

# Beneficial Ownership in International Taxation and Biosemantics – Why a Redundant, Paradoxical and Harmful Concept Can Be a Potent Weapon in the Hands of the Tax Authorities

**This article argues that the concept of beneficial ownership supports an income allocation function more than an anti-abuse one. It then demonstrates that the concept is redundant, paradoxical and harmful, and that it would be better to discard it. Finally, the article uses biosemantics to explain the concept.**

## 1. Introduction

Despite more than 50 years of attempts by the OECD to clarify the concept of “beneficial ownership” or “beneficial owner” (hereinafter both BO), its meaning and scope remains ambiguous and unresolved, not only among tax authorities and the courts, but also among scholars.<sup>1</sup>

\* Assistant professor at the University of Amsterdam, research assistant professor at the Lazarski University, advisor at the PwC Global Tax Policy and senior manager at the International Tax Services of the PwC Netherlands. The author can be contacted at [blazej.kuzniacki@gmail.com](mailto:blazej.kuzniacki@gmail.com). The author would like to thank Johann Hattingh for comments on an early draft of this article. Their incorporation contributed to the precision and quality of it. However, the content of this article is the sole responsibility of the author. The article develops ideas contained in the author's earlier work, *Beneficial Ownership in International Taxation* (Edward Elgar Publ. 2022), available at: [www.e-elgar.com/shop/gbp/beneficial-ownership-in-international-taxation-9781802206067.html](http://www.e-elgar.com/shop/gbp/beneficial-ownership-in-international-taxation-9781802206067.html) (accessed 16 Jan. 2023).

1. This article builds, among the others, on the following pieces of scholarship regarding the concept of BO in international taxation: D. Oliver et al., *Beneficial Ownership and the OECD Model*, Brit. Tax Rev. 1, p. 27 et seq. (2001); K. Vogel, *On Double Taxation Conventions Preface to Arts. 10-12, in Klaus Vogel on Double Taxation Conventions: A Commentary to the OECD-, UN- and US Model Conventions for the Avoidance of Double Taxation on Income and Capital* 3rd edn., paras. 5-14 (K. Vogel ed., Kluwer L. Intl. 1997); S. van Weeghel, *The Improper Use of Tax Treaties: With Particular Reference to the Netherlands and the United States* p. 64 et seq. (Kluwer L. Intl. 1998); C.P. du Toit, *Beneficial Ownership of Royalties in Bilateral Tax Treaties* (IBFD 1999); J. Walser, *The Concept of Beneficial Ownership in Tax Treaties*, in *The OECD Model Convention – 1998 and Beyond: Proceedings of a Seminar held in London in 1998 during the 52nd Congress of the International Fiscal Association* (Kluwer L. Intl. 2000); P. Baker, *Double Taxation Conventions Art. 10 para. 10B-09 et seq.* (Sweet & Maxwell 2000); H. Pijl, *Beneficial Ownership and Second Tier Beneficial Owners in Tax Treaties of the Netherlands*, 31 Intertax 10, pp. 353-61 (2003); R. Danon, *Switzerland's Direct and International Taxation of Private Express Trusts* p. 296 et seq. (Schulthess 2004); J. Wheeler, *The Attribution of Income to a Person for Tax Treaty Purposes*, 59 Bull. Intl. Fisc. Docn. 11, sec. 2. (2005), Journal Articles & Opinion Pieces IBFD; J. Wheeler, *General Report*, in *Conflicts in the attribution of income to a person*, International Fiscal Association (IFA), *Cahiers de droit fiscal international* vol. 92b (IFA 2007), Books IBFD; J. Bernstein, *Beneficial Ownership: An International Perspective*, 47 Tax Notes Intl.

All this has been detrimental to the stable and predictable functioning of tax treaties for several decades and more recently for the Council Directive 2011/96/EU of 30 November 2011 on the Common System of Taxation Applicable in the Case of Parent Companies and Subsidiaries of Different Member States (the PSD (2011/96))<sup>2</sup> and Council Directive 2003/49/EC of 3 June 2003 on a Common System of Taxation Applicable to Interest and Royalty Payments Made between Associated Companies of Different Member States (the IRD (2003/49)).<sup>3</sup>

The justified criticism of the OECD for the lack of a precise, holistic, principle- and consequence-based approach to the clarification of the meaning of BO does not diminish the practical importance of that concept. It continues to be regarded as a potent weapon in the arsenal of

17, pp. 1211-1216 (2007); L. De Broe, *International Tax Planning and Prevention of Abuse: A Study Under Domestic Tax Law, Tax Treaties and EC Law in Relation to Conduit and Base Companies*, p. 654 et seq. (IBFD 2008) Books IBFD; A.J. Martín Jiménez, *Beneficial Ownership: Current Trends*, 2 World Tax J. 1 (2010), Journal Articles & Opinion Pieces IBFD; C.P. du Toit, *The Evolution of the Term “Beneficial Ownership” in Relation to International Taxation over the Past 45 Years*, 64 Bull. Intl. Taxn. 10, sec. 3.2.1. (2010), Journal Articles & Opinion Pieces IBFD; *Beneficial Ownership: Recent Trends* (M. Lang et al. eds., IBFD 2013), Books IBFD; J. Hattingh, *Beneficial Ownership and Double Tax Conventions, Part II*, in *International Tax ch. 9* (A. De-Koker & E. Brincker eds., LexisNexis 2010 and 2019); A. Meindl-Ringler, *Beneficial Ownership in International Tax Law* (Kluwer L. Intl. 2016); R.J. Danon, *Treaty Abuse in the Post-BEPS World: Analysis of the Policy Shift and Impact of the Principal Purpose Test for MNE Groups*, 72 Bull. Intl. Taxn. 1 (2018), Journal Articles & Opinion Pieces IBFD; A. Zalasinski, *The ECJ's Decisions in the Danish “Beneficial Ownership” Cases: Impact on the Reaction to Tax Avoidance in the European Union*, 2 Intl. Tax Stud. 4 (2019), Journal Articles & Opinion Pieces IBFD; R. Danon, *Tax Treaty Abuse from a Swiss Perspective: Current State of Affairs, Uncertainties and Future Perspective*, in *Au Carrefour des Contributions: Mélanges de Droit Fiscal en l'honneur de Monsieur le Juge Pascal Mollard* pp. 413-446 (G. Raphaël & A. Rochat Pauchard eds., Stämpfli 2020); A.J. Martín Jiménez, *Beneficial Ownership – Global Tax Treaty Commentaries*, Global Topics IBFD; P.H. González-Barreda, *Beneficial Ownership in Tax Law and Tax Treaties* (Hart Publ. 2020); C.P. du Toit, *Beneficial Owner: The Enigma Storms Ahead*, 75 Bull. Intl. Taxn. 11/12 (2021), Journal Articles & Opinion Pieces IBFD; and D. (Dennis) Weber, *EU Beneficial Ownership Further Developed: A View from a Different Angle*, 14 World Tax J. 1 (2022), Journal Articles & Opinion Pieces IBFD.

2. Council Directive 2011/96/EU of 30 November 2011 on the Common System of Taxation Applicable in the Case of Parent Companies and Subsidiaries of Different Member States, OJ L 345 (2011), Primary Sources IBFD [hereinafter the PSD (2011/96)].
3. Council Directive 2003/49/EC of 3 June 2003 on a Common System of Taxation Applicable to Interest and Royalty Payments Made between Associated Companies of Different Member States, OJ L 157 (2003), Primary Sources IBFD [hereinafter the IRD (2003/49)].

tax authorities to attack presumably abusive behaviours involving conduit entities.<sup>4</sup> The tax authorities appear to approach that issue very pragmatically, i.e. the appropriate meaning of BO does not matter (if it exists at all) as long as its application allows withholding tax (WHT) to be levied on foreign taxpayers (investors).

The article aims to answer the question of whether BO is a necessary and helpful concept in international and EU tax law<sup>5</sup> or an unnecessary and harmful one. And, if the latter, how it can be a potent anti-abuse weapon in the hands of tax authorities. The author tries to achieve this purpose by identifying a proper function of the concept of BO (the allocation of income in the meaning explained subsequently in this section) by way of a concise analysis of the evolution of that concept (see section 2.) and then by providing arguments on its redundant, paradoxical and harmful roles in international tax world (see section 3.). Next, the article touches on biosemantics as a source of behavioural explanation for the anti-abuse perception of the concept of BO by the tax authorities and the role of the courts in changing that perception (see section 4.). The article's conclusions are then set out (see section 5.).

Before moving to the analytical part of this article, it should be noted that the fundamental assumption is that the concept of BO primarily ensures the proper operation of articles 10, 11 and 12 of the OECD Model<sup>6</sup> by following the actual (rather than the simulated) allocation of income. Accordingly, it is worthwhile explaining what the author means in that regard to avoid misunderstanding.

An actual (effective and/or real) allocation of income is a heightened tax-specific concept of when income belongs to a person (natural or legal), i.e. it entails connecting income to a taxable person rather than allocating it to a taxing jurisdiction. The allocation of income is triggered solely by domestic tax law of contracting states (hereinafter the CSs), whereas the concept of BO is a threshold factor to establish whether the limit on withholding taxation under a tax treaty in the source country (hereinafter the SC) applies or not. This threshold factor is met when income from the SC is actually allocated to the resident country (hereinafter the RC). Consequently, the concept of BO requires a careful analysis of facts that give rise to an actual allocation of income under domestic law of a CS in conjunction with a precise legal analysis of such law and the relevant treaty provisions (usually, the equivalents of articles 10, 11 and 12 of the OECD Model in the SC-RC Tax Treaty). If the established facts trigger allocation of income under the tax law of the RC, the allocation is actual. If not, the allocation is simulated (not real and/or ineffective). An allocation of income is not real, for example, when the transaction described in the documentation between companies does not take place in reality. This is a case when the documentation says that payments are transferred from one company (resident in the SC) to

second (resident in the RC), but, in reality, the payments bypass the second company, and are transferred directly to third company (non-resident in the RC).<sup>7</sup>

Even if in many countries this unreal allocation of income can be ignored for tax purposes as a sham transaction (i.e. fraud under general law), in a cross-border scenario the establishment by the tax authorities of the SC, whether or not the allocation of income to a resident of the RC is real, can be very complicated. It is also necessarily extremely fact-sensitive and requires the nearly flawless exchange of tax information between the SC and the RC.<sup>8</sup> The concept of BO is intended to ensure that the tax authorities of the SC undertake that arduous task in a proper way. Otherwise a tax treaty with the RC may be applied in an improper way. This demonstrates that the concept of “real allocation of income” refers to a general legal reality, i.e. to the allocation of income based on real facts. The tax reality, in turn, is valid when the facts are legally valid and factually established (when they are real) for all general law purposes, but, for tax law purposes alone, they are to be disregarded. They can be disregarded, for example, under general anti-abuse rules (GAARs) or other anti-tax avoidance measures, such as substance-over-form or economic substance doctrines.<sup>9</sup>

The argument of this article is that the concept of BO should not operate to disregard allocation of income by the SC for treaty purposes in accordance with the previously noted anti-tax avoidance measures. This is the role of those measures and the concept of BO does not have premises of tax avoidance, in contrast to these measures, which could lead to the ignorance of allocation of income in line with the letter of law (see section 3.). Consequently, the concept of BO is a search for “legal substance” at the level of the entity (often, an intermediate entity) in the RC, which receives income from the SC rather than the “economic substance”.<sup>10</sup> As Zimmer (2002) clarified, the legal

4. Martín Jiménez, *Beneficial Ownership – Global Tax Treaty Commentaries*, supra n. 1, at ch. 1.  
5. That is, tax treaties and the PSD (2011/96) and the IRD (2003/49).  
6. Most recently, *OECD Model Tax Convention on Income and on Capital* (21 Nov. 2017), Treaties & Models IBFD.

7. See, for example, the decision of the UK High Court (Chancery Division) (UKHC) in UK: UKHC, 7 Oct. 2005, *Indofood International Finance Ltd v. JP Morgan Chase Bank NA*, [2006] STC 192 and that of the UK Court of Appeal of England and Wales (UKCAEW) in UK: UKCAEW, 2 Mar. 2006, *Indofood International Finance Ltd. v. JP Morgan Chase Bank NA*, London Branch, [2006] STC 1195, Case Law IBFD. See also the decision of the Spanish *Audiencia Nacional* (the National Court, AN) in ES: AN, 18 July 2006, Case No. 1110/2003, JUR/2006/204307, Case Law IBFD. Similar and associated cases decided by the AN are ES: AN, 18 July 2006, JUR/2007/8915 and JUR/2007/16549; ES: AN, 10 Nov. 2006, JUR/2006/284679; ES: AN, 20 July 2006, JUR/2007/16526; ES: AN, 13 Nov. 2006, JUR/2006/284618; and ES: AN, 26 Mar. 2007, JUR/2007/101877.  
8. That is why the OECD explicitly acknowledged serious difficulties in applying the concept of BO by the SC to conduits already in 1986, not least by recognizing that it will be highly burdensome for the SC to gather the information necessary to identify a foreign recipient of the income as a conduit. See OECD, *Double Taxation Conventions and the Use of Conduit Companies* para. 14(b) (OECD 1986), Primary Sources IBFD [hereinafter the *Conduit Companies Report*].  
9. *OECD Model Tax Convention on Income and on Capital: Commentary on Articles 10, 11 and 12*, paras. 12.5, 10.3 and 4.4, respectively (21 Nov. 2017), Treaties & Models IBFD.  
10. Although it varies among countries, the concept of “economic substance” in this article is understood to be the concept of anti-tax avoidance that permits the tax authorities to “go beyond the factual and interpretative stage and substitute facts that lead to taxation for facts that reduce or avoid taxation”. See B.J. Arnold & S. van Weeghel, *The Relationship between Tax Treaties and Domestic Anti-Abuse Measures*, in Tax

substance “most often refers to the characterization which emerges from a *close study of the rights and obligations in a legal relation*” [emphasis added], and its main function “is to point out that sham or simulation transactions and wrong legal characterizations by the taxpayer will be disregarded for tax purposes”.<sup>11</sup>

This is also the claim of this article that the determination of facts towards an allocation of income to the intermediary entity should be assessed mainly from the perspective of the RC of that entity, which is usually a direct recipient of the income from the SC. To this end, the SC should enter into an exchange of tax information with the RC to gather the relevant information for an appropriate application of tax treaty with RC. From the perspective of the RC, income may be allocated under ordinary rules allocating income to its residents or by way of extraordinary rules that have an anti-tax avoidance function, for example, under GAARs, substance-over-form or economic substance doctrines. If the income fails to be allocated to the entity in the RC either under the former or the latter rules, the SC should respect that consequence also for the purposes of an application of tax treaties.<sup>12</sup> The SC is free to apply its own domestic anti-tax avoidance measures so as to disregard tax consequences of allocation of income by the RC for treaty purposes. However, this cannot be done by way of the concept of BO, which is not an anti-tax avoidance rule (measure), and cannot be applied as a handy substitute for any of them. In order to finalize that approach so as to determine properly the facts for the purposes of the concept of BO, it is worthwhile referring to Zimmer’s observation, according to which:

there is a difference of principle between establishing the facts on the basis of rules of evidence and deciding whether the legal conditions for declaring tax avoidance are fulfilled.<sup>13</sup>

In this article, the SC must take into account the allocation of income by the RC; therefore, a holistic approach is required. This means that the facts on the basis of rules of evidence and the legal conditions for determining tax avoidance, as applied by the RC, are of relevance to apply the concept of BO by the SC insofar as they permit the SC to apply a tax treaty with the RC in line with the actual allocation of income from the SC to a resident in

the RC. Accordingly, whenever in this article the role of the concept of BO is attributed to allocation of income or any role of that kind for treaty purposes (the reflection of income allocation at treaty level), it should be understood in the meaning as explained in this section.

## 2. The Allocation of an Income Rule Instead of an Anti-Abuse Rule: A Brief History of Misconception of the Concept of BO

### 2.1. The origin of the concept of BO in the OECD Model

Originally, in the 1940s to 1960s, Australia, New Zealand and the United States considered the concept of BO as being implicit in tax treaties, as it reflected the fundamental logic of applying tax treaties, i.e. no treaty application without income allocation.<sup>14</sup> Accordingly, these countries treated the concept of BO as the reflection of income allocation at treaty level.

However, in 1960, the United Kingdom forced an extra dimension on that concept in the form of its anti-treaty abuse function. This action was driven by the peculiar legal regulations in force in the United Kingdom regarding the allocation of foreign-source income to the trustees of UK trusts.<sup>15</sup> Initially, the United Kingdom’s perception of the concept of BO did not find its way to the OECD Model and the global network of tax treaties. In the 1960s and 1970s, Working Party (WP) 27, consisting of the delegations to the OECD from France, Luxembourg and the Netherlands,<sup>16</sup> did not recommend attributing an anti-abuse meaning to the concept of BO for treaty purposes at the time of its inclusion to the OECD Model (1977).<sup>17</sup> According to WP 27, the addition of the concept

*Treaties and Domestic Law* sec. 5.4.2 (G. Maisto ed., IBFD 2006), Books IBFD.

11. F. Zimmer, *General Report*, in *Form and substance in tax law*, IFA *Cahiers de droit fiscal international* vol. 87a, sec. 2. (2002), Books IBFD.
12. Cf. OECD, *The Application of the OECD Model Tax Convention to Partnerships*, 6 Issues In International Taxation para. 53 (OECD 1999), Primary Sources IBFD [hereinafter the *Partnerships Report*]. See also Martín Jiménez, *Beneficial Ownership – Global Tax Treaty Commentaries*, *supra* n. 1, at sec. 2.2.6.1. and M. Valta, *Income from Royalties. Article 12*, in *Klaus Vogel on Double Taxation Conventions* 4th edn., p. 987 (A. Rust & E. Reimer eds., Wolters Kluwer L. & Bus. 2015). Readers should note that a footnote using the abbreviation “cf.” (compare), as the present one does, does not indicate that the view expressed in the text is directly supported by that book, article, decision or other source cited. Rather, it means that the topic is discussed in such a way that it is relevant for the understanding of the issue discussed in the text.
13. Zimmer, *supra* n. 11, at sec. 5.3. Cf. B.J. Arnold, *Tax Treaties and Tax Avoidance: The 2003 Revisions to the Commentary to the OECD Model*, 58 Bull. Intl. Fiscal Docn. 6, sec. 5.1. (2004), Journal Articles & Opinion Pieces IBFD and F. Zimmer, *Domestic Anti-avoidance Rules and Tax Treaties – Comment on Brian Arnold’s Article*, 59 Bull. Intl. Taxn. 1 (2005), Journal Articles & Opinion Pieces IBFD.

14. R.J. Vann, *Beneficial Ownership: What Does History (and Maybe Policy) Tell Us*, in Lang et al., *supra* n. 1, at sec. 19.3.1.; US: Committee of Internal Revenue Taxation, *Legislative History of United States Tax Conventions* (1962) 1 Income Tax Conventions, U.S. Government Printing Office, p. 460; UK: The National Archives (TNA), File IR 40/17246, 14 February 1966; J. Taylor, *The Negotiation and Drafting of the 1967 United Kingdom – Australia Taxation Treaty* in: *Studies in the History of Tax Law* pp. 440 and 453 (J. Tiley ed., Hart Publ. 2011); and D.G. Duff, *Beneficial Ownership: Recent Trends*, in Lang et al., *supra* n. 1, at sec. 1.7.
15. Vann, *supra* n. 14, at sec. 19.4.1. and J.F. Avery Jones, *The Beneficial Ownership Concept Was Never Necessary in the Model*, in Lang et al., *supra* n. 1. Cf. Meindl-Ringler, *supra* n. 1, at p. 134 et seq. For the taxation of trustees and beneficiaries in trusts, see C.A. Brown, *Symposium: Beneficial Ownership and the Income Tax Act*, 51 Can. Tax J. 1, pp. 403-404 (2003) and A. Abass & R. Clements, *Equity & Trusts: Text, Cases and Materials* p. 22 (Oxford U. Press 2011).
16. WP 27’s task was to revise the rules on the taxation of interest and royalties in accordance with the *OECD Draft Convention on Income and on Capital*, arts. 11 and 12 (30 July 1963), *Treaties & Models IBFD* to respond to the concerns of the UK delegation. This issue in relation to article 10 of the *OECD Draft* (1963) was the subject of WP 23 which mainly concentrated on the differing corporate shareholder tax systems in the OECD member countries, and how they could be reconciled in a treaty framework. This topic was discussed later on as a result of the work of WP 1 in 1973. See WP 1 of the Committee on Fiscal Affairs on Double Taxation and WP 23 (Germany and Belgium), *Revision of Article 10 of the 1963 Model Convention, and the Commentary Thereon*, CFA/WP1(73)2 p. 2 (31 Jan. 1973), available at [www.taxtreatieshistory.org/data/html/CFA-WP1\(73\)2E.html](http://www.taxtreatieshistory.org/data/html/CFA-WP1(73)2E.html) (accessed 26 Jan. 2023). See also *Summary of Discussions at the Seventh Meeting of Working Party No. 1 on Double Taxation* (13-15 Feb. 1973) DAF/CFA/WP1/73.5 & Corrigendum p. 5 (11 Apr. 1973), available at [www.taxtreatieshistory.org/data/html/DAF-CFA-WP1-73.5E.html](http://www.taxtreatieshistory.org/data/html/DAF-CFA-WP1-73.5E.html) (accessed 26 Jan. 2023).
17. *OECD Model Tax Convention on Income and on Capital* (11 Apr. 1977), *Treaties & Models IBFD*.



of BO to articles 11 and 12 of the OECD Model would not be a significant change for the vast majority of the OECD member countries, as these countries, in contrast to the United Kingdom, did not apply rules to allocate income for tax purposes to a person that is not entitled to that income, such as a nominee or a trustee.<sup>18</sup> Consequently, the addition of the concept of BO to articles 11 and 12 of the OECD Model (1977) was intended to resolve a uniquely UK problem (allegedly) without detriment or complication to the application of tax treaties by the other states, but also without much need for such an amendment to the OECD Model from their perspective. Accordingly, the other OECD member countries eventually did not object to the implementation of the UK delegation's idea.<sup>19</sup>

## 2.2. From the addition of the concept of BO to the OECD Model (1977) to changes to the OECD Model (2017) made following the OECD/G20 Base Erosion and Profit Shifting Project

On 11 April 1977, the OECD Model (1977) was published. In contrast to its predecessor, the OECD Draft (1963), the OECD Model (1977) onwards included the concept of BO in articles 10, 11 and 12. For instance, article 10(2) of the OECD Model (1977) read:

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

- a) 5 per cent 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;
- b) 15 per cent of the gross amount of the dividends in all other cases.

As a result of adding the concept of BO to the OECD Model (1977), that concept was commonly added to tax treaties worldwide that were concluded or modified after 1977.

As the wording of the concept of BO in the OECD Model (1977) was extremely scant, comprising just two words ("beneficial owner"), the burden of clarifying this concept fell onto the Commentary on Articles 10, 11 and 12 of the OECD Model (1977). In this respect, the OECD Commentary on Articles 10, 11 and 12 (1977) read:

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. States which wish to make this more explicit are free to do so during bilateral negotiations.<sup>20</sup>

As a result, both the content of the concept of BO under the OECD Model (1977) and the explanation of that concept in the Commentaries on Articles 10, 11 and 12 of the OECD Model (1977) explicitly excluded only two types of intermediaries – agents and nominees – from the scope of BOs that may benefit from articles 10, 11 and 12. This approach reflected the views of WP 27 to the effect that the role of the concept of BO was to clarify the allocation of income to the taxpayer under domestic law of the CSs for the purposes of properly applying the aforementioned provisions of the tax treaties, as could be interpreted from the wording of articles 10(1), 11(1) and 12(1) of the OECD Draft (1963) before the advent of the OECD Model (1977). Notably, neither the OECD Model (1977) nor the OECD Commentaries on Articles 10, 11 and 12 (1977), in contrast to the reports of WP 21, referred to conduit or holding companies as intermediaries that escape the pool of BOs under articles 10, 11 and 12. This confirms that the concept of BO added to articles 10, 11 and 12 of the OECD Model (1977) should not be equated with the anti-abuse, economic concept of BO that apparently could be deduced from the reports of WP 21. This observation is also confirmed by the Commentaries on Articles 10, 11 and 12 of the OECD Model (1977).<sup>21</sup> Specifically the OECD Commentaries on Articles 10, 11 and 12 imply that the potential abuse of tax treaties by way of intermediary companies controlled by third-country residents should fall within the scope of application of special provisions added by the CSs to the tax treaties that provide for exceptions to the principles of granting reduced WHT rates or exemptions from WHT under articles 10, 11 or 12 of the OECD Model (1977). In other words, if the CSs:

had wished to attack that structure, a specific provision should have been added to the tax treaty, because the intermediate company would otherwise qualify as BO of the income received.<sup>22</sup>

Most likely, the lack of a clear exclusion of conduit companies from the scope of BO in the Commentaries on Articles 10, 11 and 12 of the OECD Model (1977) prompted the OECD to address that issue in the OECD Conduit Companies Report (1986), which, a year later, was included in the OECD's publication of four related studies on international tax avoidance and tax evasion.<sup>23</sup> The OECD Conduit Companies Report (1986) refers to the term "intermediary", and refers to the concept of BO only once.<sup>24</sup> This passage in the OECD Conduit Companies Report (1986) assimilated conduit entities with the group of agents and nominees excluded from the scope of BOs. It clarifies the meaning of such an intermediary, terming it a:

conduit... a person [who] enters into contracts or takes over obligations under which he has a similar function to those of a nominee or an agent... the formal owner of certain assets [who]

18. WP 27 of the Fiscal Committee (France, Luxembourg and the Netherlands), *Report on suggested amendments to Articles 11 and 12 of the Draft Convention, relating to interest and royalties respectively*, FC/WP27(70)1 p. 14 (16 Feb. 1970), available at [www.taxtreatieshistory.org/data/html/FC-WP27\(70\)1E.html](http://www.taxtreatieshistory.org/data/html/FC-WP27(70)1E.html) (accessed 26 Jan. 2023).

19. Martín Jiménez, *Beneficial Ownership – Global Tax Treaty Commentaries*, *supra* n. 1, at sec. 2.2.1.

20. OECD Model Tax Convention on Income and on Capital: Commentary on Articles 10, 11 and 12, paras. 12, 8 and 4, respectively (11 Apr. 1977), *Treaties & Models IBFD*.

21. Paras. 22, 12 and 7 *OECD Model: Commentaries on Articles 10, 11 and 12 (1977)*, respectively.

22. Martín Jiménez, *Beneficial Ownership – Global Tax Treaty Commentaries*, *supra* n. 1, at sec. 2.2.2.

23. OECD, *International Tax Avoidance and Evasion*, Issues in International Taxation No. 1, Four Related Studies (OECD 1987).

24. OECD, *Conduit Companies Report*, *supra* n. 8, at para. 14(b).

has very narrow powers which render it a mere fiduciary or an administrator acting on account of the interested parties.<sup>25</sup>

Such intermediary companies are typically associated with tax avoidance purposes, as they lack any meaningful function beyond transferring the income to other entities from third countries, thereby benefiting from the treaty network of the taxing RC of the intermediaries.<sup>26</sup>

The OECD Conduit Companies Report (1986) defined conduits in an exclusively pejorative way, which was intentionally vague, as entities that solely or mainly aim to obtain benefits under tax treaties for the benefit of non-residents of the CSs at the expense of the SC. The OECD also linked the existence of conduits with the improper use of tax treaties,<sup>27</sup> i.e. abusive treaty shopping, but does so in a very unclear way that suffers from not having a rigorous terminological and methodological approach.<sup>28</sup> In particular, the OECD focused solely on the tax intention of the entities that benefit from the use of conduits, i.e. indirect access to the treaty benefits under articles 10, 11 and 12 of the OECD Model, without referring to the indispensable premise of abuses of tax treaties, i.e. a contradiction between obtaining such benefits and the relevant provisions of a tax treaty.<sup>29</sup> An unclear methodology for understanding and applying the concept of BO makes it barely possible to distinguish this concept from the appropriate anti-abuse rules, i.e. the wording of which include abusive premises. The lack of clarity in that regard, however, has prompted the tax authorities and many courts around the world to apply the concept of BO as if it included several anti-abuse solutions in its wording and structure,<sup>30</sup> or even as if it was a form of GAAR with the embedded substance-over-form mechanism.<sup>31</sup> Ultimately, the concept of BO was so unspecified in terms of its wording and policy goals that it could be moulded by the OECD as it pleased at any time, until a total collapse into meaninglessness. An additional reason for such a state of affairs could be the lack of anti-abuse provisions in the OECD Model at that time, and, therefore, in the great majority of tax treaties worldwide, taken together with the OECD's position whereby the international principle of *pacta sunt servanda* (agreements must be kept) would prevent the CSs from applying their domestic anti-abuse rules and doctrines to deny treaty benefits.<sup>32</sup>

25. Martín Jiménez, *Beneficial Ownership – Global Tax Treaty Commentaries*, *supra* n. 1, at sec. 2.2.3.

26. Cf. M. Wilk, *Klauzula rzeczywistego beneficjenta (beneficial ownership) w międzynarodowym prawie podatkowym* sec. 4.4.3.3 (Wolters Kluwer Polska 2015) and De Broe, *supra* n. 1, at p. 684.

27. OECD, *Conduit Companies Report*, *supra* n. 8, at paras. 1, 2 and 3.

28. D. Rosenbloom, *Review: OECD Report Double Taxation Conventions and the Use of Conduit Companies*, *Intertax*, 6/7, pp. 179–182 (1988) and Van Weeghel, *supra* n. 1, at p. 120.

29. Being the equivalent of articles 10, 11 and 12 of the OECD Model (1977).

30. For more on this topic, see C. Garbarino, *Judicial Interpretation of Tax Treaties: The Use of the OECD Commentary* paras. 1.41–1.123 and 47–79 (Edward Elgar Publ. 2016).

31. S. (Saurabh) Jain, *Effectiveness of the Beneficial Ownership Test in Conduit Company Cases* secs. 4.3.4, 4.12 and 4.34 (IBFD 2013), Books IBFD.

32. Cf. Martín Jiménez, *Beneficial Ownership – Global Tax Treaty Commentaries*, *supra* n. 1, at sec. 2.2.3.

The OECD adopted significant changes to the Commentaries on the OECD Model (2003), which were directed at preventing the abuse of tax treaties.<sup>33</sup> The changes were proposed in the OECD Report Restricting the Entitlement to Treaty Benefits (2002).<sup>34</sup> The changes included, among other things, several recommendations from the OECD Conduit Companies Report (1986) and the OECD Report on Harmful Tax Competition (1998)<sup>35</sup> that were intended to permit tax treaties to be interpreted in an anti-abuse way without changing the content of tax treaties.<sup>36</sup> The changes made to the Commentaries on the OECD Model (2003) regarding the concept of BO are seemingly inconsistent and incoherent insofar as they gravitate towards the anti-abuse understanding of the concept of BO<sup>37</sup> and simultaneously pull its meaning in a different direction by identifying it with the term “paid to”.<sup>38</sup> The changes appear to be an explosive mix of theses from the work of WP 21 (anti-abuse), WP 27 (clarification of income allocation), the OECD Conduit Companies Report (1986) (anti-abuse) and the OECD Partnerships Report (1999)<sup>39</sup> (clarification of income allocation), all under the umbrella of the OECD Report on Harmful Tax Competition (1998) (anti-abuse and anti-fraud).

The most recent approach of the OECD to the concept of BO, as expressed in the Commentaries on the OECD Models (2014) and (2017), seems to restrict significantly its scope of application by carving out from the pool of BOs only entities engaged with mutually interdependent payments of dividends, interest and royalties.<sup>40</sup> Such payments stem from the qualified legal or contractual obligations to pass on the income received to other entities,<sup>41</sup> typically those controlling the entire chain of entities involved in the payments or transactions that trigger the payments. This approach best suits the function of the concept of BO that aims to ensure the application of articles 10, 11 and 12 of the OECD Model only to entities that actually receive income from the SCs, which are considered to be taxpayers with regard to that income in their RCs. This situa-

33. OECD Model Tax Convention on Income and on Capital: Commentaries (28 Jan. 2003), Treaties & Models IBFD.

34. OECD, *Restricting the Entitlement to Treaty Benefits* (OECD 2002), Primary Sources IBFD.

35. OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD 1998).

36. For a detailed analysis of the methodological, legal and treaty policy aspects of the 2003 revision to the Commentary see Arnold, *supra* n. 13 and C. Elliffe, *Cross Border Tax Avoidance. Applying the 2003 OECD Commentary to Pre-2003 Treaties*, *Brit. Tax Rev.* 3, pp. 307–333 (2012), available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2120834](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2120834) (accessed 26 Jan. 2023).

37. The addition of paragraph 12.1 to the OECD Model: Commentary on Article 10 (2003) (similar amendments were added to paragraphs 10 and 4.1 to the OECD Model: Commentaries on Article 11 and 12 (2003), respectively) explicitly excludes conduit entities from the scope of BOs.

38. Meindl-Ringler, *supra* n. 1, at p. 334 and Martín Jiménez, *Beneficial Ownership: Current Trends*, *supra* n. 1, at sec. 3.4.

39. OECD, *Partnerships Report*, *supra* n. 12.

40. Paragraphs 12.4, 10.2 and 4.3 of the OECD Model Tax Convention on Income and on Capital: Commentary on Articles 10, 11 and 12 (26 July 2014), Treaties & Models IBFD and OECD Model: Commentaries on Articles 10, 11 and 12 (2017), respectively.

41. Cf. B. Baumgartner, *Das Konzept des beneficial owner im internationalen Steuerrecht der Schweiz* (Schulthess Verlag 2010) and the decision of the Swiss Bundesgericht/Tribunal fédéral (Federal Supreme Court, Bg/TF) in CH: Bg/TF, 5 May 2015, Cases No. 2C\_364 and 377/2012, Case Law IBFD.

tion means that the concept of BO reflects the allocation of income rule, which aims to secure a proper operation of the noted treaty provisions, i.e. to eliminate the double juridical taxation of dividends, interest, and royalties. To be more precise, the concept of BO is a threshold factor to establish whether the limit on withholding taxation under a tax treaty in the SC applies.

Presumably as a result of adding the principal purpose test (PPT) to the OECD Model (2017), five anti-abuse treaty shopping solutions recommended by the OECD in the Conduits Report, i.e. (i) the look-through approach, (ii) the subject-to-tax approach, (iii) the channel approach (iv) the bona fide safeguard clauses and (v) the limitation on benefits (LOB) approach,<sup>42</sup> were deleted from the Commentaries on the OECD Model (2017). This deletion implies that these solutions are replaced by the PPT, which comprehensively and exhaustively deals with all types of treaty abuse, including abusive: (i) treaty shopping; (ii) rule shopping; and (iii) circumventions of domestic tax law by relying on a tax treaty as a shield against domestic anti-tax avoidance measures.<sup>43</sup> This deletion also means that applying those five solutions after 2017 for the purposes of interpreting and applying the concept of BO by the tax authorities and the courts is clearly at odds with the Commentaries on the OECD Model.<sup>44</sup> That is to say, these solutions have been absorbed by the PPT, which constitutes a separate and standalone anti-abuse rule that could before 2017, but cannot after 2017, be merged with the concept of BO to any extent for the purpose of applying that concept under tax treaties.<sup>45</sup>

The changes to the Commentaries on the OECD Model (2017) were solely motivated by anti-abuse additions to the OECD Model (2017). The concept of BO remained untouched, however, suggesting that the OECD had become aware of the normative inadequacy of the concept of BO in preventing abusive treaty shopping in general. That role was attributed solely to the PPT. In fact, an analysis of the changes to the OECD Model (2017) and the OECD Commentaries (2017) demonstrated that the space for an anti-abuse application of the concept of BO has become minimal.<sup>46</sup>

The Commentaries on the OECD Model (2017) enhances the observation that the main role of the concept of BO is to allocate properly passive income for the purposes of operation of articles 10, 11 and 12 of the OECD Model (2017). This application of the concept of BO may lead to

an anti-abuse effect whenever the income from the SCs is not actually (effectively) allocated for tax purposes in the RCs of its recipients and this aims to reduce or avoid WHT.<sup>47</sup> Such situations typically concern agents, nominees and sham conduit arrangements and transactions. This does not mean, however, that the concept of BO is an anti-abuse rule, as it does not contain anti-abuse premises. Indeed, this anti-abuse effect principally follows from the relevant interpretation of the treaty provisions in concert with domestic rules governing evidentiary procedures. The effective exchange of tax information between the SC and the RC of the income recipient also plays an important role in that regard. There is no need for the concept of BO to achieve that anti-abuse effect.

Despite an unclear message from the OECD and the diverging tax jurisprudence, it is the main contention of this article that the concept of BO, as interpreted in accordance with the canons of interpretation relevant to that concept,<sup>48</sup> may serve mainly to ensure the proper application of articles 10, 11 and 12 of the OECD Model or the UN Model.<sup>49</sup> To this end, the concept of BO is principally a reflection of actual allocation of income rule in cross-border situations, rather than an anti-abuse rule. The same is valid in relation to the IRD (2003/49). As a reflection of rule of income allocation (but not as anti-abuse rule of any kind), the concept of BO is implicit to all tax treaties and EU directives, as it reflects their basic logic of operation, i.e. no tax treaty and/or directive application without an actual (effective) allocation of income from an SC (a CS or a Member State of the European Union) to a recipient from an RC (a CS or a Member State of the European Union). Even if domestic tax systems have different rules on allocation of income, and, therefore, the approach to the concept of BO necessarily differs as well, it does not change the argument that the concept of BO reflects a rule of income allocation in respect of treaty provisions, and, therefore, can be implicit to them. However, this perception of the concept of BO is not shared necessarily by all CSs due to their different rules on income allocation and tax policies. Varying rules on income allocation and different tax policies among the CSs also mean that the concept of BO inevitably contributes to uncertainty and the divergent application of the same treaty provisions by different CSs. This is harmful to an application of tax treaties in general.

Still, if the function of the concept of BO primarily relates to the allocation of income under tax treaties and EU directives, is it not somehow redundant? Also, is it not

42. OECD, *Conduit Companies Report*, *supra* n. 8, at paras. 21-42.

43. OECD, *Action 6 Final Report 2015 – Preventing the Granting of Treaty Benefits in Inappropriate Circumstances* paras. 19-24 (OECD 2015), Primary Sources IBFD. See also B. Kuźniacki, *The Principal Purpose Test (PPT) in BEPS Action 6 and the MLI: Exploring Challenges Arising from Its Legal Implementation and Practical Application*, 10 *World Tax J.* 2, sec. 1.1. (2018), Journal Articles & Opinion Pieces IBFD and S. van Weeghel, *A Deconstruction of the Principal Purposes Test*, 11 *World Tax J.* 1, sec. 1. (2019), Journal Articles & Opinion Pieces IBFD.

44. See B. Kuźniacki, *Beneficial Ownership in International Taxation* sec. 1.IV.B *in fine* and 3.V.B.4 *in fine* (Elgar Edward Publ. 2022).

45. Cf. paragraphs 12.5, 10.3 and 4.4 of the *OECD Model: Commentary on Article 10, 11 and 12* (2017), respectively and the analysis in Kuźniacki, *supra* n. 44, at secs. 3.XI.F and 3.XII.

46. Kuźniacki, *supra* n. 44, at sec. 3.XII.

47. For the notion of actual (effective) allocation of income in light of the concept of BO, see section 2.1.

48. That is, the canons of interpretation stemming from the constitutional law, the *UN Vienna Convention on the Law of Treaties* (23 May 1969), *Treaties & Models* IBFD and EU law. They all have one common denominator, namely linguistic interpretation constitutes the starting point and dominates the process of interpretation in the sense that contextual and purposive interpretation may not alter the clear meaning of a legal norm resulting from the outcome of its linguistic interpretation. These canons apply not only to the concept of BO, but to all provisions of tax treaties. See Kuźniacki, *supra* n. 44, at ch. 2.

49. Most recently, *UN Model Double Taxation Convention between Developed and Developing Countries* (1 Jan. 2021), *Treaties & Models* IBFD.



true that its ambiguous connotations with an anti-abuse function may lead to its application with paradoxical and harmful consequences? This is the topic that the author now turns to consider in section 3.

### 3. Redundant, Paradoxical and Harmful Concept

In light of the analysis in section 2.,<sup>50</sup> the concept of BO in international taxation appears to be redundant, paradoxical and harmful. It also appears to be redundant as an allocation of income rule (although it varies among different CSs – see the comments made at the end of this section), as this rule is implicit in all tax treaties and the PSD (2011/96). This redundancy was apparent even in respect of the corrective role of the concept of BO towards the peculiar rules on allocation of income in the United Kingdom. A possible irrational effect of the application of the UK rules on tax treaties was addressed by the addition of the second sentence to article 4(1) of the OECD Model.<sup>51</sup> In addition, the basic logic of tax treaties and EU directives confirms their application only when an actual (effective) allocation of income from an SC to its recipient from an RC takes place, where both countries have in force a tax treaty or are Member States of the European Union.

The concept of BO could be deemed a necessary concept in international taxation only if it operates as an anti-abuse rule. However, its textual and structural poverty, the missing fundamental premises of abuse, does not permit this added value of the concept to be interpreted in accordance with the canons of interpretation. Admittedly, in its essence, the concept of BO is almost an “empty provision” in tax treaties and the IRD (2003/49), the addition of which has never been necessary for their proper functioning.<sup>52</sup> A correct, autonomous understanding of the concept of BO does not lead to different legal consequences than those resulting from a correct, autonomous understanding of the provisions of tax treaties and the PSD (2011/96), in which that concept is not explicitly included.<sup>53</sup> In addition, the concept of BO may be redundant due to transfer pricing rules, insofar as they may entirely, or almost entirely, disregard a non-functional conduit and therefore preclude any, or almost any, income allocation to it for tax purposes.<sup>54</sup>

The paradox of the concept of BO, partly confirming its redundancy, emerges from its potential anti-abuse application that is restricted to situations in which it is necessary to rely only on facts and circumstances to determine an implied qualified obligation to pass on the received income. The obligation is implied, as it follows solely from the facts and the circumstances, rather than legal or contractual stipulations, and it is qualified, as it links the receipt of income with its further transfer to other persons, i.e. had the income not been transferred to other

persons, it would not have been obtained by a conduit. In all such cases, the following fact patterns, germane to abusive treaty and directive shopping, arise: (i) conduits have only very negligible rights, if any, to use and enjoy the income received; (ii) they have only a very negligible function, if any, beyond receiving and passing on the income they receive; and (iii) as a result, generate only very negligible amounts of their own income, if any. This relates to both sham and/or simulated and real conduit schemes.<sup>55</sup> In the former, the concept of BO is redundant, as conduits only appear to receive the income before it passes to another person, while, in fact, they are completely skipped in transfers of income.

The concept of BO, therefore, seems to be clearly superfluous in preventing these abusive practices, given that an appropriate interpretation of tax treaties and EU directives, in concert with a rigorous application of domestic evidentiary rules, helps to eliminate granting WHT relief for sham or simulated structures or transactions.<sup>56</sup> Their application permits the tax authorities to draw tax consequences from actual events rather than from sham or simulated structures or transactions existing only on paper or digitally. In real conduit schemes, conduits are compelled, under orders or instructions (implied contractual obligations) from other persons, to enter into wholly or partly artificial transactions that lead to all or almost all of the income received being passed on to other persons.<sup>57</sup> In such circumstances, conduits may have genuine functions apart from receiving and passing on income to other persons, in which case, the income is actually and effectively allocated to them for tax purposes in their RC. The concept of BO is clearly not well calibrated to target such abusive treaty and directive shopping due to the lack of abusive premises in its wording. To this end, anti-abuse rules are required in the wording of tax treaties (for example, the PPT) or domestic provisions implementing EU directives (for example, a GAAR, as applied in accordance with the general principle of the prohibition on an abuse of rights under EU law). In recent years, the OECD and the European Union seem to have noted this, given that significant anti-abuse changes in the OECD Model and the adoption of the ATAD (2016/1164) were made in 2016 and 2017, respectively.<sup>58</sup>

50. See Kuźniacki, *supra* n. 44, at chs. 3–6.

51. Avery Jones, *supra* n. 15, at ch. 20.

52. *Id.*

53. Cf. B.J. Arnold, *Tax Treaty News*, 64 Bull. Intl. Taxn. 6, sec. 3. (2010), Journal Articles & Opinion Pieces IBFD.

54. Cf. Martín Jiménez, *Beneficial Ownership – Global Tax Treaty Commentaries*, *supra* n. 1, at sec. 1.1.2.2.2.2.

55. Cf. R. Danon et al., *The Prohibition of Abuse of Rights After the ECJ Danish Cases*, 49 Intertax 6/7, pp. 500–504 (2021).

56. DK: ECJ, 26 Feb. 2019, Cases C-115/16, C-118/16, C-119/16 and C-299/16, *N Luxembourg 1 v. Skatteministeriet, X Denmark A/S v. Skatteministeriet, C Denmark I v. Skatteministeriet, Z Denmark ApS v. Skatteministeriet*, ECLI:EU:C:2019:134, Case Law IBFD and DK: ECJ, 26 Feb. 2019, Cases C-116/16 and C-117/16, *Skatteministeriet v. T Denmark and Skatteministeriet v. Y Denmark ApS*, ECLI:EU:C:2019:135, Case Law IBFD.

57. J. Janssen & M. Garibay, *What Should Be the Scope of the Beneficial Owner Concept?* 48 Intertax 12, p. 1098 (2020). Cf. P. Baker, *The United Nations Model Double Taxation Convention between Developed and Developing Countries: Possible Extension of the Beneficial Ownership Concept*, Annex to Comm. of Experts on Intl. Cooperation in Tax Matters, in Note by the Coordinator of the Subcommittee on Improper Use of Treaties: Proposed Amendments, E/C.18/2008/CRP.2/Add.1, footnote 17 at p. 35–36 (2008), available at [www.un.org/esa/ffd/wp-content/uploads/2014/10/4STM\\_EC18\\_2008\\_CRP2\\_Add1.pdf](http://www.un.org/esa/ffd/wp-content/uploads/2014/10/4STM_EC18_2008_CRP2_Add1.pdf) (accessed 26 Jan. 2023).

58. Council Directive (EU) 2016/1164 of 12 July 2016 Laying Down Rules against Tax Avoidance Practices that Directly Affect the Functioning of the Internal Market, OJ L 193 (2016), Primary Sources IBFD [here-

Accordingly, the paradox of the concept of BO follows from the observation that, in cases in which that concept may have an added value to tax treaties and EU directives, its application is either redundant (sham and/or simulated conduit schemes) or requires an interpreter to treat that concept as an anti-abuse measure by going well beyond its wording and structure (real conduit schemes). The canons of interpretation simply do not permit the factual-economic conditions symptomatic for GAARs<sup>59</sup> to be “read out” of the very poor linguistic expression of the concept of BO. For the same reason, a reasonable application of the concept of BO, i.e. to deny WHT relief only in abusive situations, cannot be guaranteed. In other words, the concept of BO does not well suit the reasonable and predictable application of tax treaties and EU directives, although it was added to the OECD Model to secure an appropriate operation of articles 10, 11 and 12.

This conclusion touches on the issue of the harmfulness of the concept of BO. It is harmful because its very inception and evolution in international taxation has given rise to serious disputes between tax authorities and taxpayers around the world. The courts charged with resolving those disputes have never really come to a uniform and precise understanding and application of the concept of BO. As a result, the global spread of the concept of BO tempted tax authorities to misuse it to counter international tax avoidance due to the lack of appropriate anti-abuse measures. This endeavour on the part of the Danish tax authorities led to the judgments of the Court of Justice of the European Union (ECJ) in the Danish BO cases, which are now a source of doubt in respect of the application of the domestic provisions of the Member States of the European Union implementing the EU directives regarding the exemption of dividends, interest and royalty payments from WHT.<sup>60</sup>

The harmfulness of the concept of BO, therefore, manifests itself in three interlinked forms. The first concerns the divergence in its meaning, which stems from vague and inconsistent interpretative guidance on it in the OECD materials and tax jurisprudence. The second is a direct manifestation of its anti-abuse understanding and application that does not have support in its fundamental building block, i.e. its wording. The third form of harmfulness of this concept is resultant of the other two and stems from the abuse of tax law by tax authorities in cross-border situations for the fiscal interest of the SCs. As a result, as the UN Committee of Tax Experts put it, the further application of the concept of BO will most likely lead to wasting of resources of taxpayers and tax authorities on time-consuming and expensive, protracted litigation in respect of the understanding and application of that con-

cept.<sup>61</sup> Still, the question remains: why is the concept of BO such a potent anti-abuse weapon in hands of tax authorities? This issue is the subject matter of section 4.

#### 4. Tax Law Meets Biosemantics: Why the Concept of BO Is Such a Potent Weapon in the Hands of the Tax Authorities and What It Has in Common with the Behaviour of Beavers

##### 4.1. Introduction to biosemantics

Readers may now be wondering, and rightly so, why tax authorities and most courts give an anti-abuse function to the concept of BO, despite its wording not including abusive premises and given that the interpretative sources of its understanding are by no means clear and consistent in that regard. In addition to the legal and policy reasons, as explained in sections 2. and 3., this phenomenon can, in the author's opinion, be explained by international tax law entering into the domain of biosemantics, also called teleosemantics, whose creator is Ruth Millikan.<sup>62</sup> To demonstrate this, it is necessary to depict briefly the fundamentals of biosemantics and behavioural sociology, which explains why tax authorities and most courts behave like beavers when applying the concept of BO.

Biosemantics assumes that, during the ceremony of giving “names” (meanings), as well as every subsequent use of a sign (also a verbal sign), there is a correlation between the expression of the sign (the articulation of the word), and the state of affairs in which the designator of this sign is created. The chain of correlations (lineage) leads to the appearance of the “stabilizing function” of signs. The stabilizing function means that, regardless of the intentions of the particular user of a sign, the sign refers to the state of affairs to which it has referred appropriately many times in the past, thereby forming a stable, semantic link with reality. The stabilizing function reflects the influence of the sign on its “listeners” (audience and/or readers). Before the stabilizing function can arise, a semantic reality mapping function must arise, i.e. the correlation between the sign and the state of affairs to which the sign refers must occur. This is due to the need for a sufficiently frequent mapping of reality by a given sign, for it to impart an effect on listeners.<sup>63</sup> At the same time, the decisive factor for the emergence of a stabilizing function – leading to the formation of the meaning of signs – is not how often some identifying feature of the sign has been correlated with the state of affairs, but the fact that at least once the identifying feature of the sign has been used in a manner

inafter the ATAD (2016/1164)], as amended by Council Directive (EU) 2017/952 of 29 May 2017 Amending Directive (EU) 2016/1164 as regards Hybrid Mismatches with Third Countries, OJ L 144 (2017), Primary Sources IBFD.

59. Or the substance-over-form approach (judicial doctrine) in the US-styled application in respect of that approach to determine the economic substance. For more on canons of interpretation applied to the concept of BO, see Kuźniacki, *supra* n. 44, at ch. 2.

60. Martín Jiménez, *Beneficial Ownership – Global Tax Treaty Commentaries*, *supra* n. 1, at sec. 5.7.2.2.

61. See the UN Committee of Experts on International Cooperation in Tax Matters, *Eighteenth Session: Update of the UN Model Double Taxation Convention Between Developed and Developing Countries – Beneficial Ownership* paras. 21-22, E/C.18/2019/CRP.10 (UN 2019), (23-26 Apr. 2019), available at [www.un.org/development/desa/financing/sites/www.un.org/development/desa/financing/files/2020-04/18STM\\_CRP10-Update-UN-Model-Double-Taxation\\_Beneficial-Ownership.pdf](http://www.un.org/development/desa/financing/sites/www.un.org/development/desa/financing/files/2020-04/18STM_CRP10-Update-UN-Model-Double-Taxation_Beneficial-Ownership.pdf) (accessed 26 Jan. 2023).

62. See R. Millikan, *Language, Thought and Other Biological Categories* (Mass. Inst. Tech 1984); *Biosemantics*, 86 J. Phil. 6, pp. 281-297 (1989); and *Language: A Biological Model* (Oxford U. Press 2005).

63. Millikan, *Language: A Biological Model*, *supra* n. 62, at pp. 53-75.



beneficial to the organism.<sup>64</sup> Consequently, the meaning of a sign arises because the organisms that recognize that meaning benefit from it.

Millikan illustrates the formation of meaning by the fact that its correct recognition results in a benefit for the signaller and the receiver of the signal, using the example of a critical communication among beavers, i.e. one on which their survival often depends. Namely, beavers warn each other of danger by beating their tails against the water, as historically a sudden splash of water was correlated with a state of affairs related to an immediate threat to their life, for example, a hungry wolf, bear or human jumping into the water. Because beavers are extremely vigilant, their danger warning signals often misrepresent an approaching predator. Nevertheless, making the warning signal is pivotal for the survival of the organism (the beaver in question), and a dysfunction of the warning mechanism would most likely result in the death of not only one beaver, but possibly the entire species.<sup>65</sup>

Humans, unlike beavers and other organisms in the animal world, have the most intricate and complex sign system, consisting of a language for communication. Human language allows the species not only to survive, but to thrive and dominate the world. For without the complexity and almost unlimited communicative capacity of language, such intersubjective creations in the human world as the state, money and law<sup>66</sup> would not have come into existence. Language, including its most elementary particles, such as symbols (for example, “!”, “?”), words and expressions, directly serve not the survival of the individual human being and the entire human species, but some specific purpose, being part of a larger structure of signs, words, and expressions. The word “danger” and the conjunction “and” both have survival value for human beings. The word “danger” has survival value for humans in the way that slapping a tail against the water has for beavers. On the other hand, the conjunction “and” can also have a survival value, but it can also equally, or even more usefully, denote the relationship between two things or phenomena in reality, whether or not related to danger. Real numbers, punctuation marks and intonation can also have a survival value, like the thumping of a beaver’s tail against the surface of the water, but can also have quite different values and representations. What they all have in common is their indispensability in the achievement of important goals by their users, which is why they are repeated, forming chains of use. The efficiency of achieving important goals thanks to these components of language translates into the proper function, i.e. the function that a given sign performs in a specific linguistic community. In the pragmatic approach, the proper function is identified with the meaning of the sign.<sup>67</sup>

#### 4.2. Interpretation aiming at determining a proper function of the concepts interpreted

The role of the interpreter is not to determine the meaning of a given sign, word or concept according to the intention of its individual user but, rather, according to its proper function. In this sense, the meaning of a concept may not only be independent of the individual intention of its user, but may even sometimes contradict it. For instance, an individual beaver may thump its tail on the surface of the water to express satisfaction, but the other beavers in its environment may perceive this sign as an alarm of danger, and start to flee. The sign’s proper function, as developed by the critical mass of cases in which it has properly served its purpose, is to warn of danger, not to express contentment. Similarly, the intention of the individual legislator, the individual addressee of a legal norm or the individual public administration body applying the legal norm should not be crucial in determining its proper meaning. A legal text has a meaning that is autonomous from the intention of its creator, as well as its addressees and those applying the law. That meaning arises from the linguistic history of the signs of which the legal text is composed and their proper function, which has been shaped in the process of their use. This process shapes the specific function of a legal text continuously in legal, social and economic terms, and, therefore, is not one-dimensional and occurring only once invariably as a result of the legislator’s actions. The process is greatly influenced by jurisprudence and doctrine, whose positions are also not invariably bound to only one point in time – the publication of the legal text in the journal of laws – but evolve and with them the legal text. “Law in action” influences “law in books”, and the interpreter should take this into account in interpreting a legal text.<sup>68</sup>

When comparing the behaviour of beavers with that of tax authorities, it should be noted that an important factor in beaver behaviour – extreme vigilance – often comes at the cost of committing many false alarms. In the final analysis, however, these mistakes support the idea that the misrepresentation of reality by a given sign (the discrepancy between the alarm and the real threat) may be part of normal functioning rather than a dysfunction.<sup>69</sup> Calibrating the actions of beavers to more false alarms is cost-effective, as it minimizes the risk of any loss of life. In this way, despite many false alarms, the function of the tail slapping against the water as an alarm against danger is preserved and leads to the desired results. It is better to flee in terror dozens of times a year than to be eaten once. This asymmetry undoubtedly speaks in favour of false alarms in the face of trying to be as accurate as possible (minimizing false alarms) at the cost of loss of life. Accordingly, although a loud splash of water, such as when the tails of beavers hit the water surface, is the source of many false alarms, beavers have learned to recognize it as a warning

64. K. Bielecka, *Misrepresentations and the Concept of Function In Teleosemantics: An Analysis of Dretske and Millikan Concepts*, 85 Phil. Sci. 1, p. 118 (2014).

65. Id., at p. 114.

66. Y.N. Harari, *Homo Deus: A Brief History of Tomorrow* pp. 167-177 (Harvill Secker 2015).

67. Millikan, *Language: A Biological Model*, *supra* n. 62, at p. 28 et seq.

68. M. Matczak, *A Theory that Beats the Theory? Lineages, the Growth of Signs, and Dynamic Legal Interpretation*, in *Normativity and Variety of Speech Actions*, 112 Poznań Studies in the Philosophy of the Sciences and the Humanities pp. 188-189 and 202-203 (M. Witek & I. Witczak-Plisiecka eds., U. Poznań 2018).

69. Bielecka, *supra* n. 64, at p. 117.

of danger, as it may save their lives. Evolution, including the evolution of the meanings of signs, always places a greater premium on survival than on good statistics.

In statistics, false alarms are called “false positives” and missed opportunities are called “false negatives”, also known as Type I and Type II errors, respectively. In practice, improving accuracy in one type of error is at the expense of reducing accuracy in the other. In other words, increasing accuracy by reducing false positives increases the (proportional) number of false negatives. This asymmetry involves tolerating less accuracy in one type of error relative to another depending on the motivation behind the choice of asymmetry. Motivation, in turn, relates to the incentives for choosing a particular asymmetry and a decision theory belonging to behavioural sociology. The choice of the right asymmetry for beavers is simple – survival, and this is rewarded by an asymmetry in favour of false positives, as one false negative (a failure to strike the tail against the water in a case of real danger) can end in the loss of life.

In the human world, the situation is more complicated, and the choice of a trade-off between one asymmetry and another is also conditioned by incentives, as in the beaver world. A good example of asymmetry in favour of false negatives is tests in detecting illicit doping among professional athletes. Anti-doping tests are calibrated to detect as few false positives as possible, as the detection of prohibited doping substances in an athlete’s body usually attracts public attention, ruining the career of that athlete. In contrast, false negatives go unnoticed, unless the athlete himself admits to dosing with prohibited doping substances.<sup>70</sup> Anti-doping tests, therefore, de facto protect about 10% of sportspeople who get away with using prohibited substances.<sup>71</sup> In turn, an example of asymmetry in favour of false positives are lie detectors, such as those used in the United States within the framework of the preliminary credibility assessment screening system (PCASS), which serve, for example, to detect early preparations for terrorist attacks.<sup>72</sup> False negatives, i.e. situations in which a lie detector fails to detect a lie, can end in disaster, such as the series of four terrorist attacks carried out on the morning of Tuesday, 11 September 2001 on US skyscrapers in New York City using hijacked passenger aircraft. On the other hand, false positives go unnoticed until the authorities admit their mistake and reverse the consequences (the restoration of freedom and the payment of compensation) and the victims of lie detector errors tell their stories to the world. For this reason, the US military calibrates lie detectors within PCASS in such a way as to minimize false negatives.<sup>73</sup>

#### 4.3. *The psychobiological reasons for applying the concept of BO in an anti-abuse manner by the tax authorities and how to ensure its proper function*

In the author’s view, the intersection of biosemantics and behavioural sociology, presented in sections 4.1. and 4.2. in a highly simplified manner, explains the psychobiological reasons why tax authorities apply the concept of BO as if it has a dominant anti-abuse function. In the same way as beavers signal the danger lurking in the wilderness by hitting water with their tails, the tax authorities signal tax avoidance by invoking the concept of BO in WHT cases. In an analogous way to the beavers, despite many false positives, the tax authorities continue to signal tax avoidance with the concept of BO, as the asymmetry of false positives versus accuracy in the resolution of cases in the WHT works in their favour. In other words, they lose little by losing a case because, apart from the inefficient use of tax-paid human resources, the tax authorities are not liable for false positives, while they stand to gain a great deal from WHT collection. As the concept of BO has at least once in the past benefited the tax authorities with its anti-abuse application, and, in practice, this has happened not once but many times due to the majority of courts that sanction this approach, the stabilizing function of the concept in the form of an anti-abuse application has arisen.

However, the biosemantics of the tax authorities and the concept of BO appears to be more complicated than with beavers and their tails. While beavers have the same tails and evolution promotes their use in the same way irrespective of their geographic location, the practice of use of the concept of BO by tax authorities in different countries may vary to a various degree. Typically, each country has its own highest court, which the tax authorities must obey ultimately in cases concerning disputes around the meaning of the concept of BO. This is missing in case of beavers and the use of their tails. If the tax authorities in country A are setting off many false alarms, in the real world their highest court corrects their behaviour by explaining situations in which an alarm is justified and when not, such that their behaviour is altered. In that way, the tax authorities may learn (or not learn) from false alarms. There is also a cost for the tax authorities, just as for beavers, from too many false alarms – wasteful energy, lack of taking fruitful opportunity and so on. Hopefully, the ability of humans working at the tax authorities to learn from own mistakes (false alarms), sometimes corrected by the highest courts, will result in an emergence of the proper function the concept of BO and its application in line of that function by the tax authorities.

Currently, the proper function of the concept of BO, established as a result of applying the canons of legal interpretation, the analysis of the genesis and evolution of this concept in international and EU law, i.e. clarification of the allocation of income,<sup>74</sup> is not often performed by the tax authorities. For the tax authorities, the improper function, i.e. the anti-abuse, pro-fiscal function, is correct, as

70. See K. Fung, *Numbers Rule Your World. The Hidden Influence of Probabilities and Statistics on Everything You Do* pp. 174-177 and 197-202 (McGraw-Hill 2010).  
71. See D. Mottram & N. Chester, *Drugs in Sport* (Routledge 2018).  
72. See J. Reis et al., *Counterintelligence Technologies: An Exploratory Case Study of Preliminary Credibility Assessment Screening System in the Afghan National Defense and Security Forces*, 12 Info. 3 (2021).  
73. See The National Academy of Sciences (NAS), *The Polygraph and Lie Detection: Consensus Study Report* (NAS 2003).

74. Kuźniacki, *supra* n. 44, at chs. 2-7.

in their perception it enables them to collect WHT more efficiently. In order to correct the perception of the tax authorities in this respect, there would have to be more cases in which the concept of BO is applied in accordance with its proper function in favour of the tax authorities.<sup>75</sup> Identifying this function would not at all contradict the theses regarding the redundancy of the concept of BO, but might only lead to the proper application of this concept. At the same time, understanding and applying the concept of BO in accordance with its proper function does not have to entail a reduction in favourable consequences for tax authorities in terms of WHT collection in the SCs. The possibilities of applying evidentiary rules to determine the allocation of income presented in one of the recent books on the concept of BO<sup>76</sup> reveals that, in many cases of an anti-abuse application of the concept of BO, i.e. in accordance with its improper function, the same effect could be achieved by applying the concept of BO in accordance with its proper function. It would also be a much more precise and predictable approach, which would be consistent with the domestic systems of tax law in many countries, their tax treaties and EU directives.

In practice, it appears that the proper function of the concept of BO is not identified from the bottom up by the tax authorities, but, rather, that there must be a critical mass of cases applying this concept in accordance with its proper function at the level of final court judgments. In that regard, a valid question is: is the world not already at a point where a critical mass is no longer possible, as high and highest courts in different countries have all developed differently nuanced approaches, so that all hope of convergence is lost, and this state of affairs may invite the tax authorities to cherry-pick the function of the concept of BO? In a perfect world, the answer to that question can still be negative. The doctrine could also be a source of interpretative guidance in this respect for courts. With access to relevant sources of knowledge, the judge-interpreter should be able to understand that the proper function of the concept of BO leads to ensuring the proper application of tax treaties and EU directives, eliminating double taxation only if it can arise as a result of the actual allocation of income from the SC to the RC. The improper function of the concept of BO, in contrast, can lead to the opposite result, i.e. double taxation. The improper function of the concept of BO also significantly reduces the protection and predictability in the application of tax treaties and EU directives, thereby destabilizing their functionality. The proper function of the concept of BO achieves the objectives of tax treaties and EU directives when they are applied (dynamically), regardless of the intentions of the entity applying it and its addressees. The improper function, in turn, achieves the intentions of individual legislators and high officials from the ministries of finances when it is implemented (statically). Comparing the features and legal consequences of

75. For instance, the decision of the Head of the Lower Silesian Customs and Fiscal Office in January 2020, as depicted in the case of the Voivodeship Administrative Court (VAC) in Wrocław, in PL: VAC, 15 Oct. 2020, Case No. I SA/Wr 205/20.

76. Kuźniacki, *supra* n. 44.

both functions of the concept of BO should convince the judge-interpreter to apply that concept in accordance with its proper function.

Consequently, the courts can ensure the application of the proper function of the concept of BO by establishing the meaning of that concept in accordance with its autonomous international fiscal meaning and canons of its interpretation. This role has been so far effectively fulfilled by Canadian, Dutch and US courts.<sup>77</sup> The question is whether courts in other countries will discover the proper function of the concept of BO in the near future, thereby interrupting the process of strengthening the improper function of this concept around the world. Undoubtedly, the views of the doctrine may also contribute to this. Perhaps this article will also be a contribution to the disenchantment of tax authorities and most courts from beavers.

## 5. Conclusions

From its emergence in the first tax treaties (1942) through its evolution in international tax law until now (2023), the concept of BO remains a “strange tax animal” – a kind of chameleon that takes colour from the facts and circumstances of a given case and the desires of the entities that apply it.<sup>78</sup> The hyper-contextual and malleable nature of that concept allows the tax authorities and the courts to view it as a legal concept at some times, and, at other times, as an economic-factual concept, depending on the desired effect they want to achieve in a specific case by means of its application.

One of the main issues that the concept of BO raises from the most fundamental legal perspective (constitutional) is the lack of a sufficient degree of legal certainty, which means that it may escape a proper judicial review. A lack of legal certainty also makes it very difficult to assess the suitability of the concept of BO to achieve its aims, whatever they may be. This suitability is defined in the very wording that makes up the concept of BO as the potential to depict a pattern of behaviour that the members of the legislative powers (usually parliaments) find useful in achieving the aims of that concept.<sup>79</sup> As the wording of the concept of BO in international tax law is extremely sparse – it usually consists of just two words, “beneficial owner” and “beneficially owned” – almost the entire source for

77. See the decision of the US Tax Court (USTC) in US: USTC, 5 Aug. 1971, *Aiken Industries, Inc. v. Commissioner of Internal Revenue*, Docket No. 292-67, 56 T.C. 925, (U.S.T.C. 1971), Case Law IBFD, also available at <https://casetext.com/case/aiken-indus-inc-v-commr-of-internal-revenue> (accessed 26 Jan. 2022); that of the Netherlands *Hoge Raad der Nederlanden* (Supreme Court, HR) in NL: HR, 6 Apr. 1994, Case No. 28.638, BNB 1994/217, Case Law IBFD; and that of the Canadian Federal Court of Appeal (CFCA) in CA: CFCA, 26 Feb. 2009, *Prévost Car Inc. v. Her Majesty the Queen*, A-252-08, 2009 FCA 57, [2010] 2 F.C.R. 65, Case Law IBFD.

78. Hattingh, *supra* n. 1, at sec. 9.10. González-Barreda compared the concept of BO to a seahorse, as “some use it to run, some use it to swim” and perceived it as “an imprecise myth” of ownership triggering divergent opinions that “have been extending the concept into areas where it has not been considered before”. See González-Barreda, *supra* n. 1, at p. 277.

79. Cf. M. Matczak, *Three Kinds of Intention in Lawmaking*, 36 L. & Phil., sec. V (2017).



its understanding lies with non-legally binding materials of the OECD and tax jurisprudence.

However, the Commentaries on the OECD Model, the OECD's reports and international and EU tax jurisprudence do not bring much clarity and convergence in understanding and applying the concept of BO. Apart from avoiding absurd treaty consequences of the peculiar UK rules on the allocation of income to trustees in trusts, the OECD has never provided a clear historical justification for introducing the concept of BO to tax treaties. During its evolution, the OECD tore apart its meaning, between clarifying the allocation of income for the proper operation of articles 10, 11 and 12 of the OECD Model and an alleged anti-abuse function within the scope of agents, nominees and conduits, and never clearly decided which should prevail. This legal conundrum remained unchanged, even after the latest anti-abuse changes to the OECD Model (2017) and the Commentaries on the OECD Model (2017) because the inadequacy of the concept of BO in preventing abusive treaty shopping in legal and policy terms was not stated explicitly. As a result, the nearly 50 years of the OECD's clarification on the concept of BO were principally effective in breeding disputes between the tax authorities and taxpayers worldwide, to the detriment of the stable and predictable functioning of tax treaties. Had the OECD policymakers learned from this experience, the legal conundrum of the concept of BO would cease to exist together with its deletion from the OECD Model. This bad experience with the concept of BO demonstrates that open-ended, vague language is no longer good as model law to address abusive treaty shopping. Although very extensive and complex anti-treaty shopping clauses, like an LOB, can be easily criticized, they, at least, give rise to less litigation, and draw clear lines (although not always reasonable lines) between what

is acceptable and what not in comparison to the concept of BO.<sup>80</sup>

As a result of the lack of learning from a negative experience with the concept of BO by the OECD policymakers, the tax authorities continue to have a broad, economic and anti-abuse understanding of the concept of BO, irrespective of the lack of relevant legal premises embedded within the wording of that concept to clearly lead to an anti-abuse effect. As the OECD policymakers have been continuously immune to the recognition of the concept of BO as redundant, paradoxical and harmful concept in international tax law for more than 50 years, the prevalent practice of tax authorities follows suit. This immunity stems from the perception of the tax authorities of the tax reality, i.e. the improper (anti-abuse) function of the concept of BO is more beneficial to those SCs levying WHT than its proper function (the allocation of income). What matters is that such an approach pays off. Accordingly, it is very unlikely that the concept of BO will cease to be a potent anti-abuse tool in hands of the tax authorities, unless tax jurisprudence reverses that trend, just as was done in Canada, the Netherlands and the United States. Similarly, with the PPT and GAARs in force, it would be a prudent and courageous tax policy decision to delete the concept of BO from these sources of law. However, it seems that this is an unlikely future for the concept, as the OECD (and the European Union) are busy redesigning the international tax regime by way of Pillars One and Two.

80. Cf. B. Kuźniacki, *Implementation and Application of the LOB Clause in BEPS Action 6/MLI: Legal and Pragmatic Challenges*, in *International and EU Tax Multilateralism: Challenges Raised by the MLI*, pp. 291-292 (A.P. Dourado ed., IBFD 2020), Books IBFD and B. Kuźniacki, *Rzeczonywisty beneficjent a podatek u źródła: Alokacja dochodu czy przeciwdziałanie nadużyciom międzynarodowego i unijnego prawa podatkowego?* sec. 5.4 (Wolters Kluwer Poland 2022).