

Distr.: General
8 May 2020

Original: English

**Committee of Experts on International
Cooperation in Tax Matters
Twentieth session**

[Dates and location of the session TBC]

Item 3 (b) of the provisional agenda

**Update of the UN Model Double Taxation Convention between Developed and
Developing Countries - Beneficial Ownership**

**Note by the Subcommittee on the UN Model Tax Convention between Developed and
Developing Countries**

Summary

The concept of beneficial owner is used in Articles 10, 11, 12 and 12 A of the UN Model Double Taxation Convention between Developed and Developing Countries (the UN Model). Its inclusion in the UN Model followed its previous addition to the OECD Model Tax Convention in 1977, which was intended to address situations where income covered by Articles 10, 11 and 12 is paid to person such as a nominee or agent for the benefit of another person.

In 2014, a number of changes were made to the OECD Model to clarify the interpretation and application of the concept of beneficial owner. During its 17th Session (Geneva, 16-19 October 2018), the United Nations Committee of Experts on International Cooperation in Tax Matters (the Committee) agreed to consider making similar changes to the UN Model as part of its 2018-2021 work programme concerning the UN Model.

At its nineteenth session (Geneva, 15-18 October 2019), the Committee discussed the draft changes proposed in note [E/C.18/2019/CRP.21](#). It was then indicated that the Subcommittee would review these changes to adapt them to the specific characteristics of the UN Model, which – unlike the OECD Model – also uses the concept of beneficial owner in Articles 12 and 12A. After discussion of the suggestion, by one Member, to include a definition of beneficial owner in the articles of the UN Model, it was also decided that the Subcommittee would examine that suggestion at its next meeting.

This note includes the revised proposed changes that the Subcommittee finalized at its last meeting, held on 14-16 February 2020 meeting. It also includes the conclusion reached by the Subcommittee concerning the possible addition of a definition of “beneficial owner” in the articles of the UN Model. At its twentieth session, the Committee is invited to discuss and approve the proposals and recommendation included in sections A, B and C of the attached document.

Introduction

1. At its nineteenth session (Geneva, 15-18 October 2019), the Committee discussed note [E/C.18/2019/CRP.21](#), which included proposals for the clarification of the concept of beneficial owner used in Articles 10, 11, 12 and 12A of the UN Model.
2. It was then reported that the Subcommittee on the UN Model Tax Convention between Developed and Developing Countries had generally endorsed the Commentary changes proposed in the first part of the note but had also agreed that those changes, which appeared in the OECD Commentary, had to be adapted to the specific characteristics of the UN Model, which – unlike the OECD Model – also uses the concept of beneficial owner in Articles 12 and 12A.
3. During the subsequent discussion, one Member referred to his earlier written comments on a possible conflict between the proposed Commentary clarification and the interpretative rule in Art. 3(2). While the Secretariat indicated that the words “paid to” formed part of the context in which the phrase “beneficial owner” was used and required a meaning different from that of domestic law, the Member suggested that it would be better to include a definition of beneficial owner in the articles of the UN Model than to provide a Commentary clarification. Different views were expressed concerning that suggestion and the role of the beneficial owner concept. After discussion, it was decided that the Subcommittee would examine the suggestion to include a new treaty definition of beneficial owner in the UN Model at its next meeting.
4. The Committee also discussed the second part of note [E/C.18/2019/CRP.21](#), which included changes proposed to Articles 10, 11 and 12 to address cases where the beneficial owner and the direct recipient of dividends, interest or royalties are residents of different states. While there was general agreement with the results of the proposed changes, one Member suggested that it would be enough to clarify the issue in the Commentary and that changing Articles 10, 11 and 12 might be problematic as regards the taxing rights of the state of residence. The Secretariat expressed the view that the right to tax of the state of residence would not be affected by a change to a provision dealing exclusively with the taxing rights of the state of source. Two other Members supported making the changes proposed in the note, with necessary adaptations to reflect the fact that the UN Model, unlike the OECD Model, allows source taxation of royalties and fees for technical services. It was concluded that the matter would be further considered at the next meeting of the Subcommittee.
5. Section A of the attached document includes the revised proposed changes to the Commentaries on Articles 10, 11, 12 and 12A of the UN Model that the Subcommittee approved at its meeting of 14-16 February 2020. Section B includes the revised proposed changes to Articles 10, 11 and 12 of the UN Model, together with consequential Commentary changes, that were also approved by the Subcommittee. Section C provides the outcome of the discussions, at the Subcommittee meeting, of the proposal to include a treaty definition of “beneficial owner” in the UN Model.
6. At its twentieth session, the Committee is invited to discuss and approve the proposals and recommendation included in sections A, B and C of the attached document.

Clarification of the Concept of “Beneficial Owner” in the UN Model

Table of Contents

Introduction	2
Clarification of the Concept of “Beneficial Owner” in the UN Model.....	3
A. Proposed Commentary changes clarifying the meaning of “beneficial owner”	4
B. Intermediaries in third states	13
C. Should a treaty definition of beneficial owner be added to the UN Model?	15

A. Proposed Commentary changes clarifying the meaning of “beneficial owner”

[Throughout sections A and B, proposed changes to what currently appears in the UN Model are shown as ***bold italics*** for additions and ~~strike through~~ for deletions.]

Commentary on Article 10

1. It is proposed to replace existing paragraph 13 of the Commentary on Article 10 of the UN Model by the following new paragraph 13:

13. In its 2014 update the OECD made it clear, as regards paragraph 2 of Article 3, that the concept of beneficial owner was intended to be interpreted in the context in which it appears and not with reference to the domestic law of the Contracting States. In 2021, the Committee of Experts agreed with this application of paragraph 2 of Article 3 to the concept of beneficial owner and therefore considered that the following parts of the Commentary on the 2010-OECD Model Convention are applicable—contains the following passages:]

~~11.~~—[*moved to 13.1; see below*]

12. The requirement of beneficial ownership was introduced in paragraph 2 of Article 10 to clarify the meaning of the words “paid ... to a resident” as they are used in paragraph 1 of the Article. It makes plain that the State of source is not obliged to give up taxing rights over dividend income merely because that income was ~~immediately received by~~ ***paid direct to*** a resident of a State with which the State of source had concluded a convention. [*the rest of the paragraph has been moved to new paragraph 12.1*]

12.1 Since the term “beneficial owner” was added to address potential difficulties arising from the use of the words “paid to ... a resident” in paragraph 1, it was intended to be interpreted in this context and not to refer to any technical meaning that it could have had under the domestic law of a specific country (in fact, when it was added to the paragraph, the term did not have a precise meaning in the law of many countries). The term “beneficial owner” is therefore not used in a narrow technical sense (such as the meaning that it has under the trust law of many common law countries¹), rather, it should be understood in its context, in particular in relation to the words “paid ... to a resident”, and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.

¹ ***For example, where the trustees of a discretionary trust do not distribute dividends earned during a given period, these trustees, acting in their capacity as such (or the trust, if recognised as a separate taxpayer), could constitute the beneficial owners of such income for the purposes of Article 10 even if they are not the beneficial owners under the relevant trust law.***

12.12 Where an item of income is ~~received by~~ ***paid to*** a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption merely on account of the status of the ~~immediate-direct~~ recipient of the income as a resident of the other Contracting State. The ~~immediate-direct~~ recipient of the income in this situation qualifies as a resident but no potential double taxation arises as a consequence of that status since the recipient is

not treated as the owner of the income for tax purposes in the State of residence. *[the rest of the paragraph has been moved to new paragraph 12.3]*

12.3 It would be equally inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned. For these reasons, the report from the Committee on Fiscal Affairs entitled “Double Taxation Conventions and the Use of Conduit Companies”¹ concludes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties.

1 Reproduced in Volume II of the full version of the OECD Model Tax Convention at page R(6)-1.

12.4 *In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the direct recipient of the dividend is not the “beneficial owner” because that recipient’s right to use and enjoy the dividend is constrained by a contractual or legal obligation to pass on the payment received to another person. Such an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person. This type of obligation would not include contractual or legal obligations that are not dependent on the receipt of the payment by the direct recipient such as an obligation that is not dependent on the receipt of the payment and which the direct recipient has as a debtor or as a party to financial transactions, or typical distribution obligations of pension schemes and of collective investment vehicles entitled to treaty benefits under the principles of paragraphs 22 to 48 of the Commentary on Article 1. 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. It should also be noted that Article 10 refers to the beneficial owner of a dividend as opposed to the owner of the shares, which may be different in some cases.*

12.5 *The fact that the recipient of a dividend is considered to be the beneficial owner of that dividend does not mean, however, that the limitation of tax provided for by paragraph 2 must automatically be granted. This limitation of tax should not be granted in cases of abuse of this provision (see also paragraph 22 below). The provisions of Article 29 and the principles put forward in the section on “Improper use of the Convention” in the Commentary on Article 1 will apply to prevent abuses, including treaty shopping situations where the recipient is the beneficial owner of the dividends. Whilst the concept of “beneficial owner” deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on the dividend to someone else), it does not deal with other cases of abuses, such as certain forms of treaty shopping, that are addressed by these provisions and principles and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases.*

12.6 *The above explanations concerning the meaning of “beneficial owner” make it clear that the meaning given to this term in the context of the Article must be distinguished*

from the different meaning that has been given to that term in the context of other instruments¹ that concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of “beneficial owner” cannot be applied in the context of the Article. Indeed, that meaning, which refers to natural persons (i.e. individuals), cannot be reconciled with the express wording of subparagraph 2 a), which refers to the situation where a company is the beneficial owner of a dividend. In the context of Article 10, the term “beneficial owner” is intended to address difficulties arising from the use of the words “paid to” in relation to dividends rather than difficulties related to the ownership of the shares of the company paying these dividends. For that reason, it would be inappropriate, in the context of that Article, to consider a meaning developed in order to refer to the individuals who exercise “ultimate effective control over a legal person or arrangement.”²

¹ See, for example, Financial Action Task Force, *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation – The FATF Recommendations* (OECD-FATF, Paris, 2012), which sets forth in detail the international anti-money laundering standard and which includes the following definition of beneficial owner (at page 110): “the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement.” Similarly, the 2001 report of the OECD Steering Group on Corporate Governance, “*Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes*” (OECD, Paris, 2001), defines beneficial ownership as follows (at page 14):

In this Report, “beneficial ownership” refers to ultimate beneficial ownership or interest by a natural person. In some situations, uncovering the beneficial owner may involve piercing through various intermediary entities and/or individuals until the true owner who is a natural person is found. With respect to corporations, ownership is held by shareholders or members. In partnerships, interests are held by general and limited partners. In trusts and foundations, beneficial ownership refers to beneficiaries, which may also include the settlor or founder.

² See the Financial Action Task Force’s definition quoted in the previous note.

12.27 Subject to other conditions imposed by the Article *and the other provisions of the Convention*, the limitation of tax in the State of source remains available when an intermediary, such as an agent or nominee *located* in a Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State (~~the text of the Model was amended in 1995 and in 2014 to clarify this point, which has been the consistent position of all member countries~~); [UN Model was amended in 2021 to clarify this point following amendments made to the OECD Model in 1995 and 2014)].

~~13.1—[moved to 13.1; see below]~~

~~13.2—[moved to 13.1; see below]~~

~~14.—[moved to 13.1; see below]~~

[Existing paragraphs 13 and 13.1 of the Commentary on Article 10 of the UN Model would be renumbered 13.1 and 13.2 respectively and paragraph 13.1 would include the quoted paragraphs 11, 13.1, 13.2 and 14 of the Commentary of the 2010 OECD Model that currently appear in paragraph 13 of the Commentary on the UN Model]

Commentary on Article 11

2. It is proposed to replace existing paragraph 18 of the Commentary on Article 11 of the UN Model by the following new paragraph 18:

18. *In its 2014 update the OECD made it clear, as regards paragraph 2 of Article 3, that the concept of beneficial owner was intended to be interpreted in the context in which it appears and not with reference to the domestic law of the Contracting States. In 2021, the Committee of Experts agreed with this application of paragraph 2 of Article 3 to the concept of beneficial owner. It noted, however, that paragraph 1 of Article 12 of the UN Model was drafted differently from the corresponding provision of the OECD Model and that the term beneficial owner was also used in Article 12A of the UN Model. The Committee therefore considered that the following parts of the Commentary on the 2014 OECD Model Convention, with the minor changes shown below between brackets, are applicable* contains the following passages:

9. The requirement of beneficial ownership was introduced in paragraph 2 of Article 11 to clarify the meaning of the words “paid to a resident” as they are used in paragraph 1 of the Article. It makes plain that the State of source is not obliged to give up taxing rights over interest income merely because that income was ~~immediately received~~ **paid direct** to a resident of a State with which the State of source had concluded a convention. *[the rest of the paragraph has been moved to new paragraph 9.1]*

9.1 *Since the term “beneficial owner” was added to address potential difficulties arising from the use of the words “paid to a resident” in paragraph 1, it was intended to be interpreted in this context and not to refer to any technical meaning that it could have had under the domestic law of a specific country (in fact, when it was added to the paragraph, the term did not have a precise meaning in the law of many countries). The term “beneficial owner” is therefore not used in a narrow technical sense (such as the meaning that it has under the trust law of many common law countries¹), rather, it should be understood in its context, in particular in relation to the words “paid to a resident”, and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.*

1 For example, where the trustees of a discretionary trust do not distribute interest earned during a given period, these trustees, acting in their capacity as such (or the trust, if recognised as a separate taxpayer) could constitute the beneficial owners of such income for the purposes of Article 11 even if they are not the beneficial owners under the relevant trust law.

10. Relief or exemption in respect of an item of income is granted by the State of source to a resident of the other Contracting State to avoid in whole or in part the double taxation that would otherwise arise from the concurrent taxation of that income by the State of residence. Where an item of income is ~~received by~~ **paid to** a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption merely on account of the status of the ~~immediate~~ **direct** recipient of the income as a resident of the other Contracting State. The ~~immediate~~ **direct** recipient of the income in this situation qualifies as a resident but no potential double taxation arises as a consequence of that status since the recipient is not treated as the owner of the income for tax purposes in the State of residence. *[the rest of the paragraph has been moved to new paragraph 10.1]*

10.1 It would be equally inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned. For these reasons, the report from the Committee on Fiscal Affairs entitled “Double Taxation Conventions and the Use of Conduit Companies”¹ concludes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties.

¹ Reproduced in Volume II of the full version of the OECD Model Tax Convention at page R(6)-1.

10.2 *In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the direct recipient of the interest is not the “beneficial owner” because that recipient’s right to use and enjoy the interest is constrained by a contractual or legal obligation to pass on the payment received to another person. Such an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the interest unconstrained by a contractual or legal obligation to pass on the payment received to another person. This type of obligation would not include contractual or legal obligations that are not dependent on the receipt of the payment by the direct recipient such as an obligation that is not dependent on the receipt of the payment and which the direct recipient has as a debtor or as a party to financial transactions, or typical distribution obligations of pension schemes and of collective investment vehicles entitled to treaty benefits under the principles of paragraphs 22 to 48 of the Commentary on Article 1. Where the recipient of interest does have the right to use and enjoy the interest unconstrained by a contractual or legal obligation to pass on the payment received to another person, the recipient is the “beneficial owner” of that interest. It should also be noted that Article 11 refers to the beneficial owner of interest as opposed to the owner of the debt-claim with respect to which the interest is paid, which may be different in some cases.*

10.3 *The fact that the recipient of an interest payment is considered to be the beneficial owner of that interest does not mean, however, that the limitation of tax provided for by paragraph 2 must automatically be granted. This limitation of tax should not be granted in cases of abuse of this provision (see also paragraph 8 above). The provisions of Article 29 and the principles put forward in the section on “Improper use of the Convention” in the Commentary on Article 1 will apply to prevent abuses, including treaty shopping situations where the recipient is the beneficial owner of interest. Whilst the concept of “beneficial owner” deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on the interest to someone else), it does not deal with other cases of abuses, such as certain forms of treaty shopping, that are addressed by these provisions and principles and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases.*

10.4 *The above explanations concerning the meaning of “beneficial owner” make it clear that the meaning given to this term in the context of the Article must be distinguished from the different meaning that has been given to that term in the context of other*

*instruments¹ that concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of “beneficial owner” cannot be applied in the context of the Convention. Indeed, that meaning, which refers to natural persons (i.e. individuals), cannot be reconciled with the express wording of subparagraph 2 a) of Article 10, which refers to the situation where a company is the beneficial owner of a dividend. In the context of Articles 10 ~~and 11~~, 11, 12 and 12A], the term “beneficial owner” is intended to address difficulties arising from the use of the words “paid to” in relation to dividends[, ~~and~~ interest, royalties and fees for technical services] rather than difficulties related to the ownership of the ~~shares or debt claims on which dividends or interest are paid~~ [underlying property or rights in respect of which the amounts are paid]. For that reason, it would be inappropriate, in the context of these articles, to consider a meaning developed in order to refer to the individuals who exercise “ultimate effective control over a legal person or arrangement”.*²

1 See, for example, Financial Action Task Force, *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation – The FATF Recommendations* (OECD-FATF, Paris, 2012), which sets forth in detail the international anti-money laundering standard and which includes the following definition of beneficial owner (at page 110): “the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement.” Similarly, the 2001 report of the OECD Steering Group on Corporate Governance, “*Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes*” (OECD, Paris, 2001), defines beneficial ownership as follows (at page 14):

In this Report, “beneficial ownership” refers to ultimate beneficial ownership or interest by a natural person. In some situations, uncovering the beneficial owner may involve piercing through various intermediary entities and/or individuals until the true owner who is a natural person is found. With respect to corporations, ownership is held by shareholders or members. In partnerships, interests are held by general and limited partners. In trusts and foundations, beneficial ownership refers to beneficiaries, which may also include the settlor or founder.

2. See the Financial Action Task Force’s definition quoted in the previous note.

11. Subject to other conditions imposed by the Article *and the other provisions of the Convention*, the limitation of tax in the State of source remains available when an intermediary, such as an agent or nominee located in a Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State ~~(the text of the Model was amended in 1995 and in 2014 to clarify this point, which has been the consistent position of all member countries)~~. [UN Model was amended in 2021 to clarify this point following amendments made to the OECD Model in 1995 and 2014]. ~~States which wish to make this more explicit are free to do so during bilateral negotiations.~~

12. The paragraph lays down nothing about the mode of taxation in the State of source. It therefore leaves that State free to apply its own laws and, in particular, to levy the tax either by deduction at source or by individual assessment. Procedural questions are not dealt with in this Article. Each State should be able to apply the procedure provided in its own law [...]. *Potential abuses arising from situations where interest arising in a Contracting State is attributable to a permanent establishment which an enterprise of the other State has in*

a third State are dealt with in paragraph 8 of Article 29. Other questions arise with triangular cases (see paragraph 71 of the Commentary on Article 24 [as quoted in paragraph 2 of the Commentary on Article 24 of this Model]).

13. *[The paragraph]* does not specify whether or not the relief in the State of source should be conditional upon the interest being subject to tax in the State of residence. This question can be settled by bilateral negotiations.

14. The Article contains no provisions as to how the State of the beneficiary's residence should make allowance for the taxation in the State of source of the interest. This question is dealt with in Articles 23 A and 23 B.

Commentary on Article 12

3. It is proposed to replace existing paragraph 5 of the Commentary on Article 12 of the UN Model by the following new paragraph 5:

5. *In its 2014 update the OECD made it clear, as regards paragraph 2 of Article 3, that the concept of beneficial owner was intended to be interpreted in the context in which it appears and not with reference to the domestic law of the Contracting States. In 2021, the Committee of Experts agreed with this application of paragraph 2 of Article 3 to the concept of beneficial owner. It noted, however, that Article 12 of the UN Model, unlike Article 12 of the OECD Model, provides for the source taxation of royalties and that the term beneficial owner was also used in Article 12A of the UN Model. The Committee therefore considered that the following parts of the Commentary on the 2010-OECD Model Convention, with the minor changes shown below between brackets, are applicable—contains the following relevant passages:*

4. *[The requirement of beneficial owner was introduced in paragraph 2 of Article 12 to clarify the meaning of the words “paid to a resident” as they are used in paragraph 1 of the Article.]* The requirement of beneficial ownership was introduced in paragraph 1 of Article 12 to clarify how the Article applies in relation to payments made to intermediaries. It makes plain that the State of source is not obliged to give up taxing rights over royalty income merely because that income was immediately received by *paid direct to* a resident of a State with which the State of source had concluded a convention. The term “beneficial owner” is *therefore* not used in a narrow technical sense (*such as the meaning that it has under the trust law of many common law countries*¹), rather, it should be understood in its context and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.

¹ *For example, where the trustees of a discretionary trust do not distribute royalties earned during a given period, these trustees, acting in their capacity as such (or the trust, if recognised as a separate taxpayer) could constitute the beneficial owners of such income for the purposes of Article 12 even if they are not the beneficial owners under the relevant trust law.*

4.1 Relief or exemption in respect of an item of income is granted by the State of source to a resident of the other Contracting State to avoid in whole or in part the double taxation that would otherwise arise from the concurrent taxation of that income by the State of residence. Where an item of income is received by *paid to* a resident of a Contracting State

acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption merely on account of the status of the ~~immediate~~-direct recipient of the income as a resident of the other Contracting State. The ~~immediate~~-direct recipient of the income in this situation qualifies as a resident but no potential double taxation arises as a consequence of that status since the recipient is not treated as the owner of the income for tax purposes in the State of residence. *[the rest of the paragraph has been moved to new paragraph 4.2]*

4.2 It would be equally inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned. For these reasons, the report from the Committee on Fiscal Affairs entitled “Double Taxation Conventions and the Use of Conduit Companies”¹ concludes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties.

¹ Reproduced in Volume II of the full version of the OECD Model Tax Convention at page R(6)-1.

4.3 *In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the direct recipient of the royalties is not the “beneficial owner” because that recipient’s right to use and enjoy the royalties is constrained by a contractual or legal obligation to pass on the payment received to another person. Such an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the royalties unconstrained by a contractual or legal obligation to pass on the payment received to another person. This type of obligation would not include contractual or legal obligations that are not dependent on the receipt of the payment by the direct recipient such as an obligation that is not dependent on the receipt of the payment and which the direct recipient has as a debtor or as a party to financial transactions, or as a party to financial transactions or typical distribution obligations of pension schemes and of collective investment vehicles entitled to treaty benefits under the principles of paragraphs 22 to 48 of the Commentary on Article 1. Where the recipient of royalties does have the right to use and enjoy the royalties unconstrained by a contractual or legal obligation to pass on the payment received to another person, the recipient is the “beneficial owner” of these royalties. It should also be noted that Article 12 refers to the beneficial owner of royalties as opposed to the owner of the right or property in respect of which the royalties are paid, which may be different in some cases.*

4.4 *The fact that the recipient of royalties is considered to be the beneficial owner of these royalties does not mean, however, ~~that the provisions of paragraph 1 must automatically be applied~~ [that the limitation of tax provided for by paragraph 2 must automatically be granted]. ~~The benefit of these provisions should not be granted in cases of abuse (see also paragraph 7 below).~~ [This limitation of tax should not be granted in cases of abuse of this provision]. The provisions of Article 29 and the principles put forward in the section on “Improper use of the Convention” in the Commentary on*

Article 1 will apply to prevent abuses, including treaty shopping situations where the recipient is the beneficial owner of royalties. Whilst the concept of “beneficial owner” deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on the royalties to someone else), it does not deal with other cases of abuses, such as certain forms of treaty shopping, that are addressed by these provisions and principles and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases.

4.5 The above explanations concerning the meaning of “beneficial owner” make it clear that the meaning given to this term in the context of the Article must be distinguished from the different meaning that has been given to that term in the context of other instruments¹ that concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of “beneficial owner” cannot be applied in the context of the Convention. Indeed, that meaning, which refers to natural persons (i.e. individuals), cannot be reconciled with the express wording of subparagraph 2 a) of Article 10, which refers to the situation where a company is the beneficial owner of a dividend. ~~The term beneficial owner was intended to address difficulties arising from the use of the words “paid to”, which are found in paragraph 1 of Articles 10 and 11 and were similarly used in paragraph 1 of Article 12 of the 1977 Model Double Taxation Convention, in relation to dividends, interest and royalties rather than difficulties related to the ownership of the shares, debt-claims, property or rights with respect these dividends, interest or royalties are paid. [In the context of Articles 10, 11, 12 and 12A, the term “beneficial owner” is intended to address difficulties arising from the use of the words “paid to” in relation to dividends interest, royalties and fees for technical services rather than difficulties related to the ownership of the underlying property or rights in respect of which the amounts are paid]. For that reason, it would be inappropriate, in the context of these articles, to consider a meaning developed in order to refer to the individuals who exercise “ultimate effective control over a legal person or arrangement”.~~²

1 See, for example, Financial Action Task Force, International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation – The FATF Recommendations (OECD-FATF, Paris, 2012), which sets forth in detail the international anti-money laundering standard and which includes the following definition of beneficial owner (at page 110): “the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement.” Similarly, the 2001 report of the OECD Steering Group on Corporate Governance, “Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes” (OECD, Paris, 2001), defines beneficial ownership as follows (at page 14):

In this Report, “beneficial ownership” refers to ultimate beneficial ownership or interest by a natural person. In some situations, uncovering the beneficial owner may involve piercing through various intermediary entities and/or individuals until the true owner who is a natural person is found. With respect to corporations, ownership is held by shareholders or members. In partnerships, interests are held by general and limited partners. In trusts and foundations, beneficial ownership refers to beneficiaries, which may also include the settlor or founder.

2 See the Financial Action Task Force’s definition quoted in the previous note.

4.26 Subject to other conditions imposed by the Article **and the other provisions of the Convention, the limitation of tax exemption from taxation** in the State of source remains available when an intermediary, such as an agent or nominee **located in a Contracting State or in a third State**, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State **(the text of the Model was amended in 1995 and in 2014 to clarify this point, which has been the consistent position of all member countries). [UN Model was amended in 2021 to clarify this point following amendments made to the OECD Model in 1995 and 2014]).** States which wish to make this more explicit are free to do so during bilateral negotiations.

B. Intermediaries in third states

Proposed changes to the Articles of the UN Model

Art. 10(2)

4. It is proposed to replace existing paragraph 2 of Article 10 of the UN Model by the following:

2. However, ~~such~~ dividends **paid by a company which is a resident of a Contracting State** may also be taxed in **that State** ~~the Contracting State of which the company paying the dividends is a resident and~~ according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

- (a) ___ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 25 per cent of the capital of the company paying the dividends throughout a 365 day period that includes the day of the payment of the dividend (for the purpose of computing that period, no account shall be taken of changes of ownership that would directly result from a corporate reorganisation, such as a merger or divisive reorganisation, of the company that holds the shares or that pays the dividend);
- (b) ___ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the dividends in all other cases.

The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of these limitations. This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

Art. 11(2)

5. It is proposed to replace existing paragraph 2 of Article 11 of the UN Model by the following:

2. However, ~~such~~ interest **arising in a Contracting State** may also be taxed in **that State** ~~the Contracting State in which it arises and~~ according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed ___ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

Art. 12(2)

6. It is proposed to replace existing paragraph 2 of Article 12 of the UN Model by the following:

2. However, ~~such~~ royalties ***arising in a Contracting State*** may also be taxed in ***that State*** ~~the Contracting State in which they arise and~~ according to the laws of that State, but if the beneficial owner of the royalties is a resident of the other Contracting State, the tax so charged shall not exceed ___ per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the royalties. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

Proposed changes to the Commentary of the UN Model

Commentary on Article 10

7. As indicated in section A above, the following paragraph 12.7 of the Commentary on Article 10 of the OECD Model will be added to the paragraphs quoted in paragraph 13 of the Commentary on Article 10 of the UN Model:

12.27 Subject to other conditions imposed by the Article ***and the other provisions of the Convention***, the limitation of tax in the State of source remains available when an intermediary, such as an agent or nominee located in a Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State ~~(the text of the Model was amended in 1995 and in 2014 to clarify this point, which has been the consistent position of all member countries).~~***[UN Model was amended in 2021 to clarify this point following amendments made to the OECD Model in 1995 and 2014].***

Commentary on Article 11

8. As indicated in section A above, the following version of paragraph 11 of the Commentary on Article 11 of the OECD Model will be added to the paragraphs quoted in paragraph 18 of the Commentary on Article 11 of the UN Model:

11. Subject to other conditions imposed by the Article ***and the other provisions of the Convention***, the limitation of tax in the State of source remains available when an intermediary, such as an agent or nominee located in a Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State ~~(the text of the Model was amended in 1995 and in 2014 to clarify this point, which has been the consistent position of all member countries).~~***[UN Model was amended in 2021 to clarify this point following amendments made to the OECD Model in 1995 and 2014].***
~~States which wish to make this more explicit are free to do so during bilateral negotiations.~~

Commentary on Article 12

9. As indicated in section A above, the following version of paragraph 4.6 of the Commentary on Article 12 of the OECD Model will replace paragraph 4.2 currently quoted in paragraph 5 of the Commentary on Article 12 of the UN Model:

4.26 Subject to other conditions imposed by the Article *and the other provisions of the Convention, the limitation of tax exemption from taxation* in the State of source remains available when an intermediary, such as an agent or nominee *located in a Contracting State or in a third State*, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State *(the text of the Model was amended in 1995 and in 2014 to clarify this point, which has been the consistent position of all member countries)*. [UN Model was amended in 2021 to clarify this point following amendments made to the OECD Model in 1995 and 2014]). States which wish to make this more explicit are free to do so during bilateral negotiations.

C. Should a treaty definition of beneficial owner be added to the UN Model?

10. In accordance with the Committee's decision that the Subcommittee should consider the possible addition of a treaty definition of "beneficial owner" to the UN Model (see paragraph 3 of the Introduction), the Subcommittee discussed this issue at its February 2020 meeting on the basis of the following draft definition prepared by a member of the Committee for possible inclusion in Art. 3(1) UN Model:

- (g) The term 'beneficial owner' occurring in Articles 10, 11, 12 and 12A refers to the recipient who has the right to use and enjoy the dividends, interest, royalties or fees, as the case may be, unconstrained by a contractual or legal obligation to pass on the payment received to another person.

11. The majority of the Subcommittee decided to recommend against the inclusion of such a definition in the UN Model. The main arguments supporting that recommendation are:

- Since the definition would only apply to future treaties in which it would be included, it would not address issues related to the interpretation of the concept of beneficial owner in existing treaties.
- Adding a definition that would only apply to future treaties may be interpreted as an attempt to modify the concept that is found in existing treaties, which does not appear to be intended.
- The fact that the definition would be included in the UN Model but not in the OECD Model would likely be used to support the suggestion that the concept has a different scope in the two models, contrary to the view previously expressed by the Committee.
- The definition proposed in paragraph 10 above could indeed be interpreted as changing (and narrowing) the concept of beneficial owner, in particular because it does not pick up the reference, included in the Commentary, to the existence of a contractual or legal obligation to pass on a payment being determined on the basis of facts and circumstances.
- The proposed definition may also unintentionally narrow the scope of the concept since, unlike the Commentary, it does not address the situation of collective investment vehicles and pension funds and, by providing a definition, it may be more difficult to rely on the Commentary as a court will apply the definition as drafted.

- By referring to the beneficial owner as being the recipient of income, the proposed definition confuses the person to whom the payment is made and the beneficial owner.
- To the extent that it would not address such issues, adding the definition would not be helpful from the practical standpoint of tax auditors. It would create additional problems and may in fact facilitate tax avoidance because it would provide a roadmap as to the legal conditions to be satisfied to qualify as beneficial owner. In other words, the risks of including a definition for “beneficial owner” outweigh any potential benefit of addressing the perceived uncertainty.
- As indicated in the proposed Commentary in section A, the words “paid to” form part of the context in which the phrase “beneficial owner” is used, which avoids the application of the domestic law meaning of the term pursuant to Art. 3(2) contrary to what was argued by proponents of a definition.

12. A dissenting view, however, favoured the inclusion of a definition of beneficial owner. The main arguments supporting that dissenting view are:

- A definition would address the uncertainty resulting from the concept of beneficial owner.
- Since it is agreed that the domestic law meaning of beneficial owner should not be applied, a definition of that term would solve the possible conflict between the proposed Commentary clarification, which suggests an autonomous meaning of “beneficial owner”, and the interpretative rule in Art. 3(2) according to which terms not defined in a treaty should be interpreted according to domestic law.
- Without a treaty definition, it is likely that issues concerning the interpretation of beneficial owner will continue to arise.
- While the draft definition in paragraph 10 above may have technical flaws, these could be addressed and the definition could be improved with further work.
- When interpreting the provisions of tax treaties, what really matters is what appears in the treaty itself as opposed to the interpretations found in the Commentary.
- It seems inconsistent to modify Articles 10, 11 and 12 to clarify the situation of intermediaries in third states (see section B) but not wanting to modify the articles in order to clarify the meaning of beneficial owner.