

# The Elusive Fingerprint

An analysis of the current challenges in identifying beneficial owners in Bilateral Income Tax Treaties (BITTs)

**Lucas de Lima Carvalho**

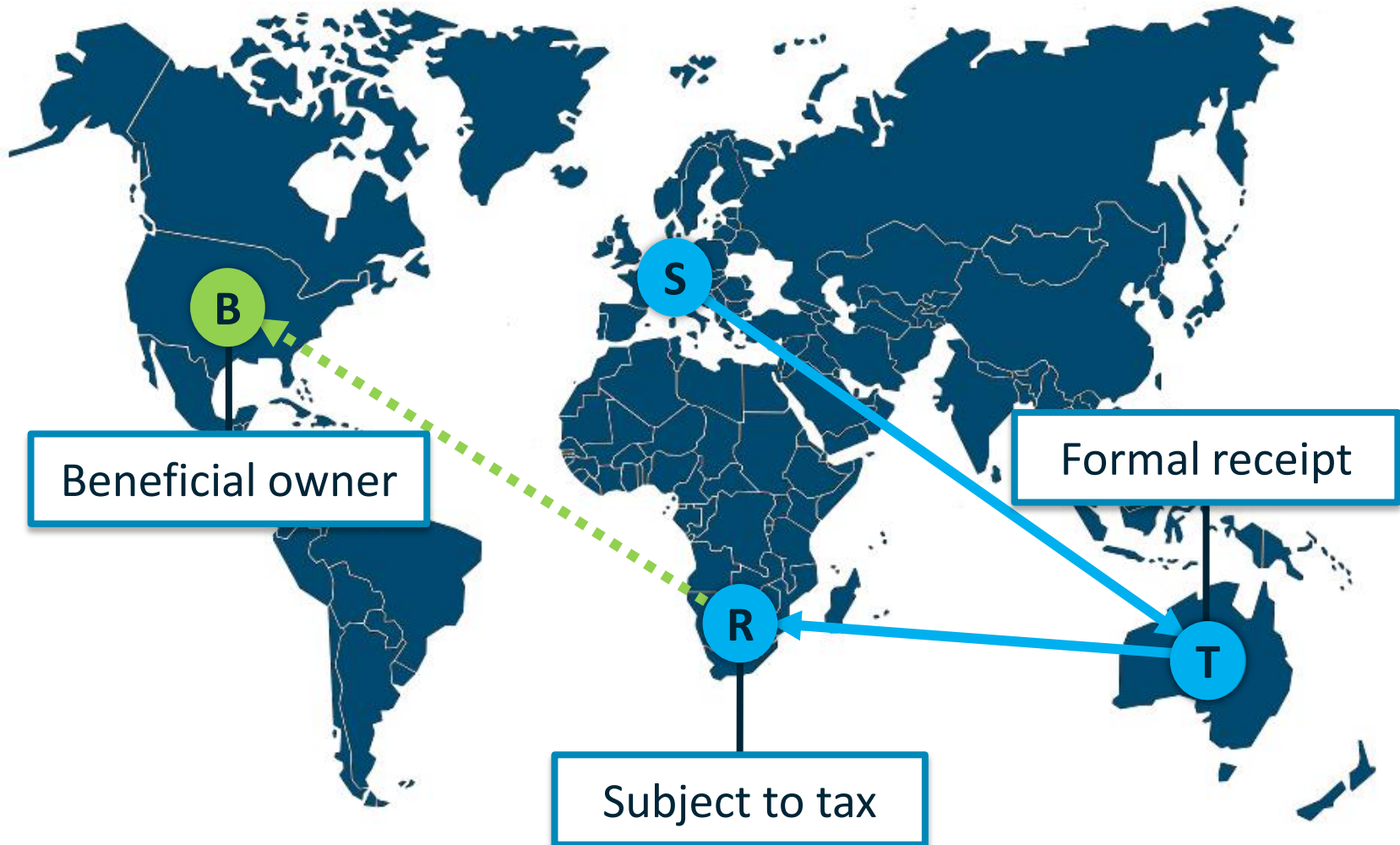
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# Disclaimer

- This presentation is a brief summary of the article “The Elusive Fingerprint: An analysis of the current challenges in identifying beneficial owners in Bilateral Income Tax Treaties (BITTs)”, dated June 26, 2015.
- The views expressed in the article and in this presentation are those of the author and do not necessarily correspond to those of TozziniFreire Advogados or of other members of the firm.
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# Introduction: BITTs and Entitlement Standards



# The identity of a beneficial owner: four key attributes

## 1. Control over the income.



### SPAIN (2006-2007)

Hungarian conduits wiring payments for image rights.



### CANADA (2009 & 2012)

Dividends and royalties used in back-to-back structures.



### OECD COMMENTARY (2014)

Conduit companies having narrow powers are not beneficial owners.

# The identity of a beneficial owner: four key attributes

1. **Control** over the income.
2. **Substantial risk** attached to the income.



## FRANCE (2005)

Usufruct rights of shares to earn income with reduced risks.



## ITALY (2010)

Luxembourg brand owner not carrying business risks.



## OECD COMMENTARY (2014)

Risk is a relevant factor, but not an exclusive one.

# The identity of a beneficial owner: four key attributes

1. Control over the income.
2. Substantial risk attached to the income.
3. **Business purpose** (other than the avoidance of tax).



## UNITED KINGDOM (2006)

HMRC will not challenge conduit arrangements with business purpose.



## CHINA (2009)

Assets and activities must be compatible with income.



## INDIA (2011)

Mauritius company used as a shell in a sale of stock.

# The identity of a beneficial owner: four key attributes

1. Control over the income.
2. Substantial risk attached to the income.
3. Business purpose (other than the avoidance of tax).
4. **Resident** of a BITT partner (for validation of a claim of beneficial ownership).



## DENMARK (2011)

Beneficial owner is a person entitled to benefits of a BITT.



## UNITED STATES

Allows benefits for so-called “derivative beneficiaries” in a number of BITTs.

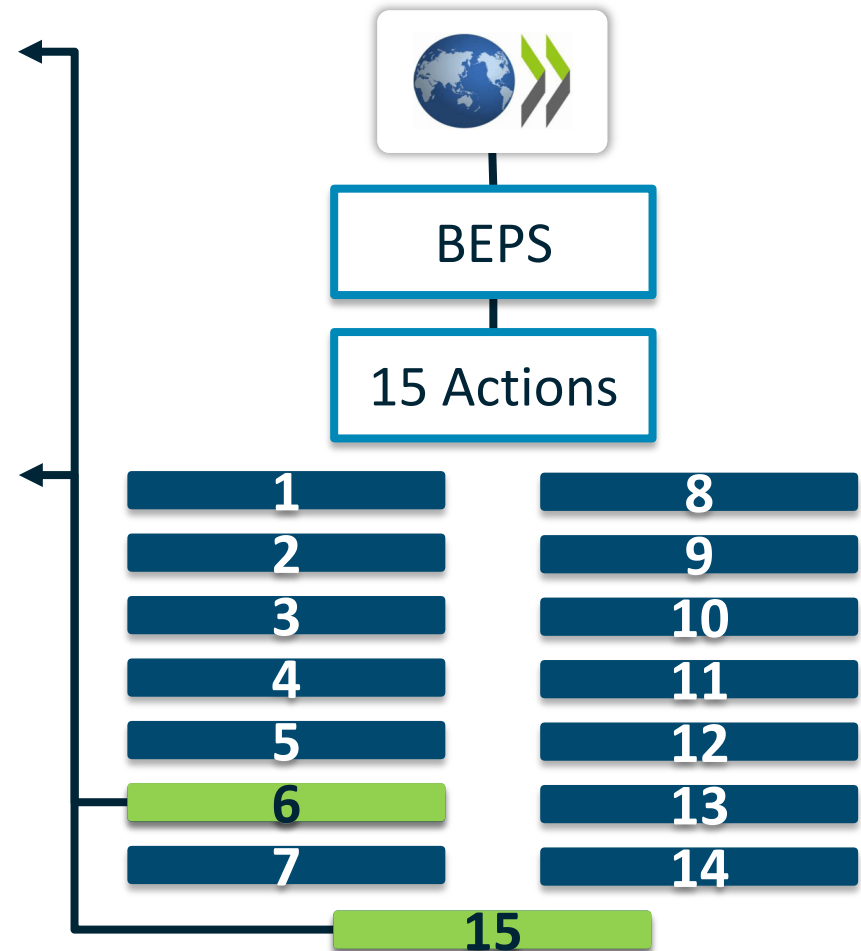
# The challenges with beneficial ownership: what can be done?

- Application of “beneficial ownership” nowadays follows similar guidelines, but States disagree on the specifics.
  - Current combination of domestic anti-abuse doctrines with BITTs results in increased uncertainty for taxpayers.
  - Lack of cooperation results in less sophisticated and more abstract beneficial ownership clauses.
- Potential solution: a harmonized approach to the task of finding beneficial owners in the context of BITTs.
- **But how?**



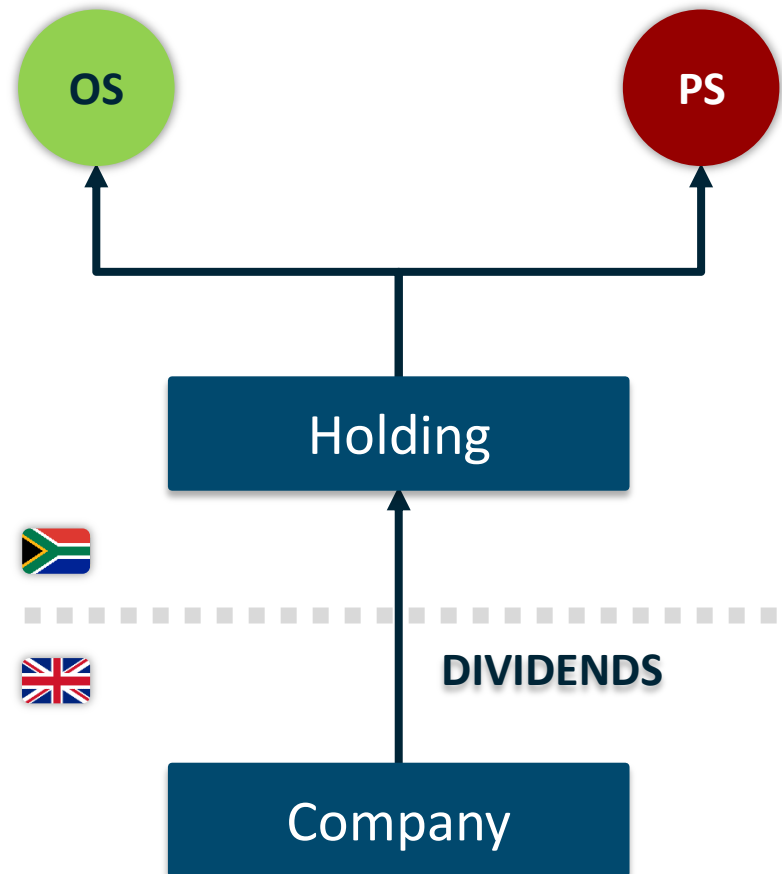
# A potential solution: the OECD BEPS Action Plan

- **Action 6:** Prevent granting of treaty benefits in so-called inappropriate circumstances.
- The OECD intends to create a harmonized set of rules to be adopted in **Action 15**.
- Proposals describe a set of objective and subjective tests to identify beneficial owners.



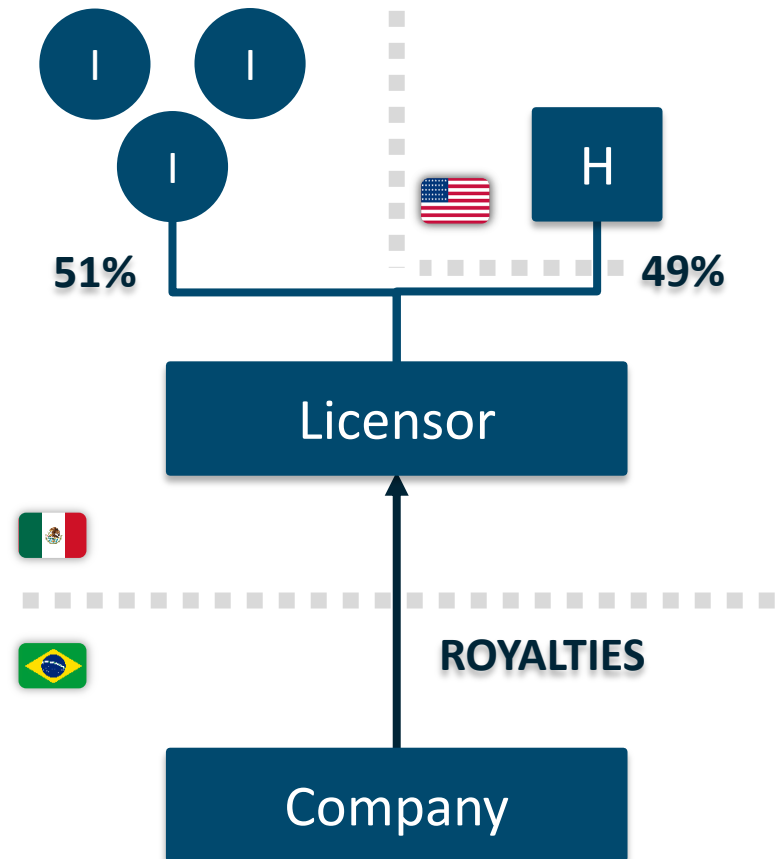
# Objective tests: the simplified LOB clause

1. **Qualified if** principal class of shares (or interest) is traded in recognized stock exchange.



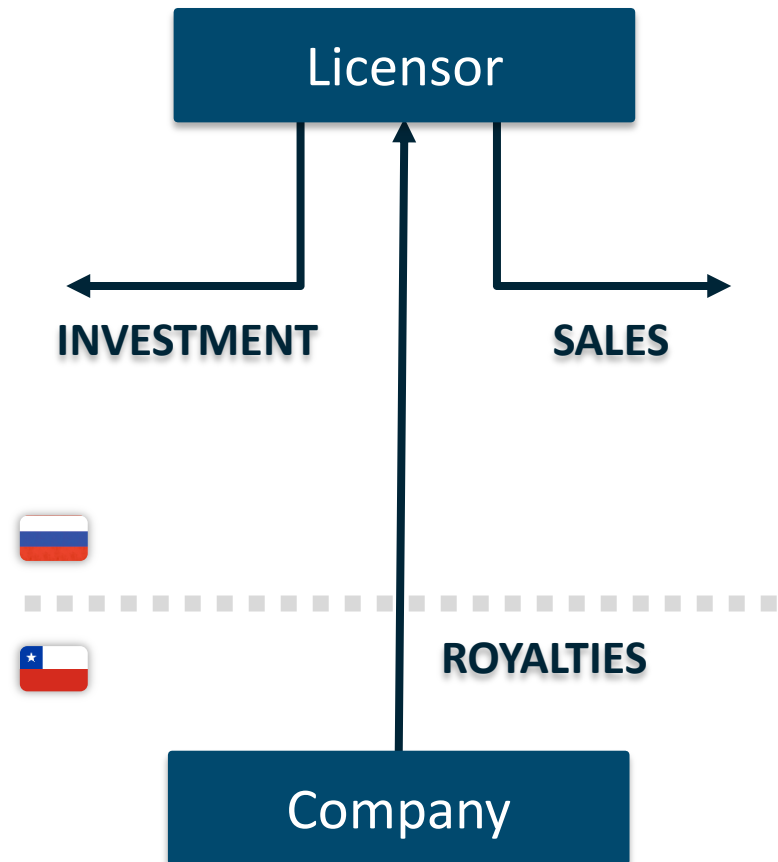
# Objective tests: the simplified LOB clause

1. **Qualified** if principal class of shares (or interest) is traded in recognized stock exchange.
2. **Qualified** if over 50% of shares (or interest) are owned by qualified persons.



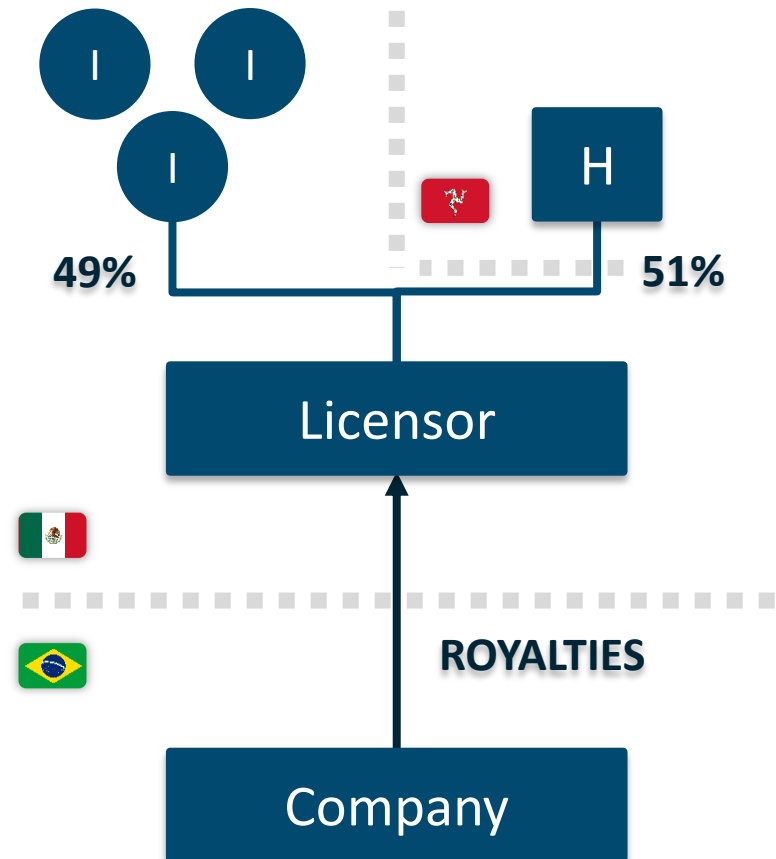
# Objective tests: the simplified LOB clause

1. **Qualified** if principal class of shares (or interest) is traded in recognized stock exchange.
2. **Qualified** if over 50% of shares (or interest) are owned by qualified persons.
3. **Qualified** if carries on a business in the State of Residence (and the income is related to the business).



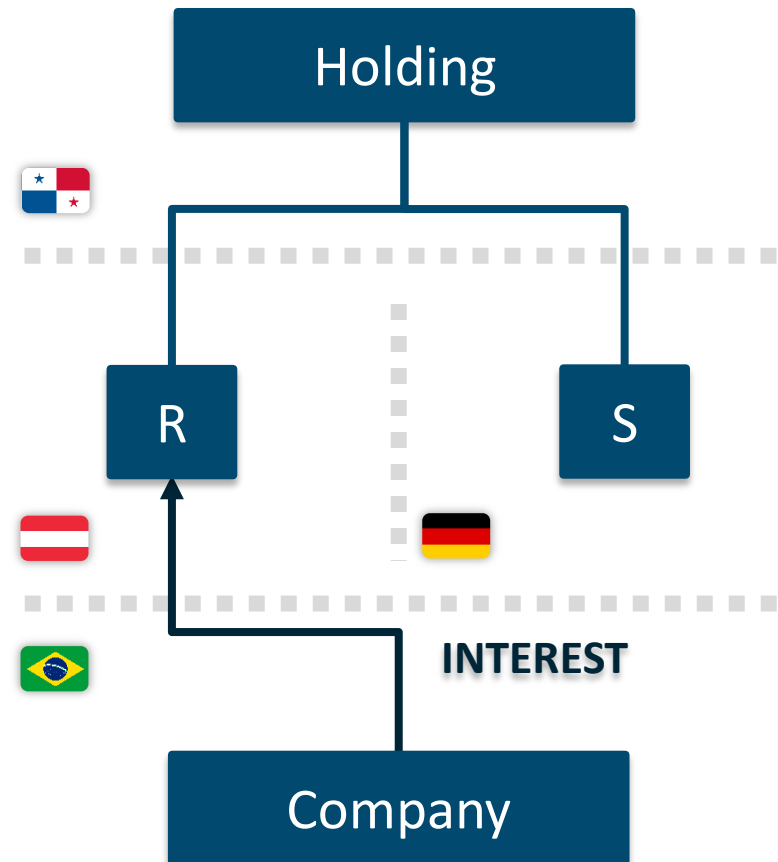
# Subjective tests: discretionary benefits and PPT

1. Qualified even if does not comply with objective tests. But has to prove that obtaining treaty benefits was not one of the goals.



# Subjective tests: discretionary benefits and PPT

1. Qualified even if does not comply with objective tests. But has to prove that obtaining treaty benefits was not one of the goals.
2. Disqualified even if does comply with objective tests, if obtaining treaty benefits was one of the goals.



# Conclusions

- Action 6 is a possible solution for the problem of incoherent application of the beneficial ownership standard in BITTs.
  - Objective ownership test may be improved by special “discretionary benefits” clause. Application of objective tests to CIVs and non-CIVs is yet to be further developed.
  - Subjective ownership test should focus on “main purpose” (with objective criteria).
- Harmonized use of LOB + PPT clauses (with derivative benefits) must be ensured by proper ratification of **multilateral instrument** in Action 15.

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Thank you!