

*Legal certainty and the beneficial ownership concept in international tax law**

1. Introduction

My doctoral research aims at establishing legal certainty towards beneficial ownership in international tax law. Divergent laws, jurisprudence, and literatures on beneficial ownership have jeopardised taxpayers' ability to foresee the legitimacy of their transactions and entitlement to subsequent treaty benefits. In 2016, Meindl-Ringler¹ concluded that beneficial ownership has not been interpreted in its ideal meaning as an income attribution measure, but rather as means to encounter 'improper corporate structures' (i.e. conduit structures). Furthermore, she argued that it will be difficult to direct judges away from their upheld jurisprudence.² Her studies closely examined scholarly discussions on approaches in defining beneficial ownership, namely anti-avoidance rule, attributes-of-ownership, the so-called forwarding approach, Wheeler's 'new approach', and income attribution.³ She eventually favoured for the income attribution approach, as it is advantageous in the sense that it 'excludes agents and nominees from claiming treaty benefits, eliminates double taxation, (...) relatively easy to apply, and (...) has a strong historical foundation (...) in the 1977 OECD Model and earlier U.K. treaties'.⁴ This approach has not, however, established legal certainty, for states and courts have continued to legislate and rule on the issue differently.

My research is based on an inductive reasoning that legal certainty must be established towards beneficial ownership in international tax law. For the purpose of the research, I adopt the meaning of legal certainty as established in case laws of the Court of Justice of the European Union (CJEU) and compiled by van Meerbeek,⁵ namely as a principle requiring that "rules of law be clear, precise, and predictable as regards their effects". Notable legal principles often associated with the principle of legal certainty include the principles of non-retroactivity and legitimate expectations. In the EU, the principle of non-retroactivity requires that the law limits its enforcements *ex nunc*—as opposed to *ex tunc*. Consequently, any conduct committed prior to publication of enacted legislations or court rulings governing on such conduct may not be sanctioned. Time constraint is also decisive in establishing the principle of legitimate expectations, which requires that persons affected by newly-enacted legislations or new court decisions are able to foresee the consequences of their conducts.

Meanwhile, also, in the EU, the principle of prohibition of abuse of law has taken precedence over the principles of legal certainty and legitimate expectations. Not only that the principle of prohibition of abuse of law can remove the limitations on the *ex tunc* effect of CJEU decisions, but also the *res judicata* effect of national court decisions in EU Member States. In international tax law, prohibition of abuse of law has influenced the OECD to shift its paradigm towards the purpose of DTCs, from avoidance of double taxation to prevention of double non-taxation. Questions of my research are first, what are the flaws of the existing concepts of beneficial ownership leading to legal uncertainty? second, how can legal certainty within the international tax law concept of beneficial ownership be established?

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¹ Angelika Meindl-Ringler, *Beneficial Ownership in International Tax Law*, (Wolters Kluwer 2016), 386.

² Angelika Meindl-Ringler, *supra* 1, 386.

³ Angelika Meindl-Ringler, *supra* 1, 85 et seq.

⁴ Angelika Meindl-Ringler, *supra* 1, 385.

⁵ Jeremy van Meerbeek, "The principle of legal certainty in the case-law of the European Court of Justice: from certainty to trust" (2016) 41 *European Law Review* 275, 279.

2. Research methodology statements

Methodologically, my research is a doctrinal study, primarily because it analyses the existing international fiscal meaning of beneficial ownership in order to, as Hutchinson⁶ asserted, establish a systematic exposition of the rules. My research is also doctrinal because it attempts to influence judges with principles, methods and propositions that best accommodate legal certainty. The output of this research is a monograph dissertation analysing the drawbacks of the existing concepts on beneficial ownership, and proposing methods that support for the establishment of legal certainty towards beneficial ownership.

My research aims at proposing changes towards the conceptualisation of beneficial ownership requirement in international tax law, after having initially identified and analysed the shortcomings of the current concepts. Therefore, my research can also be classified as reform-oriented research. The hypotheses of my research are:

- a. legal uncertainty within the international tax law concept of beneficial ownership arises within the substantive tax law and procedural tax law;
- b. legal uncertainty within the international tax law concept of beneficial ownership arises because the OECD has its own preference in defining beneficial ownership, while repudiating developments taking place in the international settings; and
- c. legal certainty within the international tax law concept of beneficial ownership can be established through definitional balancing and systematic interpretation.

Based on the above research aims and hypotheses, the main objectives of my research are, therefore, to realign the beneficial ownership requirement in international tax law with the meaning of the requirement found in other fields of law, and reformulate the purpose of the requirement in the operation of Double Tax Conventions. In achieving these objectives, a definitional balancing and systematic interpretation are necessary in improving the foreseeability of the requirement, and to maintain the integrity of international tax law.

In attaining the above aim and objectives, I limit the scope of my research to beneficial ownership measures found in landmark direct tax cases, selected states' legislations—the English version of which can be validated, multilateral initiatives on direct taxation, and recent international tax law literature on beneficial ownership. Systematic interpretation may be conducted by making references to property ownership in selected states. In order to gain its value, my research primarily focuses on cases of interposed entity or entities whose beneficial ownership are being challenged, save for those dealt with by anti-avoidance rules.

Novelty of my research is ensured by the inductive reasoning that it is necessary to construct legal certainty, being one of the main pillars of rule of law, into the existing conceptual building of beneficial ownership requirement in international tax law. Existing body of literature on beneficial ownership requirement is based on deductive reasoning, using which historical, comparative, and critical analysis are deployed in order to reveal the evolvement of the concept since its introduction in 1977, as well as the many approaches used in defining the requirement including the foremost income attribution approach. Needless to say, in interpreting the beneficial ownership requirement, deductive method has been successful in exploring the complex issues arise within the conceptual framework and practical experience of the requirement. The method has, however, failed to propose viable solutions that are directly applicable by stakeholders (taxpayers, tax authorities, tax judges).

⁶ Terry Hutchinson, "Developing legal research skills: expanding the paradigm" (2008) 32 Melbourne University Law Review 1065, 1068.

3. Main findings

As concerns the first question of this research, I conclude that substantively, the current nature of beneficial ownership requirement as an attributive clause, which addresses the phrase ‘paid...to’ in Article 10, 11, and 12 of the OECD MC, has led discussions on beneficial ownership towards treaty entitlement issues as governed in the new Article 29 of the 2017 OECD MC. Procedurally, issues on evidence of beneficial ownership have left taxpayers, particularly withholding agents, uncertain about the legitimacy of their affairs.

3.1. Identifying Flaws of the current concept of beneficial ownership

Legal uncertainty in the field of beneficial ownership arises due to substantive and procedural issues persisting in clarifying the requirement. Substantive issues include the unadjusted adoption of the trusts law meaning of beneficial ownership into its meaning in international tax law. The prevailing trusts law view dictates that a beneficial owner of a trust yield is the person to whom the yield is attributed, while maintaining the legal rights of the assets to the trustee. This view cannot be upheld, for beneficial ownership must be read as a rule that limits source state taxation on dividends, interests, and royalties, by virtue of possessions of ownership elements of the recipient. Thus, the income attribution approach should be implausible, as the operation of the requirement has been preconditioned by the OECD MC provisions on treaty entitlement provisions and conflict of classification. This means that beneficial ownership requirement may not be assigned with an anti-avoidance purpose, for it does not seek to analyse a transaction with reference to its artificiality, secrecy, and use of loopholes in the law, all of which are inherent to tax avoidance practices.

Meanwhile, I found that procedural issues within the operation of beneficial ownership requirement include the lack of satisfactory evidence during litigations. This is inherent to the lack of legal certainty towards the substantive meaning of the requirement. As a set of rules which norms are not independent from principles and definitions laid down within the substantive tax law, it is virtually impossible to formulate a common evidence procedure that courts should adhere to. As a result, case laws have suggested that some courts are satisfied with a relatively low threshold of evidence, such as document evidence; while some other courts require tax authorities to factually proven the existence of control amongst related entities. Equally problematic is the undefined liability of withholding agents in applying the beneficial ownership requirement. These agents, although have presented advantages towards revenue collection, are bearing the risks of being held liable of underpaid taxes resulted from applying beneficial ownership requirement in accordance with their best interpretation. States are still of the purview that withholding agents may be in a state of negligence if their interpretation of the requirement immediately result in revenue losses. In the lack of certainty towards beneficial ownership, this should not be the default position of states.

I also found that the above uncertainties have their underlying fundamental issue on the OECD’s inconsistencies in approaching treaty terms. Asynchronous series of approaches have been adopted by the OECD in assigning any meaning to the term. Divergent views, along with mere linguistic feature and the mismatch between the expressed objectives of the law and distorting tools used by lawyers, have been identified as reasons behind legal uncertainty. Inconsistencies have been identified within the Commentary to the OECD MC, in which preferences and objections against a particular point of argument is not supported by arguments or views taken in similar settings elsewhere within the document. Lastly, I also found that the OECD’s preference for teleological approach in defining DTC terms does not support for the argument that beneficial ownership should be understood as not including individual beneficial owners and as excluding economic substance tests from its discussions.

3.2. Aligning with contemporary measures that affect beneficial ownership

My research upholds that information asymmetries is the crux of abusive tax practices, as it is of money laundering and financing of terrorism. Apparently, as Nakajima⁷ pointed out, these issues are ‘(...) intrinsically linked, as the laundering process is a necessary element in tax evasion, which in turn is recognised as one of the predicate offences of money laundering.’ The importance of exchange of information has also been acknowledged in transfer pricing areas—the areas in international tax law whereby profits and other income of multinational corporations should be effectively taxed by tax authorities of the jurisdictions in which they are generated, value-created, or sourced—with the introduction of CbCR.

Unilaterally, tax transparency regimes have been enforced as to promote the acquisition, storage, and extraction of beneficial ownership information. Voluntary disclosure, such as that embedded into the Indonesian tax amnesty and Canadian Offshore Tax Informant Program regimes, has provided variation to the classical compulsory disclosure, such as that upheld in the Danish beneficial owner register, UK disclosure regulations, and New Zealand’s enhanced foreign trust disclosure regimes. Transnationally, establishment of common framework that coordinate efforts against information asymmetries have also been pursued by the EU organs with the enactment of the Administrative Cooperation Directive. Freedman⁸ reminded, however, that transparency—and its counter-information-asymmetry measures—is only tool for formulating inquiries, but not for solving issues. The challenges confronted by tax authorities in applying the law onto the facts and collect taxes due are, therefore, persistent, notwithstanding the vast amount of information available at their disposal.⁹ In other words, they are materials for further analysis performed in solving issues.

The efforts to establish legal certainty towards beneficial ownership requirement in DTCs need not, therefore, deviate from the works on exchanging information for tax purposes. In fact, convergence of both endeavours may assist the achievement of the requirement’s purpose—namely to limit source state taxation on outbound passive income—in a manner that is most foreseeable to stakeholders in international tax law. Formulation of ingenious solutions might resulted in further legal uncertainty on the issue. Yet, it would not be so efficient to have multiple measures laid down on issues that are intrinsically linked.

3.3. Deploying definitional balancing towards beneficial ownership

Within the efforts to define beneficial ownership requirement—and to apply the definition to the case at hand, judges often have to deploy proportionality balancing between the competing interests surrounding the requirement. This has not been done explicitly by weighing two directly-competing interests, but rather implicitly when making analysis on abusive tax practices, which are often associated with taxpayers’ practices that trigger the tax authority’s scrutiny on the requirement. If proportionality balancing continues to be used worldwide as method of interpreting beneficial ownership, the results would be unsatisfactory in terms of legal certainty. This is true, because the OECD’s shift of paradigm—i.e. the objective of avoiding double non-taxation—concerning the purpose of DTCs would suggest tax judges in different jurisdictions on the magnitude of tax avoidance. Consequently, tax benefits derived by a certain taxpayer are presumed as having been based on ingenuity on the part of the taxpayer. This is when the balance in analysing beneficial ownership is tilted.

⁷ Chizu Nakajima, ‘Confidentiality vs. transparency - discussion at the "Panama Papers" conference’, (2017) 38 *Company Lawyer* 137, 137.

⁸ Judith Freedman, ‘UK institutions for tax governance: reviewing tax settlements’, (2016) 1 *British Tax Review* 7, 11.

⁹ Judith Freedman, *supra* 8.

Either performed within the framework of LoB provisions, PPT rules, or enhanced arm's length principle, proportionality balancing (e.g. by way of business purpose tests) do not preserve the legitimate expectations a taxpayer has when entering into a transaction. This is not to mention that proving a factual control is not an easy task, and would involve further balancing on the weight of evidence which eventually leads to further uncertainty. I conclude, therefore, that in order to preserve the legitimate expectations of taxpayers, a definitional balancing method should be deployed on beneficial ownership. The method, along with proportionality balancing, are traditional to constitutional courts, and usually deployed when determining the scope of basic human rights. In the context of beneficial ownership, the method would reduce the scope of the right to use and enjoy income of a taxpayer.

My research found that definitional balancing as such may also preserve for legitimate expectations of a source state in exercising their right to tax on income. This is inline with the previously submitted argument that the beneficial ownership requirement has the character of limiting a source state's taxing rights over dividends, interests, and royalties arising or paid from its jurisdiction. The method should, however, be deployed cautiously, for any over- or under-generalisation of a factual circumstance could lead to a 'wrong result'. One can arrive at such result if the exclusion of a particular conduct fails to consider all the relevant interests.

4. Future research activities

At the next stage of my research, I will explore the possibility of judicial dialogues that would harness the use of definitional balancing in defining beneficial ownership. This is necessary, for definitional balancing deployed by a court in a contracting state must be disseminated to other courts in different contracting states. That way, the scope of the right to use and enjoy income could be restricted across jurisdictions and enhance legal certainty. A list of occasions—based on evidence conducted during litigations—in which a person is ruled as *not* a beneficial owner of income will provide a robust shape to the requirement and render it more foreseeable by taxpayers, tax authorities, and tax judiciaries across the globe.

Not only that the use of definitional balancing found its legitimacy in constitutional courts, but also in the EU. The shaping of the EU fundamental freedoms through negative integration is arguably deploying some sort of definitional balancing. Definitional balancing must not, however, be mistaken with the principle of narrow interpretation of exceptions. The CJEU had drawn the scope of the principle in *Jean Reyners v. Belgian State* (C 2-74), namely that any exception to the fundamental principles of freedom of movement and equality of treatment within the [European] Community may only be interpreted restrictively, which, in doubtful events, must be interpreted in the light of protection for the fundamental right.

Additionally, I will also explore the systematic interpretation method and its possible implementation in defining the beneficial ownership requirement. The method emphasises on the legislative acts to define beneficial ownership. This includes the legislations enforced by different states, and the OECD's efforts in interpreting DTC terms in its Commentary to the OECD MC. A systematic interpretation on the beneficial ownership requirement means that the term is interpreted in accordance with its meaning and use in other fields of law, but for the adjustments made inline with its context as a rule that limits source state taxation on dividends, interests, and royalties, by virtue of possessions of ownership elements of the recipient. Accordingly, the OECD hard-and-fast rule of excluding definitions found in trusts law or anti money laundering law, must be relaxed. Elements derived from those laws should be regarded as valuable, unless the context otherwise requires. Lastly, both the definitional balancing and systematic interpretation methods must be deployed in solving the substantive and procedural tax law issues on beneficial ownership in international tax law.