracting state, whereas articles 10(2) and 11(2) were lacking a beneficial ownership test. Article 12(1) also simply addressed royalties arising in one state and *paid to* a resident of the other contracting state.

8 Interest is by all means considered *Finnish sourse income* (in section 10 of the Income Tax Law) and is even subject to a withholding tax of 29 % (in section 7 of the Law on the Taxation of Non-residents), but these provisions are eliminated by section 9(2) of the Income Tax Law redering such interest tax free in Finland.

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foreign loans, which are actually *equity* investments.[9] A broad application of these domestic rules is, however, doubtful in a European Community law as well as a tax treaty context because a corresponding restriction on interest deductions is not applicable in purely domestic situations, where related persons are financing their thinly capitalised entities. In general the right to deduct interest while determining taxable income is fairly extensive in Finland.[10]

Insofar as *dividends* and *royalties* are concerned the question of access to reduced rates is highly relevant as the statutory withholding tax rate is 29 % and it is substantially lowered – often to a maximum of 15 % or less – when the relevant tax treaty provisions apply.[11] Dividends distributed by a Finnish company are naturally taxed to Finland and royalties paid abroad are considered Finnish source income, provided that the relevant intellectual property right is utilized here.

Currently a majority of Finnish tax treaties concluded *expressly include* a beneficial ownership test. The term *beneficial owner* has been translated into Finnish in slightly different ways, but they do not really seem to vary in meaning.[12] There are also still many treaties lackning this requirement, most on them - but not all - being rather old.[13]

With respect to dividends the importance of the applicability of tax treaty provisions is somewhat reduced by the requirements of the *parent-subsidiary directive*. As implemented into domestic law, withholding tax is eliminated altogether when the dividend is paid to a company resident in another European Union member state and the recipient is owning at least 10 % of the voting power or at least 25 % of the capital in the distributing Finnish company. In this context, Finland has chosen not to make use of the possibility provided in article 3(2) of the directive enabling ownership time requirements for withholding tax

9 This implicit *thin capitalisation* provision must be read in conjunction with section 36 of the *Wealth Tax Law* according to which loans from foreign related persons, which are actually equity investments, cannot be deducted from the value of the assets while calculating the basis for wealth tax. As wealth tax is abolished for most enterprises, the only practical significance of the provision is its application *ex analogia* in the field of income tax: interest paid on what is actually equity is non-deductible because it is a profit distribution.

10 While calculating business income interest is deductible even if its level would be dependent of the *profitability* of the debtor enterprise (thus introducing a profit distribution element) and interest incidental to passive operations is deductible, provided that the interest is paid in order to accrue income, which is almost always the case.

A special feature of the Finnish tax system is that interest is deductible even if the income hereby produced would be *tax free*, e.g. when the leverage has been invested in shares producing a tax-free foreign dividend.

11 For a treaty rate chart see IBFD, *European Tax Handbook*, Amsterdam 2002, at 198-199.

12 The countries with whom Finland has concluded tax treaties *including* a beneficial ownership test are listed in footnotes 25-26 and 28-29 under point 5 below.

13 Treaties lacking a beneficial ownership test are the ones concluded with Bulgaria (1985), Egypt (1965), France (1970), Germany (1979), India (1983), Japan (1972), the Philippines (1978), Poland (1977), Portugal (1970), the Soviet Union (1987, still applicable to Russia), Spain (1967), Thailand (1985), Turkey (1986) and the recent treaty with Austria (2000).

Treaties lacking the test, but where the contracting states are to *negotiate* over the application of reduced rates are the treaties with Greece (1980), Hungary (1978), Jugoslavia (1986, applicable to Croatia 1995 and Slovenia 1992 onwards), Marocco (1973), South Korea (1979) and Tanzania (1976).

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elimination to apply. Nor has Finland chosen to introduce special domestic anti-avoidance provisions with respect hereto, albeit such provisions are approved by article 1(2) of the directive.

Under Finnish domestic law the *allocation of income* is decided applying the general principles of income tax law. Title to a share denotes a strong factual presumption as to ownership of the share as well as any dividends it may generate. But section 28 of the Law on Tax Procedure contains a *general clause* against tax avoidance stipulating that tax is to be assessed in accordance with the factual circumstances when a misleading legal form has been utilized. Re-characterization of ownership to a share and entitlement to a dividend by virtue of this provision requires both evidence of the transaction setup being artificial and a proven intent of the taxpayer to avoid withholding tax otherwise payable.

5 Beneficial Ownership as a Treaty Level Concept

Considering the constant international flow of dividends, interest and royalties the lack of a more exact interpretation of the concept and considerable differences of opinion are truly regrettable. Even the basic question whether beneficial ownership is to be regarded as an independent *treaty level concept* or whether it shall be interpreted in accordance with the domestic law of a contacting state is disputed.

Article 3(2)[14] of the OECD model convention provides a general rule of interpretation for terms used in a treaty, but not defined therein. A domestic tax law meaning shall prevail over any other meaning and an interpretation when the tax is imposed shall prevail over an interpretation in force when the treaty was signed. This reference to domestic law applies, however, only if the context does not require otherwise. The context is determined in particular by the intention of the parties when signing the treaty as well as any meaning given to a term in the legislation of the other state.

In spite of the clear wording of article 3(2) there is strong support for the view that terms being well established in international tax law, such as a beneficial owner, should be interpreted in a purely *treaty framework* and not by reference to domestic law.[15] Such a standpoint clearly promotes a more consistent treaty application both in a given case between the contracting states as well as generally in the network of tax treaties. This alternative has also been advocated by stating that domestic legal systems do not give a precise definition of the term. Therefore it is said to seem most appropriate that the meaning of the term be given by way of treaty interpretation bearing in mind the reason why the qualification was introduced.[16]

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14 Article 3(2) reads: "As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, *unless the context otherwise requires*, have the meaning that it has at that time under the law of that State for the purposes of taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State."

15 IFA, *The Concept of Beneficial Ownership in Tax Treaties*, The Hague 2000, at 15-22.

16 Vogel, Klaus, *Klaus Vogel on Double Taxation Conventions*, London 1997, at 562.

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It does not, however, seem altogether appropriate to say that the term *beneficial owner* is lacking a meaning altogether in the common law family of countries. Quite to the contrary, one could well argue that the concept has been adopted from this tradition into international tax law especially due to the profound characteristics of the concept.[17] Therefore, the position that the concept should be interpreted autonomously from domestic law should rather be based upon the *context requiring otherwise*.

When member states conclude tax treaties following the text of the model convention, it is reasonable to presume that those states want the treaty provision to convey the meaning intended by the model convention and its commentary, as long as there are not any particular circumstances indicating to the contrary.[18] One could even say that as the concept has now already for decades been included in the model convention, upon which a myriad of treaties are directly based, it is reasonable to strongly assume that any contracting parties have intended to adopt the term as a treaty concept, unless they have expressly indicated otherwise when a specific treaty was concluded.

Under such conditions the meaning given by the model convention and the commentary represents the *ordinary meaning* of the term in accordance with the Vienna Convention. According to article 31 of the Vienna Convention the general rule of interpretation is that a treaty shall be interpreted in good faith in accordance with the ordinary meaning of the terms of the treaty in their context and in the light of its objectives and purpose.[19]

Among the OECD countries especially the United States is advocating an interpretation by reference to *domestic tax law*. The reason for this is that such a view inevitably renders the source state flexibility as to the application of domestic anti-avoidance provisions in treaty situations. If the concept of a beneficial owner is defined by reference to domestic law then this definition can be adapted to various domestic anti-abuse vehicles (such as the business purpose doctrine, substance over form considerations, the step transaction rule and general conduit principles).[20] If this line of reasoning is adopted then purely domestic anti-avoidance tests of the source state can quite freely be transferred to a treaty level via the beneficial owner concept. The United States has not, however, received much support from the other OECD member states regarding

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17 According to common law ownership is indivisible, whereas the *rules of equity* allow divided ownership, with legal title being in one person and beneficial ownership in another. du Toit, Charl P., *Beneficial Ownership of Royalties in Bilateral Tax Treaties*, Amsterdam 1999, at 241-242.

18 Vogel, Klaus, *Klaus Vogel on Double Taxation Conventions*, London 1997, at 44-45.

19 The context comprises the entire text and any related *agreement* concluded or *instrument* accepted by the parties. Any subsequent agreement or *established practise* relating to the interpretation shall also be taken into account. A *special meaning* shall be given to a term if it is established that the parties so intended.

Article 32 states that recourse *may be had* to supplementary means of interpretation, including preparatory work of the treaty and the circumstances of its conclusion to determine the meaning when the interpretation according to article 31 leaves the meaning *ambigous* or *obscure* or leads to a result which is *manifestly absurd* or *unreasonable*.

20 IFA, *The Concept of Beneficial Ownership in Tax Treaties*, The Hague 2000, at 27-29.

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this view, which in fact leaves the door wide open for application of domestic anti-avoidance provisions on a treaty level.[21]

Once a treaty is concluded, there is an implicit reference to the principle of *reciprocity* on which the convention is based. Therefore a contracting party should not be allowed to make a convention partially inoperative simply by amending afterwards in its domestic law the scope of terms not defined in the treaty.[22] As such article 3(2) of the model convention governs only the interpretation of words used and provides no justification for reliance on general legal principles of domestic law in interpreting treaty law, or for closing loopholes within the treaties by reference to domestic law.[23] Thus, it seems most appropriate that the term be interpreted with reference to the context of a treaty, and in particular with a view to the purpose pursued by the restriction.[24]

In fact it seems inevitable to dare to find a *treaty level* interpretation of a beneficial owner even if article 3(2) would be applicable. Being a member of the civil law countries Finland, as many other states, does obviously not have any domestic law meaning of beneficial ownership to revert back to. In cases where the term is not included in the domestic laws of both contracting states or the meanings given to it there are at variance, it does not seem reasonable that the concept be interpreted *differently* in the contracting states. One may even say that use of the concept of a beneficial owner in treaties concluded by states, whose domestic law does not know the word confirms that the term has status as a treaty level concept.

As much as it seems reasonable to treat the concept of a beneficial owner as established in international tax usage, the same cannot necessarily be said about various *translations* of the term into national languages. In Finland the concept has, nevertheless, been translated simply to denote a person who *has a right to* the dividend, interest or royalty,[25] which being a neutral expression seems to be well in line with the interpretation of the model convention commentary. In some treaties the expressions »osinkoetuuden omistaja», »korkoetuuden omistaja» and »rojaltietuuden omistaja» are used, which can be translated as meaning the *owner of the dividend, interest and royalty benefit*.[26] This wording

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21 IFA, *The Concept of Beneficial Ownership in Tax Treaties*, The Hague 2000, at 17.

22 OECD, *Model Tax Convention on Income and on Capital*, Volume I, Paris 1997, at C(3)-4.

23 Vogel, Klaus, *Klaus Vogel on Double Taxation Conventions*, London 1997, at 209-210.

24 Vogel, Klaus, *Klaus Vogel on Double Taxation Conventions*, London 1997, at 562.

25 Such treaties are the ones concluded with Argentina (1994), Australia (1984), Barbados (1989), Canada (1990), Communist China (1986), Estonia (1993), Ireland (1992), Latvia (1993), Lithuania (1993), New Zealand (1982), Pakistan (1994), Singapore (1981), South Africa (1995), Sri Lanka (1982), Switzerland (1991), Czechien (1994), Ukraine (1994), the United Kingdom (1969, as amended 1997) and the United States (1989).

In one treaty, the one with Indonesia (1987), the requirement is included only in the permanent establishment provision.

26 Such treaties are, besides the one among the Nordic countries, the treaties with Israel (1997), Italy (1981), Luxembourg (1982), Makedonia (2001), Malta (2000), Mexico (1997), the Netherlands (1995), Romania (1998), Russia (1996, not yet in force), Slovakia (1999) and Uzbekistan (1998).

The treaty with Zambia (1978) includes the beneficial ownership requirement for dividends and interest, but not for royalties, where the competent authorities are to negotiate on how the

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is used in the tax treaty between the Nordic countries (1996) as well as the translation into Finnish of the model convention (2000).[27] A few treaties use the word »todellinen» as an explicit distinction demanding that the recipient must be a *true owner* of the dividend, interest and royalty benefit.[28] Sometimes the expressions used even vary between the dividend and the other articles within the context of one single treaty.[29] The variation in expressions used are, however, so small that the expressions used - at least for practical purposes - denote the same thing. In some cases a treaty has been drawn up in English as a third language besides the languages of the contracting parties, stating expressly that the English version shall prevail.[30]

Translations in the other Nordic counties have meanings close to the Finnish translation. Sweden also simply refers to the beneficial owner as a person who *has a right to* (har rätt till) the dividend, interest or royalty. In Denmark the term *rightful owner* (retmaessige ejer) is used, where Norway utilizes the term *rightfully entitled* (rettmessig tillkommer). All these translations refer to a *real owner* or *true owner* as contrasted to an intermediary.[31]

Insofar as domestic translations have a *special meaning* this may indicate that the contracting party has intended not to rely on the model convention at this point while concluding the relevant treaty. The German term »Nützungsberechtigter» suggests that a beneficiary is a person with a *right to benefit* from the item in question, which is close to the meaning in the common law countries. The French term »bénéficiaire effectif'» on the other hand, does not focus on rights, but instead suggests that the concept of beneficial ownership requires the situation to be such, that the person is in *reality benefitted* from the payment. This again may imply that factors precluding beneficial ownership could also be merely factual.[32] As beneficial ownership under Finnish law denotes a person with *a right to* the item, the mere factual payment onwards of

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restriction is to be applied.

27 This translation was presented by the late director of international tax affairs, Mr. Hillel Skurnik from the Ministry of Finance, who has negotiated many of the currently existing Finnish treaties.

28 Such are the treaties with the United Arab Emirates (1996) and Brasil (1996).

29 In the treaty with Belgium (1976) the dividend article speaks of the recipient *having a right to* the dividend (on oikeus), whereas the interest and royalty articles use the expression of the recipient *being the owner of the interest* and *royalty benefit* (korkoetuuden omistaja; rojaltietuuden omistaja).

As to dividends the treaty with Malesia (1984) speaks of a *resident being entitled to the dividend* (henkilö on oikeutettu), whereas the interest and royalty articles simply require that the recipient *has a right to* (on oikeus) the item in question.

30 Such is the treaty with Turkey (1986), which does not include a beneficial ownership requirement.

31 The term *entitled* may, nevertheless, be comprehended as being somewhat at variance with the term *owner*. The term *beneficially entitled* is used in the English version of the treaty Finland has concluded with Australia (1984), but in Finnish it is translated as a person who *has a right to* the dividend, interest or royalty. The term is also used in the treaty with Malesia (1984) being translated as to dividends with the expression of a *person being entitled* (henkilö on oikeutettu) to the dividend, whereas the articles relating to interest and royalties only speak of a person who *has a right to* the item. Thus, no variation in meaning seems to be intended between the terms *beneficially entitled* and *beneficial owner*, at least when it comes to Finnish treaty practice.

32 See Vogel, Klaus, *Klaus Vogel on Double Taxation Conventions*, London 1997, at 562-563.

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amounts received to another person, without a legal obligation, does not constitute beneficial ownership with the transferee.

It seems evident that the need for *legal certainty* speaks strongly in favor of a beneficial owner being regarded solely as a treaty level concept, unless a state has clearly indicated otherwise while concluding a specific treaty. Resorting generally to domestic law by way of article 3(2) can in fact undermine treaty solutions by making them vulnerable to subsequent changes in the domestic laws of the contracting states. While treaty benefits are granted particularly in order to eliminate double taxation it is logical to speak out under what distinguishing circumstances such benefits generally granted are denied. As treaties are based on reciprocity it is reasonable that denial of treaty benefits should be effected by way of treaty provisions likewise applicable in both contracting states.

6 Interpretation of Beneficial Ownership in the Light of OECD Materials

6.1 Introduction

Originating from the common law family of states, the concept of beneficial ownership was borrowed into the model convention and can now be said to form a part of this treaty tradition. As not one country has made any reservation or observation as to its meaning in the model convention, the commentary should be taken as a starting point when interpreting the concept. This interpretation should then be subjected to the context of a relevant treaty to discover any variance in relation to the model convention.

In Finland the law, its preparatory documentation, published cases and legal research are established sources of law. Tax treaties are usually brought into force by way of an act with this effect, but the preparatory documentation to such acts is usually rather superficial and of a general character. Leaving aside the considerations as to the exact right importance to be given to the model convention in the interpretation process, it is nevertheless clear that the model convention is regarded as a strong de facto source of law in Finland.

The exhaustive meaning of the term aimed at when the concept was introduced in the model convention cannot be derived directly from the commentary, nor the context of the model convention as a whole. It is, however, evident the that restriction was inserted especially in order to avert tax avoidance. It aims at preventing persons not otherwise entitled to the protection of a specific treaty to benefit from it by way of intermediary persons inserted between the parties. Further guidance can be found from the meaning given to the concept in the common law states, mainly the United Kingdom, which is the ultimate source of the concept.[33]

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33 du Toit, Charl P., *Beneficial Ownership of Royalties in Bilateral Tax Treaties*, Amsterdam 1999, at 178.

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6.2 The Commentary on the Model Convention

Unfortunately and somewhat surprisingly the commentary on the model convention does not cast any substantial light on how the term is to be interpreted. Relating to article 10 on dividends the commentary is satisfied with merely stating the following:

> "Under paragraph 2, the limitation of tax in the State of source is not available when *an intermediary, such as an agent or nominee, is interposed between the beneficiary and the payer*, unless the beneficial owner is a resident of the other Contracting State. (The text of the Model was amended in 1995 to clarify this point, which has been the consistent position of all Member countries.) States which wish to make this more explicit are free to do so during bilateral negotiations."[34]

Exactly the same text is repeated in the commentaries on articles 11(2) and 12(1) with respect to interest and royalties.[35] From the model convention commentary it can, nevertheless, directly be concluded that the limitation of benefits does not apply only to nominees and agents, but also when other *similar intermediaries* have been interposed between the beneficiary and the payer of the item. Furthermore, the commentary notes the possible need to *further clarify* the concept in bilateral treaties.

Thus, the terms *agent* and *nominee* merely *illustrate* the kind of intermediaries intended to be caught by the beneficial ownership test. When property stands in the name of a person, but is actually the absolute property of someone else, the person holding title is a *nominee* for the beneficial owner. A nominee is a person who owns property in name only, but not in reality. An *agent* again is a manifold concept denoting a person who is authorized to act on behalf of another person for or in place of him.[36] Depending on whether he is acting in his own name or not, he may or may not disclose the identity of his principal to a third party. Generally speaking, an agent is a business representative who handles contractual arrangements between the principal and third persons.[37]

An *intermediary* is an utterly broad concept which can, besides agents and nominees, be denoted to include any administrator, conduit, broker, employee, fiduciary, go-between, middleman, proxy, representative, trustee etc. In this context intermediaries are, however, limited to those similar to nominees or agents.

Thus, according to the model convention commentary the concept of a beneficial owner should be limited to excluding from entitlement to treaty

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34 OECD, *Model Tax Convention on Income and on Capital*, Volume I, Paris 1997, at C(10)-3.

35 OECD, *Model Tax Convention on Income and on Capital*, Volume I, Parsi 1997, at C(11)-3 and at C(12)-1.

36 Black, Henry Campbell, *Black's Law Dictionary with Pronounciations*, St. Paul, Minnesota 1990, at 63-64.

37 Garner, Bryan A., *A Dictionary of Modern Legal Usage*, New York 1995, at 38.

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benefits only agents, nominees and other *similar middlemen*, but does not support the view of a more broad interpretation of the term.

6.3 The Conduit Companies Report

The OECD conduit companies report of 1986 somewhat further elaborates on the meaning of the concept. After recalling in general terms what has already been said in the commentary it goes on to specify as follows:

> "The Commentaries mention the case of a nominee or agent. The provisions would, however, apply also to other cases where a person enters *into contracts or takes over obligations under which he has a similar function* to those of a nominee or an agent. Thus the conduit company can normally not be regarded as the beneficial owner if, though the *formal owner of certain assets, it has very narrow powers which render it a mere fiduciary or an administrator* acting on account of the interested parties (most likely the shareholders of the conduit company)."[38]

The description relating to an *interposed* intermediary, i.e. thrown in between the payer and the recipient implies that a payment received by the intermediary is *transferred onwards* to the beneficial owner. More precisely it relates to cases where a person has entered into contracts or taken over obligations under which he has so limited powers that his role is reduced merely to that of a fiduciary or an administrator acting on account of the beneficial owner.

This invites into an analysis of the *nature and extent of rights and obligations* retained by the respective parties, and if such investigation shows that the immediate recipient of the item is under a *legal obligation* to render the amount onwards to someone else, then he cannot be regarded as the beneficial owner of the item. Thus, the concept of a beneficial owner is used to indicate a person who is *really entitled* to an item, which is received on his behalf by another person who may, or may not, be the owner in the formal, i.e. legal sense and whose ownership can be regarded as fictious.

Beneficial ownership is forfeited when there is a legal obligation to transfer the *specific payment* onwards to another person. If the recipient is entitled to use the moneys to fulfil his obligations in general he must, however, be regarded as the beneficial owner of the item. Then it is not relevant that he may decide to use the funds to pay debts directly related to the income received. In due course of all business it is indeed natural that enterprises are obliged to pay out most of the resources received to cover their expenses.

By contrast, if a third party has a legal right to acquire and the intermediary has an obligation to transfer a specific payment to him, then the ownership attributes are vested in the final recipient and not in the intermediary, who lacks a right to deal with the funds as his own. In such a case there is an *enforceable right* against the party to claim the specific payment and the intermediary cannot be regarded as a beneficial owner of the item. The situation does not change by

[38] OECD, *Model Tax Convention on Income and on Capital*, Volume II, Paris 1997, at R(6)-10.

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the possible fact that the intermediary may be entitled to deduct a commission or a fee while fulfilling his contractual obligation to pass the income on to the beneficial owner.

6.4 The "Paid to" Requirement in the 1977 Model Convention

The wording of articles 10(2), 11(2) and 12(1) in the 1977 model convention may, i.e. until their clarifying amendment in 1995, have implied that treaty reduction of withholding tax rates is available only when the item is *paid directly to the beneficial owner*.[39] As transfer usually takes place to the person holding formal title to the item, this would result in treaty benefits being available only when the formal recipient and beneficial owner are *identical*. This again would indicate that treaty benefits should be rejected even in totally bona fide cases where the beneficial owner and the formal recipient are residents of the same state. In such cases the beneficial owner would have been rightfully entitled to treaty benefits had payment only taken place directly to him.

This line of restrictive reasoning is not in conformity with the commentary on the model convention. The commentary expressly deals with the case of the beneficial owner being a resident of the *same state* as the formal recipient, and regards treaty benefits to arise directly from the treaty itself. Intermediaries are to be denied treaty benefits unless the beneficial owner is a resident of the same state.[40] This conclusion can be drawn only if a payment to the formal owner is simultaneously regarded as a payment to the beneficial owner as well.

This view is fully in line with the idea that the beneficial ownership restriction was introduced in order to prevent the abuse of tax treaties. Thus, the term *payment* should be given a fairly broad meaning in this context. In case transfer takes place to a formal owner, but for the benefit of the beneficial owner, such a payment is invariably also a payment to the beneficial owner also. Therefore, treaty protection is granted provided, however, that the beneficial owner is a resident of the same contracting state.[41]

6.5 The "Paid to" Requirement in the 1963 Draft Convention

In the 1963 draft convention, and older tax treaties based upon it, the condition spelled out for acquiring a reduced rate of withholding tax is merely that the item is *paid to a person resident* in the other contracting state.[42] For treaty benefits to apply it thus seems sufficient that the transferee is a resident of the other contracting state. Therefore, it becomes important to decide the width of the concept of a *payment* in this context also. The crucial question is whether,

39 For details see point 3 above.

40 OECD, *Model Tax Convention on Income and on Capital*, Volume I, Paris 1997, at C(10)-3, C(11)-3 and at C(12)-1.

41 Vogel, Klaus, *Klaus Vogel on Double Taxation Conventions*, London 1997, at 563.

42 For details see point 3 above.

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and to what extent, a beneficial ownership requirement can be implied by the treaty context.

The view taken here is that the residence of purely facade payees, who are proven to be mere nominees or comparable go-betweens, cannot be taken into account while determining treaty benefits. This should be the case even if the transferee would be holding formal title to an item of income or the property generating it.

Moreover, it is of course self evident that persons who do not have beneficial, nor even a formal right to an item, cannot claim treaty protection. Therefore, banks who collect payments for their customers cannot claim treaty benefits, as they are not in any way themselves entitled to the amounts in question. As such payees are not even formal owners of the amounts received, they cannot be regarded as recipients of the respective amounts under treaty law at all.

6.6 The Importance of "Subject to Tax" Considerations

The OECD Committee on Fiscal Affairs originally considered making treaty benefits dependent on the payments being liable to tax in the residence state with a *subject to tax* clause. As this solution would have introduced difficulties as to the right allocation of income that alternative was ultimate abandoned in favor of the requirement of beneficial ownership.[43]

Currently, the commentary on the model convention notes that articles 10, 11 and 12 *do not specify* whether or not relief in the source state should be made conditional upon the item being subject to tax in the state of residence, which issue can be settled separately by bilateral negotiations.[44]

Conceptually, the denotation of beneficial ownership does not require that the item is inevitably subject to tax in the hands of the recipient in his state of residence. But generally speaking, a beneficial owner usually refers to a person resident in a contracting state to whom that state attributes the payment for purposes of its tax. As a result of this it seems natural, inter alia, that a trustee of a discretionary settlement (lacking specified beneficiaries), who is subject to tax in the state of which he is a resident, should be regarded as a beneficial owner of the relevant items, which are attributed to him for taxation purposes.[45]

By contrast, agents and nominees, in their capacity as middlemen, usually shall not enter property and the income such wealth generates into their books. This usually applies both for accountancy and taxation purposes. Even if there is consensus that agents and nominees are not beneficial owners, the status of agents is more problematic. This is due to the fact that agents come in various shapes and may, besides holding legal title – entirely depending on the

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43 Vogel, Klaus, *Klaus Vogel on Double Taxation Conventions*, London 1997, at 561.

44 OECD, *Model Tax Convention on Income and on Capital*, Volume I, Paris 1997, at C(10)-6, C(11)-3 and at C(12)-2.

45 Among the common law family of states New Zealand in general regards trustees who are subject to tax as beneficial owners of the income. OECD, *Model Tax Convention on Income and on Capital*, Volume I, Paris 1997, at C(3)-5.

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peculiarities of each case – also have physical control over an item and possess other ownership attributes making judgement of their status truly blurred.

Before deciding in favor of the beneficial ownership requirement the Committee on Fiscal Affairs also considered to adopt the concept of a *final recipient* instead.[46] This concept would have been problematic as to cases where the immediate recipient does not have a *legal obligation* to transfer the item onwards, but does so voluntarily. In such cases it is not, however, appropriate to claim that the transferor is acting in a capacity similar to a nominee or an agent. Therefore, the beneficial ownership requirement is of a more distinctive character.

6.7 The Object of Beneficial Ownership

The model convention does not demand that the beneficial owner of the dividend, interest or royalty must also be a beneficial owner of the property, i.e. the share, claim or immaterial right, originating the payment, but this may be provided for in negotiated treaties. The wordings of articles 10(2), 11(2) and 12(1) clearly speak of beneficial ownership to the dividend, interest and royalty specifically, without dealing with the ownership of the underlying asset.

Cases where the recipient of the income does not hold title to the asset generating the item can, however, give rise to dispute as to the right characterization of the transaction. Lack of ownership to the underlying asset *invites scrutiny* as to whether the person really owns the yield or is merely acting as a collecting agent for the owner of the income-producing asset. As money is fungible the ultimate decisive factor may be whether or not, and to what extent, the person claimed to be an intermediary *bears a risk* of his own in the transaction.[47]

The beneficial ownership test focuses on the ownership attributes regarding a *specific payment* of a dividend, interest or royalty. It does not contain a condition that the beneficial owner must also be the owner of the income-generating asset. Ownership to the underlying right, i.e. a share, claim or intellectual property is, however, usually vested in the recipient of the payment, but this need not always be the case. Therefore, ownership to the underlying property may give *guidance* as to ownership of the yield, but cannot direct the question in a conclusive manner in a treaty context.

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46 Vogel, Klaus, *Klaus Vogel on Double Taxation Conventions*, London 1997, at 562.

47 If for example a person buys dividend coupons in an arm's length transaction on the market before the dividend becomes payable and realized, i.e. in his own name on his own account and on his own risk, without any obligation to render the coupons, nor the proceeds received to any other person, then he is to be considered as the beneficial owner of the dividend once it becomes payable.

But if dividend coupons are only transferred in to the name of a person for him to be able to take advantage of treaty benefits and he is under an obligation to pay any amounts received forward to the owner of the shares, with or without a deduction for his costs and commission, then he is merely acting as an intermediary on behalf of the owner of the shares.

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6.8 Preliminary Conclusion

Bearing in mind the need for *legal certainty* of tax treatment and in the light of the model convention commentary focusing on agents and nominees and other interposed similar intermediaries, it does not seem correct to give beneficial owner a very wide interpretation. The concept is too vague and uncertain to operate as a general anti-abuse vehicle rendering other explicit limitation of benefits clauses superfluous.

The qualification is mainly a *clarification* of the terms *received by* and *paid to a resident of the other state* and should be read to denote a *true and real owner* as distinct from a nominee or other similar person who is not the actual recipient. Beneficial ownership is a legal concept which should be interpreted quite strictly without a broad analysis in terms of abuse of law. Virtually all it brings about is to illuminate the situation as it actually already existed under earlier circumstances and can be expected to continue to exist in the future.[48]

7 Further Analysis of the Beneficial Owner Concept

The exact meaning of the term aimed at when the concept was introduced in the model convention cannot completely be derived from the model convention, its commentary, nor the circumstances surrounding the drafting of the model convention. Choice of this term was, nevertheless, a *deliberate pick* among several other expressly rejected possibilities.[49] It would also have been possible to settle for broad references to substance over form or conduit arrangements, but this was not the case.

While interpreting the concept on a treaty level the meaning given to the term in the *common law* family of states should be taken into account because the concept originates from that tradition. Determining the more precise meaning of beneficial ownership the *plain word meaning* should be taken as the starting point. Doing this dictionary descriptions can prove helpful. The Black's Law Dictionary gives the following definition:

> "Term applied most commonly to cestui que trust[50] who enjoys ownership of the trust or estate in equity, but not legal title which remains in trustee or personal representative. Equitable as contrasted with legal owner.
>
> One who does not have title to property but has rights in the property which are the normal incident of owning the property. The persons or whom a trustee holds title to property are the beneficial owners of the property, and the trustee has a fiduciary responsibility to them."[51]

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48 Vogel, Klaus, *Klaus Vogel on Double Taxation Conventions*, London 1997, at 564 and at 46.

49 See above under point 6.6.

50 The term *cestui que trust* is nearly equivalent to a *beneficiary*. Aiyer, P. Ramanatha, *The Law Lexicon*, Nagpur 2001, at 209.

51 Black, Henry Campbell, *Black's Law Dictionary with Pronounciations*, St. Paul, Minnesota 1990, at 156.

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In the common law tradition beneficial ownership denotes ownership for ones *own benefit* as opposed to ownership as trustee for another. This distinction becomes interesting when legal ownership is vested in one person and the beneficial ownership in another, but applies also to cases where there is no division of legal and beneficial ownership. A beneficial owner is one who, though not having apparent legal title, is in equity entitled to enjoy the advantage of ownership.[52] The heart of the concept is related to trust law where the trustees are holding legal title to property using it for the good of the beneficiaries. Thus a beneficiary is a person who has a right to benefit financially from property held by another person, i.e. has a *beneficial interest* therein.[53]

Conceptually, the term beneficial owner requires that a person entitled to treaty benefits is an *owner* of the payment, i.e. has a right to it, but he need not necessarily have legal title to the payment. The term may be somewhat stronger than the term *beneficially entitled* which does not include an explicit reference to ownership.[54] The term denotes ownership, which is not plainly the legal ownership by the mere fact of being on the register, but the right at least to some extent to deal with the property as one's own.[55]

Beneficial ownership includes a right to *dispose* of the payment for the benefit of oneself or a desired third party. A person thus entitled to the payment has the right to receive the item for himself and he also has the right to reject the payment. If he rejects the payment it is not realized for taxation purposes, but if he directs the payment to be utilized in favor of a third party, this constitutes receipt for the transferor. As to power to *control* the item, beneficial ownership does not necessary denote a right to cause an item to be realized, but rather addresses the question whether he receives it, and has a right to dispose of it, if and when it is realized.[56]

The question whether a person is entitled to receive an item is determined by applicable domestic *private law*, dominantly civil, contract and company law. Condensly, beneficial ownership can be described as a right to enjoy the benefits of property as exists where legal title is held by another and such right is recognized by law and can be enforced by the courts at the suit of the owner or of someone on his behalf.[57] By contrast a person who is merely an intermediary lacks such rights, because he does not have a beneficial interest in the property. Generally, if an item is acquired subject to the obligation to *transfer* it to someone else, such an acquisition is not regarded as beneficial ownership.[58] The

52 Aiyer, P. Ramanatha, *The Law Lexicon*, Nagpur 2001, at 208.

53 Aiyar, K. J., *Judicial Dictionary*, New Delhi 2001, at 144.

54 The term *beneficially entitled*, however, also means being entitled for one's own benefit and not simply as trustee for others. Aiyer, P. Ramanatha, *The Law Lexicon*, Nagpur 2001, at 208. Thus the distinction between the terms seems rather insignificant.

55 Aiyer, P. Ramanatha, *The Law Lexicon*, Nagpur 2001, at 208.

56 E.g. a shareholder in a company does not necessary have the powers to decide upon a dividend distribution, but he receives a dividend if such is declared.

57 Aiyar, K. J., *Judicial Dictionary*, New Delhi 2001, at 144.

58 In this context *securities lending* is interesting because it involves on the one hand a clear transfer of title to the shares to the borrower, but on the other hand comprises an obligation for the borrower to re-deliver (not the same but) an equivalent amount of the same kind of shares to

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question whether ownership rights are to be considered formal to such an extent that rejection of treaty benefits is possible is, nonetheless, always a question of treaty application.

Beneficial ownership must be determined by looking into the *nature and extent of rights* and obligations retained by the parties. Incidents of ownership are a right to freely avail of an item as well as the benefit of appreciation and risk of depreciation relating to it. It is marked by command over property and enjoyment of its economic benefits. How the attributes of ownership are divided between the parties is a question strongly determined by the specific circumstances of each case.

If rights vested in one person are merely a legal shell, then his is not the beneficial owner. Formal title cannot constitute beneficial ownership unless the person has a right at least *to some extent* deal with the property as his own. Where beneficial ownership is separated from title, then mere naked title of a person must be balanced against the indicia of beneficial ownership in another. The beneficial owner is the person whose ownership attributes outweigh that of any other person.[59] In principle, there can be only one beneficial owner with respect to an item at a specific time, albeit e.g. shares and dividends can of course be owned by several persons in quotas, i.e. proportional parts.

The common law tradition customarily makes use of the dichotomy of legal title versus beneficial ownership, which is somewhat awkward for the civil law tradition countries. But being an established concept in treaty practice civil law states, such as Finland, have to acknowledge the split notion of ownership in this context. Actually, this only denotes taking into account the contractual and similar rights held by others against the person having legal title to property. A person may have legal title, but be subject to rights and obligations in respect of another person making the ownership right artificial and empty of substance and then he cannot be regarded as the beneficial owner.

Treaty benefits should not be granted based only on the recipient's formal title to the payment, but be determined according to ownership in substance.[60] It is always tempting to say that substance shall prevail over mere form, but then

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the lender along with (not the dividend as such) but a compensation for any yield which the shares have generated.

It belongs to the peculiarities of securitites lending that the terminology used is somewhat misleading. Albeit lebelled as *lending* of shares it involves the transfer of ownership to the shares. The transaction also takes place specifically for the borrower to be able to *dispose* of the shares borrowed, i.e. for him to be able to meet his obligations towards third parties.

The dividend compensation does not denote the lender retaining a right to any dividend distributed, but includes only a contractual obligation on the part of the borrower to *compensate* the lender for any yield. This compensation is payable even if the borrower has already transferred the shares to a third party when the dividend becomes payable and he does not receive any dividend. Considering all this it seems from a Finnish perspective appropriate that the borrower in a securities lending transaction be regarded as a beneficial owner entitled to treaty benefits with respect to a dividend received in due course of a bona fide securities lending transaction.

59 du Toit, Charl P., *Beneficial Ownership of Royalties in Bilateral Tax Treaties*, Amsterdam 1999, at 249.

60 Vogel, Klaus, *Klaus Vogel on Double Taxation Conventions*, London 1997, at 562.

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again it is often not at all easy to determine whether there is a deviation between them in an actual case.

8 Specific Problems Relating to Group Situations

The fact that international business is inevitably conducted under the rules of multiple legal systems induces enterprises to adopt group formations. These structures usually serve a clear business purpose, but may also have their origin in tax considerations or be purely coincidental as a result of a pragmatic business history.

It belongs to the characteristics of a corporate structure that ownership in a company and management of its affairs are *separated*. Company law prescribes that the mere ownership of shares in a subsidiary does not comprise, but rather excludes, ownership to the subsidiary's property. Thus, the substance of the matter is strongly dependent on the legal form chosen and not only vice versa. A smooth function of the legal system also requires that tax law follows the approved structures of private law, i.e. as a starting point.

The fact that companies belonging to the same group are strongly *related*, nevertheless, complicates matters as to the question of where beneficial ownership rests. The reason for this is that subsidiaries are, and should be, dependent on their parents as vehicles to materialize business operations, albeit under the immediate supervision of the board of directors and the management. Especially with respect to holding companies, which are lacking independent business operations of their own, the question becomes delicate. The decision as to whether the company's ownership is merely formal in a given case depends heavily on the specific circumstances.

The fact that a company's main function is to *own assets* or rights is not in itself sufficient reason for categorizing it as a mere intermediary, but this may invite to further examination.[61] The question must be decided by asserting whether the company can *dispose* of dividends, interest and royalties received to cover its expenses and for distribution to its shareholders, or whether it is obliged to pass said specific items on, perhaps reduced by a commission, to its shareholders or other third parties.

If a company is simply distributing as a dividend to its shareholders the after tax profits it is making on dividends from shares held, interest on loans granted and royalties from rights licensed, there seems to be very little reason to question the structure. Bearing in mind the limitations of the scope of the beneficial ownership test, the situation does not differ much from the mere fact that the shareholders of the company are *financing* the acquisitions of the holding company by way of loans, which are generating a deductible interest.[62] Nor does

61 OECD, *Model Tax Convention on Income and on Capital*, Volume II, Paris 1997, at R(6)-10.

62 The model commentary, however, draws attention to cases where a company resident in the other contracting state, but owned by shareholders of a third state, is the beneficial owner of assets generating income from the source state. If such a company is enjoying *preferential tax treatment* in its state of residence and does not re-distribute its profits in the form of dividends, it may be appropriate to deny lower treaty rates in the source state by way of special treaty

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the structure deserve being considered artificial by way of the shareholders having reserved themselves *collateral* in the subsidiary's property as a security for payment of their claims. The creditor's power over pledged property does not as such deprive the rights of the owner to the property, but may, depending on the case, together with other indicators show that title to the item is merely formal.

The situation, however, becomes different if the holding company is obliged to *pass on* specific items of income to a third party upon receipt of a payment. Pure back-to-back structures do not deserve treaty protection. Such vehicles relating to financing and licensing are also not necessarily difficult to reveal. An important criterion while determining the character of an arrangement is the question of who is to *bear the risk* of non-performance. An intermediary which does not itself have to bear any risk of non-performance of its debtor may have problems convincing that it is the beneficial owner of the item.[63]

As companies themselves are basically legal fictions, beneficial ownership cannot be excluded merely by the fact that the company holding an asset finally has to adjust to the will of its owners. Thus, the fact that a company is a wholly-owned subsidiary does not as such denote that the company is merely an intermediary. Even if the parent company has a possibility to remove the board of directors from their position and re-elect a new more flexible composition, such a threat does not transform the sitting board into a mere mechanical extension of the owner's will. In fact, the board of directors cannot subdue to just any request presented by the shareholder, because the board has to look to the interests of the company. Any decision in clear conflict with this may lead to civil liability and distribution in violation of company law may also carry penal sanctions.

On the other hand it is also possible that a company having title to property has so *limited powers* as to decide over the asset and yield thereon, that it cannot be regarded as the beneficial owner. If a company has made a commitment to be bound by the controlling shareholder's decision as to ownership of an asset and any yield generated, then its ownership is merely formal and it cannot qualify as a beneficial owner for treaty benefit purposes. While the mere use of ownership rights by the shareholder does not turn the company into an agent for the parent as principal, there has to be other indications of the fact that the subsidiary's management is not in position to make decisions differing from the detailed will of the controlling shareholder. Whether this is the case or not depends entirely on the facts of the individual case.

Even though the beneficial ownership requirement is clearly designed to combat treaty abuse, the test cannot include an over-all judgement into the

provisions.

Especially with respect to interest the model commentary simultaneously notes that such measures may result in *double taxation* as withholding tax is imposed on gross income and not the actual economic net result. OECD, *Model Tax Convention on Income and on Capital*, Volume I, Paris 1997, at C(10)-6, C(11)-3, C(11)-4 and at C(12)-2.

63 The fact that a person cannot freely use the payments received (e.g. they are pledged to a third party in due course of a project finance arrangement), but he still carries the risk of non-performance of his debtor, does not as such preclude him from being a beneficial owner of the item in question.

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questions why a certain group structure was elected. Existing group structures, both domestic and international, should therefore be respected as such also for tax purposes without disregarding them entirely or stripping them of their assets and income to other persons. With respect to holding companies who are enjoying preferential tax treatment in their country of residence and who are utilized by residents of third states as tax avoidance vehicles, explicit exceptions should, when appropriate, be made by way of specific treaty provisions.

9 The Problem of Evidence

The question of determining the person to be regarded as the appropriate beneficial owner of an item is by necessity strongly dictated by the specific circumstances of each case. The context here requires that the tax authorities of the source state are to establish the beneficial owner in the residence state, that is *abroad*. Needless to say, this may in practice be a very difficult if not an impossible task.[64] To reveal all the agreements between the parties and to adequately ascertain the nature of the relationship between them, may require the use of administrative assistance.

As the taxpayer who is the recipient of an item is seeking to enjoy the benefits of a treaty, it is reasonable to require him to present proof as to his entitlement to treaty protection. Thus, the taxpayer is to provide evidence as to himself being *resident* in a contracting state and his *title* to the relevant payment in question.[65] The problems relating to the tax authorities' possibilities to search into the factual circumstances of a given case in an international context also speak in this same direction.

The importance of taxpayer co-operation cannot be overstated and therefore it is not the task of the tax authorities to present evidence as to the *customary requirements* entitling to treaty benefits. But having said this, it is important to keep in mind that one simply cannot require the taxpayer to present proof of the impossible. Therefore, it is to be considered unreasonable to require the taxpayer to explicitly prove that he is *not* a nominee, nor an agent with respect to the item in question. Usually it is clearly beyond the possibilities of a person to prove outright negative circumstances.

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64 OECD, *Model Tax Convention on Income and on Capital*, Volume II, Paris 1997, at R(6)-10.

65 According to section 10 of the Law on the Taxation of Non-residents, the provisions of an international convention are to be followed if the recipient before payment provides the payor with information as to his *residence* and *other conditions* for application of the treaty.

If information needed is supplied after tax has been withheld, but not yet transferred to the state, such withholding made is to be *corrected*. Excessive withholding tax already transferred to the state is according to section 11 returned to the taxpayer upon *application* to be made within five consecutive calendar years.

The procedures used in Finland are fairly flexible and treaty benefits are effortlessly available. In cases of doubt (e.g. where it is clear that the immediate transferee is an intermediary and there is explicit reason to doubt the correctness of information given as to the treaty benefit entitlement of the beneficial owner) it is according to sections 12 and 12a possible to request an *advance ruling* from either the Central Board of Taxation (with a possibility of appeal directly to the Supreme Administrative Court) or the local tax office.

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As shares, claims and other rights are usually held in the true owner's name on his own account, anyone claiming a person to be an intermediary has to prove this circumstance. Thus, there is a quite strong factual presumption that a person holding title to an asset is also the beneficial owner hereof. Legal title implies power to control and right to utilize an item and is thereby prima facie evidence as to ownership of it.

Where it is claimed that an *individual* is an intermediary not entitled to treaty benefits it may indeed be utterly difficult to prove the existence of factual restrictions of his powers of disposition precluding beneficial ownership. These difficulties are stressed by the fact that private individuals are usually not subject to detailed book-keeping requirements.

In *group situations* difficulties in asserting the nature of a relationship arise from the fact that relatedness of the parties mitigate the usual need to precisely document the rights and obligations of the parties. Guidance as to the factual relationship between the them can, nevertheless, at times be found by examining their *accounts*. The function of book-keeping is, however, to adequately describe the business, but not to render it its substance. Thus, the books are clearly evidence, though not necessarily conclusive.

An investigation into the dealings of the parties may lead to the conclusion that a holding company is in fact acting as a representative of the shareholder with respect to certain assets and the income they generate. If rights and obligations from a transaction concluded by a representative arise directly between the principal and a third party, then the representative has the clear status of an agent. In a case where the agent is acting in his own name on his own account in his dealings with a third party, but is in fact concluding the transactions on behalf of a principal, he is acting as an undisclosed agent. Such a characterization should always be founded on sufficient proof, but in group situations one cannot always demand such a relationship to be shown by a formal agreement. Nevertheless, the true nature of the relationship and the transactions should, in both cases, be reflected correctly in the books of both the agent and his principal.

Establishing a company's status as an agent on behalf of its controlling shareholder denotes that the rights and obligations of the transaction in question are re-allocated to the principal, i.e. while the separate legal personality of the company is left intact. For practical purposes the effect may, nevertheless, be much the same as that of piercing the corporate veil. Lifting the corporate veil denotes circumstances where it is proven to the satisfaction of the court that the company is a mere front concealing the true facts.

The need for *legal certainty* demands that measures directly comparable to lifting the corporate veil are not made on easy grounds. Therefore, the conclusive issue should be whether there is sufficient proof as to the company's legal obligation to pass on an item received to a third party. Such a conclusion cannot be inferred merely from control of a company or ownership of shares. Nor can there be a presumption in favor of an intermediary relationship, but such an outcome must always be supported by evidence. In the absence of proof to the contrary the recipient who is holding title should be regarded as the beneficial owner of the item.

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10 Summary and Conclusions

The foremost object and purpose of tax treaties is to eliminate international double taxation, but doing this they should not help tax avoidance and evasion.[66] The beneficial ownership requirement is positively a measure aimed at combating the improper use of tax treaties. It does so by preventing tax avoidance by means of denying treaty benefits, which are aimed at with the help of interposed persons. The beneficial ownership test is ultimately a means of identifying the *right recipient* when the formal one is not the true owner. It excludes agents, nominees, bare trustees and other similar intermediaries imposed for the sole purpose of enjoying treaty benefits not otherwise available to the recipient of the dividends, interest or royalties.

The beneficial owner test does not, however, denote the same thing as a pure avoidance of tax test, because it does not preclude treaty benefits when the interposed person holds the ownership attributes constituting beneficial ownership. The test only denies treaty benefits when the go-between is inserted merely as a strawman suggesting artificial application of the treaty. On the other hand the mere absence of an intent to avoid tax on the part of the taxpayer does not make the intermediary a beneficial owner. Thus some, but not all, situations of improper use of the convention are dealt with by introduction of the concept of a beneficial owner.[67] As persons holding very few attributes of ownership do not qualify as beneficial owners the test should, in principle, rather effectively limit the prospects of this kind of tax avoidance.

Determining whether a person is the beneficial owner does not include a test as to the ultimate reasons for executing a transaction in the existing form.[68] Such considerations involve the application of broader avoidance principles needing the support of more precise treaty provisions making scope for this. This interpretation is in line with the ordinary meaning of the term in both the model convention and the common law tradition from where it originates. It should be accepted that the beneficial ownership test alone cannot be a solution to all conduit situations. Currently, the situation in Finland stands far from any threat of an excessively widespread application of the requirement as published cases relating to this are still lacking altogether.

The use of artificial legal constructions created in a state essentially to obtain treaty benefits that would not be available directly can be labelled as improper use of a convention.[69] Simultaneously the absence of a tax treaty with a certain state may invite the creation of a holding company in a state with a more broad tax treaty network in order to prevent double taxation. In many cases such a measure does not deserve the label of treaty shopping, but rather only denotes the repair of a flaw in the tax treaty network.

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66 OECD, *Model tax Convention on Income and on Capital*, Volume I, Paris 1997, at C(1)-2.

67 OECD, *Model Tax Convention on Income and on Capital*, Volume I, Paris 1997, at C(1)-3.

68 Vogel, Klaus, *Klaus Vogel on Double Taxation Conventions*, London 1997, at 127.

69 OECD, *Model Tax Convention on Income and on Capital*, Volume I, Paris 1997, at C(1)-3.

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