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## Beneficial Ownership

*International skatteret 2012*



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# Agenda

- Background and Status
- Recent Danish cases
- Bill No. L 10
- International case law
- Revised OECD Commentary



# Background

- International trend
- Danish Tax Authorities have initiated a number of cases (more than 30) involving app. 19 BN DKK regarding the beneficial ownership requirement.
- The notion of beneficial ownership is unknown in a Danish legal context
  - Traditionally considered a matter of formal legal ownership
  - No implementation of specific anti-abuse rules from EU directives

# Status

- Tax tribunal and high court decisions
  - SKM 2010.268 LSR (Taxpayer prevails) – confirmed by the Eastern High Court on 20. December 2011 – SKM 2012.121 Ø
  - SKM 2010.729 LSR (Taxpayer prevails)
  - SKM 2011.57 LSR (Tax authorities prevail)
  - SKM 2011.485 LSR (Tax authorities prevail)
  - SKM 2012.26 LSR (Tax payer prevail)
  - SKM 2012.409 LSR
  - Tax Tribunal 29. August 2012
  
- A number of binding rulings from the Danish Tax Board

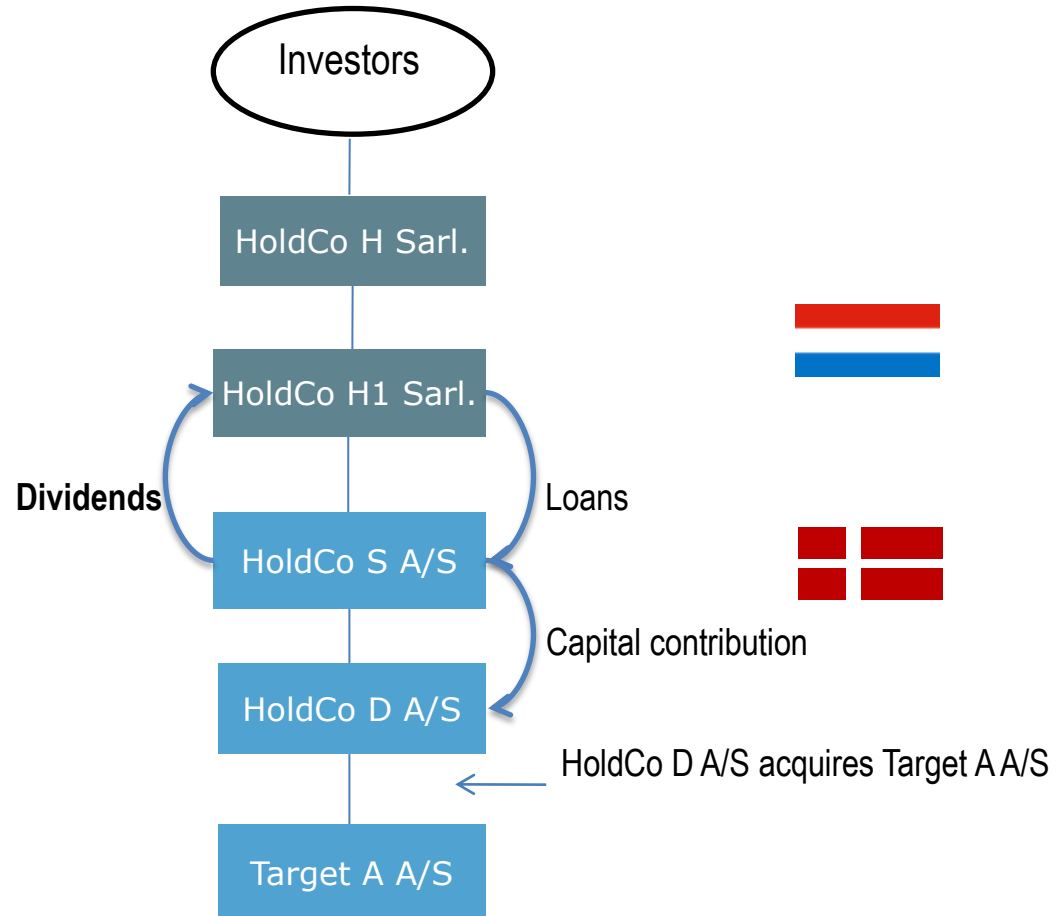


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## Recent Danish Case Law

# SKM 2012.121 Ø - Dividend case - Taxpayer prevails –"ISS Case 1"





## SKM 2012.121 Ø - Dividend case - Taxpayer prevails –"ISS Case 1"

- The reasoning of the Court:
  - The Eastern High Court upheld the Tax Tribunal Decision with a very clear and unambiguous decision.
  - Notion of beneficial ownership to be understood in accordance with an international fiscal meaning (autonomous).
  - Dynamic interpretation of tax treaties
  - Luxembourg holding company should be considered the beneficial owner of the dividends in question:
    - The Court did not consider it relevant to apply the a beneficial owner test in the actual case at hand.
    - The interposed entity should forward the payment in question to the recipient in a non-tax treaty state.
    - This requirement was not fulfilled in this case.



## Liquidation proceeds – SKM 2012.320 SR and SKM 2012.592 SR

- Liquidation proceeds (SKM 2012.592) and distributions in kind and liquidation proceeds (SKM 2012.320 SR)
  - Tax Board accepted distributions without withholding tax
    - In so far liquidation proceeds are not made available to other companies within the group in non-treaty/non-EU countries.





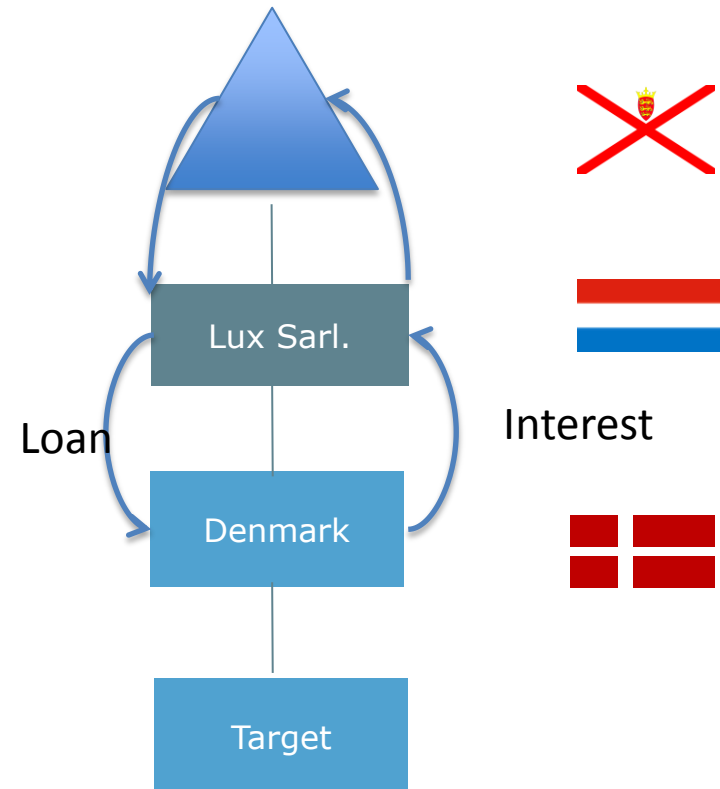
## Beneficial Ownership and EU Law



## SKM 2012.409 LSR Nycomed

### Facts

- Danish company was acquired by a Danish SPV owned by a foreign private equity fund which was organized with a Limited partnership in Jersey.
- The Danish SPV financed its acquisition of Danish target by a subordinated loan with an annual interest rate of 9%.
- Subsequently, a Luxembourg holding company was interposed.
- The Luxembourg holding company acquired the shares in Danish SPV and the original claim.
- Moreover, the Luxembourg holding company financed its acquisition of the Danish SPV through a loan from the Jersey LP with an annual interest rate of 9.875%. The interest payments on both loans were rolled into the principal and both loans were repaid with the principal on the same date.



## SKM 2012.409 LSR Nycomed

### **The Decision of the Tax Tribunal**

- Referred to the OECD commentary to article 11 and the Interest-/royalty directive.
- Luxembourg Holding was not the beneficial owner of the interest payments in question.
- Paid attention to
  - The actual construction, whereby the Luxembourg holding company forwarded the received interest payments to the investors of the private equity fund.
  - The fact that the two loans were almost identical in size and terms, neutralized taxation by the offsetting interest deduction.
  - Concluded that the Luxembourg holding company did not have any right to use and enjoy the income in question.
- Application of tax treaty with the country of residence of the investors of the private equity fund?
  - Refused to answer this question because no documentation was provided with respect to the existence of double taxation.

## SKM 2012.409 LSR Nycomed

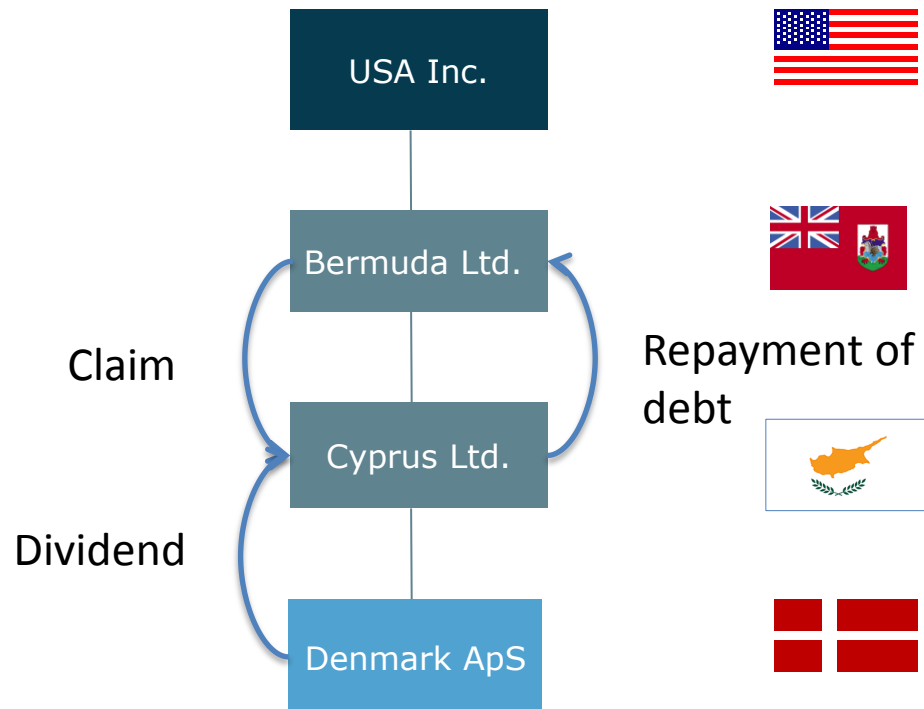
- **The Decision of the Tax Tribunal (cont'd)**
  - Rejected the argument that the Danish interest tax should be considered an infringement of the freedom of establishment and the free movement of capital in the European Union.
  - The rejection was based on a referral to the Cadbury Schweppes decision (Case C-196/04) and the European abuse of right doctrine.
  - The tax tribunal in effect stated that because a domestic restrictive measure may be justified on the basis that it prevents abuse, this consequently means that the Danish Interest withholding tax is not a violation of the freedom of establishment or the free movement of capital.
- **Comment**
  - Not surprising and seems in line with the previous decisions within the area.
  - Most interesting part of the decision is the Tax Tribunals reasoning on the EU law conformity.
  - In essence the Tax Tribunal must have reasoned that the interposition of the Luxembourg holding company should be considered an abusive practice for EU law purposes.



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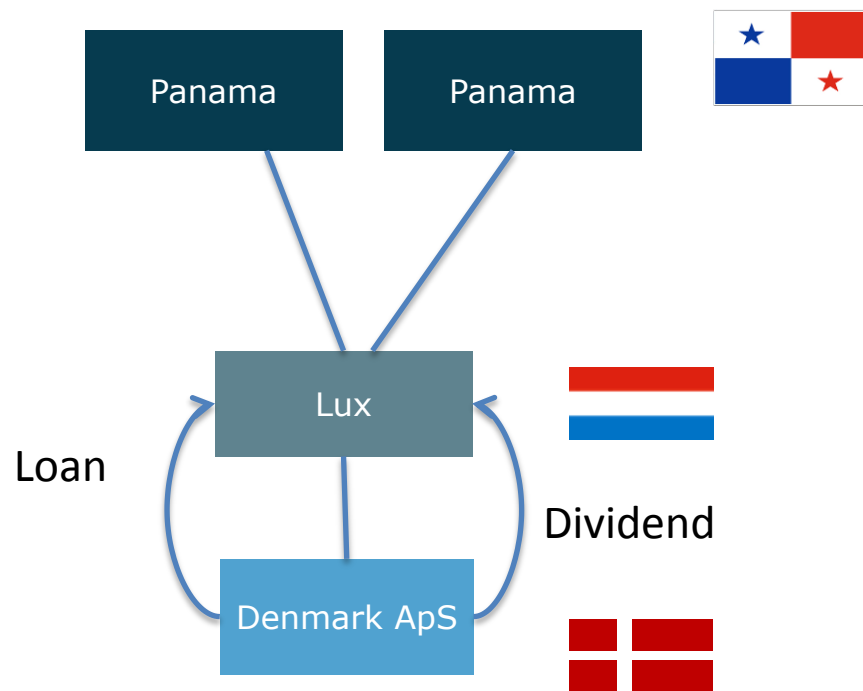
## SKM 2012.26 LSR



# SKM 2012.26 LSR

- Reasoning of the Danish Tax Tribunal:
  - Cyprus Ltd. not the beneficial owner of the dividends.
  - Burden of proof for the status as beneficial owner rested on the companies.
  - Scope of the parent-/subsidiary directive:
    - Article 1(2) of the directive grant the member states the opportunity to deny the benefits of the directive in cases of abuse etc.
    - Denmark has not introduced specific provisions with this aim, but legal basis to disqualify formally legal and correct dispositions exists in the form of general legal principles including case law.
    - The Danish Supreme Court has, however, not allowed a reclassification of an existing company on the basis that the company was established to save tax.
    - Consequently, the Cyprus company of this case, which was legally established and operating, which also owns the shares of the Danish company, should be considered the rightful recipient of the dividends distributed from the Danish company.
    - Consequently, the dividends are exempt from Danish withholding tax according to article 5 of the directive.
  - Obvious basis for a referral to the European Court of Justice.

Danish Tax Tribunal decision of 29. August 2012



## Danish Tax Tribunal decision of 29. August 2012

- Reasoning of the Danish Tax Tribunal:
  - Lux not the beneficial owner of the dividends.
    - Related parties
    - Actual payment of funds to Panama
  - Burden of proof for the status as beneficial owner rested on the companies.
  - Scope of the parent-/subsidiary directive:
    - Referring to SKM 2012.26 LSR
      - The dividends are exempt from Danish withholding tax according to article 5 of the directive.



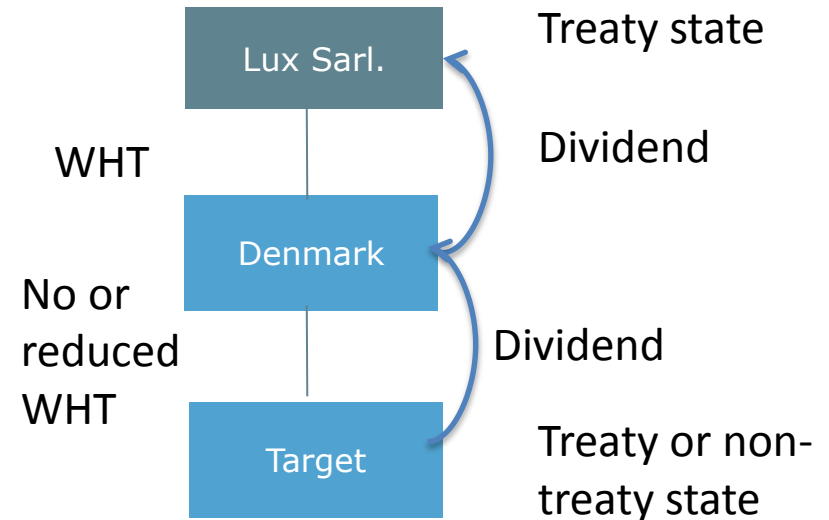


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Bill No. L 10

- Background
  - Denmark as international "watch dog"
  - Closing "loop holes"
    - Denmark used in tax treaty shopping.
    - Emphasis on developing countries which do not impose WHT on the basis of beneficial ownership.
      - Administrative resources?
  
- Danish participation exemption on outbound dividends does not apply, if:
  - Dividend is passed on from tax exempt dividends received (directly or indirectly) from foreign subsidiary or group shares.
  - Danish company is not the beneficial owner of the dividends.
  - Treaty WHT rate applies in stead of exemption
  - Does not apply, if the Danish WHT should be eliminated according to the EU parent-/subsidiary directive.



## Bill No. L 10

- Problems
  - Not a Danish problem
  - Application of the notion of beneficial ownership in a wrong context
    - The beneficial ownership test does not apply to a paying company
    - This means that the test does not rely on any applicable tax treaty.
  - Directly mentioned in the wording of domestic tax provisions
    - Without a fixed content
    - Danish understanding of notion of beneficial ownership refers to the OECD Model convention.
  - Different classification of payments?
  - Definition of "passing on dividends"
    - SKM: no timing requirement due to circumvention
    - Case by case assessment of the origin of dividends.
  - No relief for foreign WHT



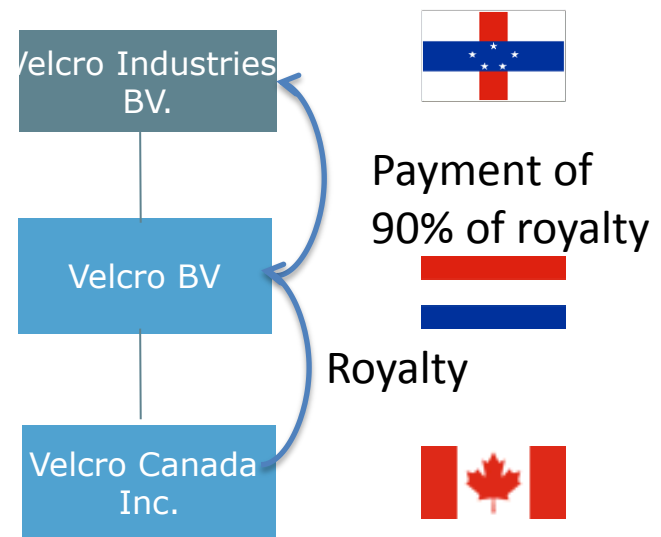
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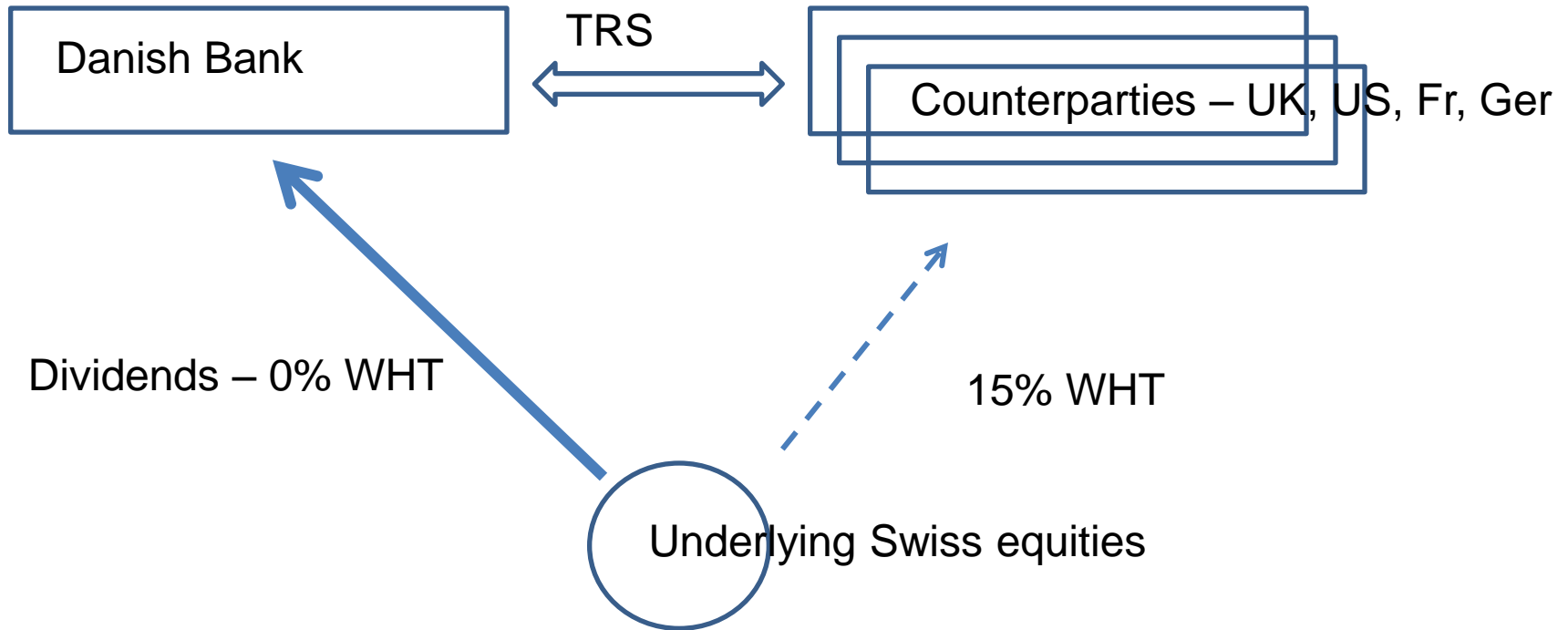
## International case law

## Velcro Canada v. The Queen 2012 TCC 57

- The Tax Court of Canada
- Royalties paid to a Dutch group company and 90% paid on to its Netherlands parent
- WHT reduction from 25% to 10% under Canada-Netherlands treaty
- NL company considered beneficial owner
  - Based on Prevost case
  - Corporation is beneficial owner of amounts received “unless the corporation is a conduit for another person and has absolutely no discretion as to the use or application of funds put through it as conduit.”
- Threshold for beneficial owner is very low under Canadian treaties.



## Swiss Swap case - Federal Administrative Court 3/7 2012 A-6537/2010

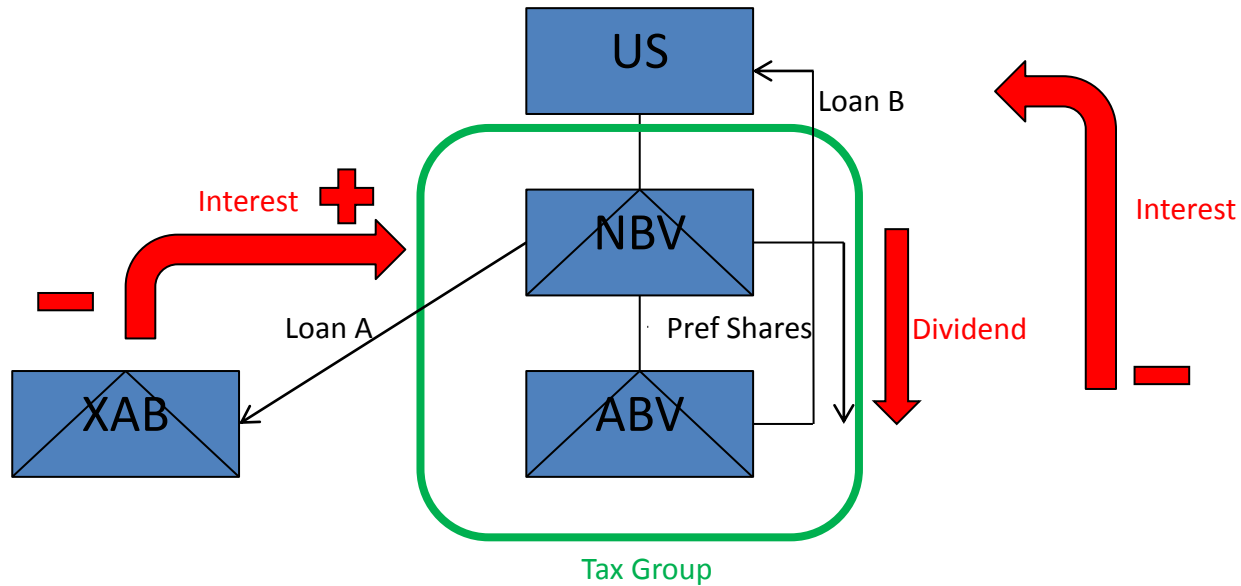




## Swiss swap case

- Federal Administrative Court 3/7 2012 A-6537/2010
- The share contracts do not contain any provisions that would construe a contractual obligation to transfer dividend payments to the share swap counterparties.
- A substance over form approach has to be applied.
- Bank A has effective power of authority to dispose of the dividend payments.
- Therefore not under a de facto obligation to pass on the payments to a third party.

## Recent Swedish case law – HFD 21 maj 2012 nr. 6063







## Recent Swedish case law – HFD 21. maj 2012 nr. 6063

- **Swedish interest deduction limitation rules**
  - Possible to escape if recipient of interest payments is taxed at 10%
  - Require the “actual right to the interest.”
- **Swedish Supreme Administrative Court.**
  - Not directly related to the interpretation of Swedish tax treaties.
  - However, notion of actual right to interest is based on DTCs
  - Supreme Administrative Court agreed with Council of Advanced Rulings (CAR) - US entity had the actual right to the interest.
  - SAC Majority Reasoning
  - It must be assumed the NBV will use the interest received to pay the dividend on the preference shares, even if not allowed to pay dividend for other reasons, since group company guarantees the interest payment on Loan B



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## Recent Spanish case law

- New Spanish Supreme court cases regarding the anti avoidance clause regarding EU intermediate holdings companies
  - Dated 22 March 2012 and 4 April 2012.



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OECD releases new draft commentary

## OECD Update

- CLARIFICATION OF THE MEANING OF “BENEFICIAL OWNER” IN THE OECD MODEL TAX CONVENTION - DISCUSSION DRAFT - 29 April 2011 to 15 July 2011
  - Revised draft 25. September 2012
    - In light of the comments received.
- Clarification
  - Emphasis on the context: “paid... to a resident”.
  - Clearly stated that autonomous interpretation is preferred.
  - “Unrelated obligations”.
  - No obvious clarification of the notion of beneficial ownership.
- ... Where the recipient of a dividend does have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person, the recipient is the “beneficial owner” of that dividend.



## OECD Update

- *12.4 In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the recipient of the dividend is not the “beneficial owner” because that recipient’s right to use and enjoy the dividend is constrained ~~that recipient does not have the full right to use and enjoy the dividend that it receives and this dividend is not its own; the powers of that recipient over that dividend are indeed constrained in that the recipient is obliged (because of a contractual, fiduciary or other duty) to pass the payment received to another person. The recipient of a dividend is the “beneficial owner” of that dividend where he has the full right to use and enjoy the dividend unconstrained~~ by a contractual or legal obligation to pass on the payment received to another person. ...*



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## Summary

# Summary

- Great uncertainty regarding the exact delineation of the notion of beneficial ownership.
- **Lessons so far:**
  - Taking an international fiscal meaning
  - The meaning derived from the OECD Commentary
  - The focus on the power to control the specific payment received
  - The focus is on the existence of a legal / contractual obligation to pay on the specific funds received
  - Transactional approach.
  - Decisive is the full right to use and enjoy the income in question.
  - Significant impact whether dividend/interest was not paid on in the structure.
  - Automatic transfer of the payment in question.
  - Difference between the domestic concept of a rightful recipient and the notion of beneficial owner.
  - Subjective intent to avoid taxes.
  - Related parties in transactions.
  - Timing overlap.
  - Taxation of the income in another country.



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