The concept of
Beneficial Ownership
– An Indian tax treaty perspective

Pramod Kumar
Vice President, Income Tax Appellate Tribunal, Mumbai, India

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The Source of the BO concept

- The concept of beneficial ownership is not defined under the Indian tax laws or for the purpose of the Indian tax treaties.

- Under Explanation 4 to Section 90 of the Indian Income Tax Act, 1961, the Government of India has the unilateral powers to define any term, not defined under the tax treaties, by way of a notification, for the purpose of interpretation of the tax treaty in question. This power has not yet been exercised with respect to the concept of 'beneficial ownership'. However, as in the case of a domestic law amendment in the context of Article 3(2), inappropriate use of this power is likely to be seriously judicially scrutinized in the light of VCLT Article 26, which provides that, "Every treaty in force is binding on the parties to it and must be performed by them in good faith". [Reliance Jio Infocom Ltd (2019) 111 taxmann.com 371]

- While India is not an OECD Member, Indian judicial bodies have frequently referred to, and generally, *sub-silientio* followed the OECD Commentary. There are some conflicting voices on the status of the OECD Model Convention Commentaries, but, at the minimum, these commentaries are given utmost respect and serious consideration by all Indian judicial forums.

- The OECD Commentary and UN work may not provide a definition of beneficial ownership, but this material certainly gives all the relevant elements to be taken into account for a working definition of the term.

The Source of the BO concept

- In Golden Bella Holdings Ltd's case [(2019) 109 taxmann.com 83 (Mum)], a reference was made, with approval, to the 2017 version of OECD Commentary (Para 10.2- Article 11), which states that "**Where the recipient of interest does not have the right to use and enjoy unconstrained by a contractual or legal obligation to pass on the payment received, to another person, the recipient is the 'beneficial owner' of the interest**"

- In J C Bamford Investment's case [(2014) 47 taxmann.com 283 (Del)], following the same path, it is held that "**an ownership which is not merely the legal ownership by the mere fact of being on the register but the right at least to some extent to deal with the property as your own'. …. who is free to decide (i) whether or not the capital or other assets should be used or made available for use by others or (ii) on how the yields therefrom are used or (iii) both**". However, the distinction between beneficial ownership of assets and beneficial ownership of income did not come up for consideration in this case.

- In Universal International Music BV [(2011) 10 taxmann.com 29(Mum)], a "tax residency certificate" *per se* is accepted as evidence in support of beneficial ownership, in the absence of anything to indicate the contrary- though it was on the basis of Azadi Bachao Andolan's SC judgment which was Mauritius-specific. The subsequent developments, as noted above, seem to negate this approach.

The Source of the BO concept

- The emphasis seems to be on the timing of transmission of the consideration by the alleged conduit to the alleged beneficiary, rather than on the fact of such transmission. Except in the cases of a back-to-back transmission of consideration (i.e. interest, dividend, royalties and fees for technical services), usually, judicial forums do not seem to be readily inclined to explore the connotations of 'beneficial ownership' to deny treaty benefits. The alternative approach is without a beneficial ownership approach inbuilt in tax treaties, a treaty with one jurisdiction, with the contemporaneous high degree of business mobility, becomes a treaty with the world.

- So far, there have been no occasions in which substance tests have been invoked by the judicial bodies to deal with the connotations of 'beneficial ownership', though conceptually, such tests make immense sense in real business situations. In domestic law, the principles of substance over form are well established.

- The concept of beneficial ownership being a *sine qua non* to entitlement to treaty benefits cannot, in the absence of a specific provision to that effect or in the absence of any specific reasons for holding so, be inferred or assumed- **Blackstone FP Partners Mauritius [2022] 138 taxmann.com 328 (Mumbai - Trib.)], referring to HMTQ Vs Alta Energy Luxemburg SARL [2021 SCC 49]**

The relationship of 'beneficial ownership' in tax treaties, with anti-abuse principles/statutory GAAR

- The GAAR provisions, under the Indian Income Tax Act, 1961, override the treaty provisions, and as such, these are the most dominant anti-abuse provisions under the domestic tax law. These provisions can also be invoked to disregard an apparent beneficiary and claim that the beneficial owner is some other person.

- Under Section 96, GAAR is a two-step process: - Is there a tax benefit? If so, is the tax benefit arising from an impermissible avoidance arrangement that (a) creates rights and obligations not generally created in arm's length situations; (b) results, directly or indirectly, in misuse or abuse of the provisions of law; (c) lack, or are deemed to lack, commercial substance; and (d) which are entered into, or carried out by means or in manner, which is not ordinarily employed for bonafide purposes.

- Beneficial ownership is a much narrower concept in the anti-abuse law, and it is mainly confined to three main areas – interest, dividend and royalties, whereas GAAR or even other treaty-based anti-abuse provisions, such as PPT or LoB clauses, cover much broader areas. BO is one of the anti-abuse provisions and it works in a limited field.

The relationship of 'beneficial ownership' in tax treaties, with anti-abuse principles/statutory GAAR

- The relevance of beneficial ownership in tax treaties is limited to the narrow concept of beneficial ownership of income, rather than beneficial ownership of a structure or an income-yielding asset. The statutory GAAR, and even the Principal Purpose Test (PPT) under Article 7 of the MLI modifying all the CTAs, extend to beneficial ownership of the income-yielding asset and the structure as well.

- Article 7 states that "Notwithstanding any provisions of the Agreement, a benefit under the Agreement shall not be granted in respect of an item of income if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Agreement".

The relationship of 'beneficial ownership' in tax treaties, with anti-abuse principles/statutory GAAR

- Does the PPT, wherever applicable, overshadow the concept of 'beneficial ownership' in conventional tax treaties, or are there simply overlapping areas in the concept of BO, in the domestic GAAR, and treaty-based anti-abuse provisions?

- Impermissible avoidance arrangement **VS** treaty shopping in general **VS** treaty shopping by adding a conduit structure for specific passive incomes such as dividends, interest and royalties

Beyond anti-abuse, which tests are applied when using BO concept?

- As was the emphasis on '**international fiscal meaning**', in the Indofood decision by the UK Court of Appeal (2006), an Indian High Court decision, in the case of Visakhapatnam Port Trust (1983- 144 ITR 146), has, referring to the OECD Commentaries, approved the theory that language employed therein should be accepted as the 'international tax language'. In effect, the meaning assigned to the beneficial ownership in the work of multilateral bodies such as the UN and OECD etc, is likely to be given significant and critical importance by the Indian judicial bodies, even though there is an alternative theory finding a place in some Indian judicial precedents to the effect "**when OECD Commentary is the same as the judicial interpretation, one can refer to same, with approval, but when a fair and judicious interpretation takes you to some other conclusion, the OECD Commentary cannot come in the way**" [Nokia Network OY [(1998) 94 taxmann.com 111 (Del SB)]

- The test usually applied in the Indian judicial precedents is the legal test (on legal rights and obligations of the apparent beneficiary) and the factual test (timing of the flow of income and amounts forwarded), rather than the functional test (the entrepreneurial functions of the apparent beneficiary). However, the emerging trend, to the mind of this panellist, may gradually tilt towards the functional test.

Procedural issues

- When both anti-abuse and the BO provisions can be applied with equal vigour, the narrow technical position seems to be that the general provisions have to make way for the specific provisions (*generalia specialibus non-derogant*), though, such situations could be limited. As the provisions of the GAAR and PPT are seemingly much more comprehensive, the tax administration is less likely to use the BO provisions on a standalone basis.

- The burden of proof, under the Indian GAAR, is substantially on the taxpayer [See Section 96 (2)- "**An arrangement shall be presumed, unless it is proved to the contrary by the assessee, to have been entered into, or carried out, for the main purpose of obtaining a tax benefit, if the main purpose of a step in, or a part of, the arrangement is to obtain a tax benefit, notwithstanding the fact that the main purpose of the whole arrangement is not to obtain a tax benefit**"

- The burden of proof, under the tax treaty situation, is much less onerous inasmuch as there is no such deeming fiction under the tax treaties.

Reconstruction of the real situation

- When a beneficial owner is resident of the same country as is the apparent owner, the treaty benefits are to be granted anyway. [J C Bamford Investment's case [(2014) 47 taxmann.com 283 (Del)],- "**Despite the fact that the assessee, a resident of UK, is not a beneficial owner as per the standpoint of the Revenue, still the benefit of lower rate of tax cannot be denied because the beneficial owner of the royalty, being JCBE, is admittedly resident of UK**"

- However, when the beneficial owner is a resident of a jurisdiction other than the jurisdiction of the apparent beneficiary, the treaty benefits of the apparent beneficiary cannot be applied. However, the treaty benefits, if any, of the treaty with the beneficial owner's fiscal domicile can indeed be directed to be examined for application.

- The powers of the Indian Income Tax Appellate Tribunal, which is the final fact-finding authority in direct tax matters, are quite wide as these are to "**such orders thereon** *(the appeals)* **as it thinks fit**". The situation before the revenue authorities, however, may be affected by the procedural constraints, as no fresh claims can be made before the Assessing Officer except by filing revised returns with certain time frame.

Emerging trends in Indian international tax jurisprudence

- The decisions are much closer to what is correct on the first principles, and quite in tune with the best practices globally. The academic literature on the subject, work of the multilateral forums, and judicial precedents from the other jurisdictions are being noted and analyzed, in a fair and impartial manner, before taking the judicial calls. Many decisions, particularly from the European and North American Courts are finding a place in Indian decisions.

- Inevitably, therefore, the concept of beneficial ownership as developing in Indian tax jurisprudence will be in harmony with the approach of the judiciaries worldwide, particularly in western countries, which, in turn, are much more likely to be influenced by the OECD approach on the issue. Wherever there will be any significant deviations from this common approach, which is quite unlikely, specific and cogent reasons for such deviations will, in all likelihood, find a place in the judicial rulings.

- Indian judicial forums are making, consciously as also at a subliminal level, a significant contribution to creating an atmosphere conducive to a consistent, predictable and globally acceptable international tax jurisprudence.