TACKLING ABUSE OF TAX TREATIES RELATED TO PASSIVE INCOMES: IS BENEFICIAL OWNERSHIP THE MOST EFFECTIVE SOLUTION? AN EVALUATION OF INTERNATIONAL AND FRENCH PRACTICES

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1. Introduction

> *The term 'abuse of tax treaties' may be defined loosely as the use of tax treaties by persons the treaties were not designed to benefit, in order to derive benefits the treaties were not designed to give them.*[2]

Whether it is called 'abuse of tax treaties', 'improper use of tax treaties' or in some circumstances 'treaty-shopping', these wordings usually cover the same idea when related to passive income; a taxpayer resident in country A is receiving passive income (either dividends, interests or royalties) from country C through a company resident in a 'treaty-friendly' jurisdiction B.

Some jurisdictions make a stand for a 'tax-friendly' environment so as to attract investments or because they are of the opinion that a small amount of taxes is better than no taxes at all.[3] On the other hand, some countries take the view that

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2 The United Nations *Ad Hoc* Group of experts on International Co-operation in Tax Matters, Fourth Meeting, Geneva, 1987, *Prevention of abuse of tax treaties* (United Nations Secretariat, New York 1987), 3.

3 Indeed, in a globalised world, we have seen more individuals and companies move tax residence.

resident companies and individuals must be treated equally in taxation; thus, egregious tax avoidance or evasion should not be tolerated. The main arguments explaining why improper use of tax treaties is not allowed are the economic distortion side effects and the fact that it creates inequalities between taxpayers paying the 'right' amount of tax and those who do not.[4]

Accordingly, the attitude of governments towards taxation influences tax treaty negotiations considerably. Yet, all tax treaties tend to be based on Models; the Organisation for Economic Co-operation and Development Model Tax Convention[5] is more widely followed, especially by developed countries whereas the United Nations Model (UN Model) stands out for developing countries. Finally, the United States Model works as a free electron but is becoming more and more important.

The OECD Model introduced the concept of beneficial ownership in its 1977 version in Articles 10, 11 and 12 (respectively related to dividends, interests and royalties) in order to deal with certain types of treaty-shopping.

The main consequence is that '[such provision] precludes the extension of specific treaty benefits to entities which are not *beneficial owners* of the particular income, even if they are formal recipients of it.'[6]

By its introduction, mere agents or nominees were excluded from treaty benefits as they were not considered to be the beneficial owner of the income. The principle was extended to include conduit companies after an OECD report in 1986. Although this concept is of utmost importance, it had not been defined by the OECD or the UN Model until recently.

It is important to note that, aside from the beneficial ownership test, the United States (US) developed a side track concept. The US currently inserts in all its tax treaties Limitation-of-Benefits Clauses that are based on a substantial business activity from the taxpayer in the country of residence.[7] However, this is not within the scope of this research.

The interpretation of the meaning of beneficial ownership rapidly became an issue for taxpayers, tax authorities, judges and academics. Indeed, although the concept was found in common law countries, civil law jurisdictions had no similar notions.

4 CHJI Panayi, *Double Taxation, Tax Treaties, Treaty Shopping and the European Community* (1st, Kluwer Law International BV, The Netherlands 2007) 76.

5 Referred henceforth as OECD Model.

6 Panayi (n 4) 44.

7 ibid 56.

Most treaty concepts are defined in the tax treaties in an Article entitled 'General definitions'. However, terms that are not defined, according to the Article 3(2) of the OECD Model and unless the context otherwise requires:

> *Have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State*.[8]

However, most academics agree that the concept of beneficial ownership should have an international meaning rather than a domestic meaning established under Article 3(2) of the OECD Model using domestic law.[9]

An overhaul discussion draft on the meaning of beneficial ownership was launched in 2011 by the OECD to clarify the concept and extract its substrate. It was revised in 2012 and was finally adopted in 2014 with a formal definition.

In these circumstances, it is not surprising that many jurisdiction have difficulties to grasp the meaning of the notion and Courts in different jurisdictions tend to diverge in their understanding of the concept of beneficial ownership. This confusion, undoubtedly, prejudices taxpayers as they have difficulties to see the border between 'appropriate' tax planning and aggressive planning.

Moreover, some civil law countries struggle to understand the meaning of beneficial ownership as it is a common law concept. Therefore, some of them are using domestic notions to supplement an alien and complex concept in order to obtain an equivalent result. For example, France uses its domestic concept of *Abus de droit* (Abuse of rights) to identify treaty abuses. The two concepts are working well together. Contrary to what one may think, it does not appear to be a hurdle.
This paper aims to evaluate the interactions between an international concept that was not defined until recently and domestic civil law concepts that are used to supplement the international uncertainties.

With regards to the structure of this research, Part two will be dedicated to the international concept of beneficial ownership and its meaning. The first section will demonstrate that the uncertainties are deep-rooted from the origins of the concept while the second section will delve into cases from the United Kingdom, Canada and Denmark. Finally, a third section will shed light on the OECD discussion on the meaning of beneficial ownership to try to establish if this might be the missing piece of the puzzle.

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8 Article 3(2), *OECD Income and Capital Model Convention* (2010), Models IBFD.

9 P Baker, B Gouthière, S Van Weeghel, K Vogel.

In Part Three, the focus will be on France and its use of domestic law to counter the uncertainties of the international concept in order to deal with improper use of tax treaties. Therefore, the first section will have to set the very basic principles of the French legal system and the main taxation principles; while the second section will be devoted to dissecting domestic case law to understand the meaning of *Abus de droit* and its tax alter ego, the general anti-abuse rule; to see their intricate use in cross-border disputes.

2. The concept of beneficial ownership in its International meaning

> *To very many … taxpayers, the tax system is a mystery as unfathomable as Einstein's Theory of Relativity.*[10]

Although *nemo censetur ignorare legem,*[11] one must admit that tax law is not easy to understand for laymen but the liability to tax is still unavoidable. The concept of beneficial ownership is most certainly the best embodiment of that difficulty. It is essential to recognise that its diverse and regular modifications have been 'filling in the gaps'. As no definition of the concept used to exist, it allowed more flexibility for tax authorities around the world but increased the uncertainty for taxpayers. Therefore, attention must be given to the origin of the problems arising from the concept of beneficial ownership (2.1.) as much as the judicial solutions found (2.2.) in order to assess any proposition for clarification (2.3.) to finally identify the impact on international tax law (2.4.).

2.1. The origin of the difficulties

One of the major issues with the notion of beneficial ownership is the fact that it already exists in most of the common law countries but does not in civil law jurisdictions. Therefore, the ambivalence of the concept makes it difficult to fully understand.

2.1.1. Domestic meaning in common law countries

The term 'beneficial ownership' has a specific resonance in English law[12] due to the peculiar split between the common law and equity. Common law only admits the validity of the legal ownership. On the contrary, equity recognises that legal title and beneficial ownership can be held by two separate persons.

10 Speech given on September 15, 1978 by Rt. Hon. Robert Sheldon.

11 Aristotle, nobody is thought to be ignorant of the law.

12 JDB Oliver and others, 'Beneficial Ownership and the OECD Model' [2001] BTR 27, 40.

Although not limited to the notion of trust,[13] cases dealing with the concept of beneficial ownership can be useful when trying to understand its International meaning.

Widgery L.J. in *Wood Preservation* stated:

> *If one finds, as here, that the company […] though still the legal owner of the shares, is bereft of the rights of selling or disposing or enjoying the fruits of these shares, then, I have in the end concluded that it would be a misuse of language to say that it still remained the beneficial owner of these shares*.[14]

In the same case, Harman L.J. carried on and added 'that means, I think, 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.'[15]

Albeit useful, these domestic definitions are for information purposes only as it has already been mentioned that domestic meaning under Article 3(2) of the OECD Model should be avoided when dealing with the meaning of beneficial ownership.[16] Indeed, conceding such a domestic meaning would cause even more uncertainty as each country would have its own understanding of the concept, rather than a tax treaty meaning.

Thus, a vital step in the understanding of the concept takes place at the level of the Models and their Commentaries. Delving into the OECD and UN Models as well as their Commentaries will allow for a more in-depth understanding of the issues related to beneficial ownership.

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13 See generally JF Avery Jones, 'The Origins of Concepts and Expressions Used in the OECD Model and their Adoption by States' [2006] BIT, 246.

14 Wood Preservation Ltd v. Prior (inspector of Taxes) [1968] 45 TC 112, CA [132].

15 ibid [133].

16 See generally K Vogel, *Klaus Vogel on double taxation conventions : a commentary to the OECD-, UN- and US model conventions for the avoidance of double taxation of income and capital with particular reference to German treaty practice* (1st, Kluwer Law and Taxation Publishers, Deventer, The Netherlands 1991) 562.

2.1.2. The OECD approach towards the concept of beneficial ownership

> *[Beneficial ownership] is a term with unique and subtle characteristics, which must have played a role in the decision of the OCED to employ it as a treaty concept.*[17]

The United Kingdom incorporated the concept of beneficial ownership in its tax treaties as early as in 1966 (UK-US Tax Treaty), it is therefore, not surprising that it is under this country's influence that such a notion was primarily undertaken in an OECD ambit.

Undoubtedly, the Report of the Working Party No.27 delivered in 1970[18] is significant as it gives an insight into the thoughts around the concept of beneficial ownership at a very early stage of its conception. Indeed, it fits into the OECD process of improvement through the use of reports created under the Fiscal Committee to deal with important issues between delegations of the different OECD members.

It is specially worth noting the United Kingdom delegation's remarks in the last page of the document:

> *As they stand, Articles 10, 11 and 12 are defective in that they would apply to dividends, interests and royalties paid to an agent or a nominee with a legal right to the income. To remedy this situation, it proposes either that a 'subject-to-tax clause' be introduced, under which the country of source would give up its right to tax only if the country of residence taxed the income, or else that these Articles be made to apply only to income paid to the 'beneficial owner'.*

It is the idea of beneficial ownership that remained and it was first introduced in the 1977 OCED Model for the Articles 10 (dividends), 11 (interests) and 12 (royalties) in order to combat specific agent and nominee schemes. Agents and nominees were used as efficient treaty-shopping tools at that time.

As Philip Baker stated, 'the meaning of the phrase still remains less than fully clear.'[19] The original version of the Commentaries on Article 10 was as follows:

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17 C Du Toit, 'The Evolution of the Term "Beneficial Ownership" in Relation to International Taxation over the Past 45 Years' [2010] BIT 500, 504.

18 Fiscal Committee, OECD, *Report on suggested amendments to Articles 11 and 12 of the draft convention, relating to interest and royalties respectively*, Working Party No.27 of the Fiscal Committee (Paris: OECD, February 16, 1970).

19 P Baker, *Double Taxation Conventions* (London: Sweet & Maxwell), loose-leaf ed., October 2009, 10B-09.

> *Under paragraph 2, 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.*[20]

The main flaw of this wording is the lack of guidance from the OECD Model drafters in embracing the concept of beneficial ownership. However, it appeared acutely that treaty-shopping was something unacceptable. Yet, the drafters failed to give precise criteria to define the concept but instead gave some information as to who is not a beneficial owner (i.e. agents and nominees), making it a negative definition rather than an active one.

In 1986, the Conduit Companies Report[21] dealt with the most important situation of treaty-shopping, 'where a company situated in a treaty country is acting as a conduit for channelling income economically accruing to a person in another State who is thereby able to take advantage "improperly" of the benefits provided by a tax treaty.'[22] It widened the scope of the concept by extending its negative definition to conduit companies;

> *A conduit company can normally not be regarded as the beneficial owner if, though the formal owner of certain assets, it has very narrow powers which render it a mere fiduciary or an administrator acting on account of the interested parties (most likely the shareholders of the conduit company).*[23]

The Report strongly criticised the 1977 attempt as only dealing 'with the conduit situation in a rudimentary way'[24] which is not sufficient to preclude treaty-shopping.

Nearly ten years later, in 1995, the Commentaries to Article 10 were subject to a minor modification when the phrase 'if the recipient is the beneficial owner of the dividends' was replaced by 'if the beneficial owner of the dividends is a resident.'[25]

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20 *OECD Income and Capital Model Convention* (11 April 1977), Models IBFD.

21 *Double Taxation Conventions and the use of Conduit Companies*, Report adopted by the OECD Council on 27 November 1986.

22 ibid para 2.

23 ibid para 14 b).

24 ibid para 15.

25 Para 2, *OECD Model: Commentary on Article 10* (1995).

In 2003 a major change came from an amendment to the Commentaries to Articles 10, 11 and 12 of the OECD Model by the addition of new paragraphs 12 to 12.2.

> *The term 'beneficial owner' is not used in a* ***narrow technical sense****, rather it should be understood in its context and in light of the object and purpose of the convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.*[26]

As it has been pointed out, this amendment has 'fuelled the uncertainty'[27] on the meaning of 'beneficial ownership'. Agency, nominee and conduit company situations were subject to a wider economic test that needed to be assessed as a practical matter. Going even further, one commentator noted that such a change was 'the most dramatic'[28] over the past 45 years. Indeed, this 'narrow technical sense' has not been defined and gave rise to even more uncertainties.

Although the OECD Model is the most commonly used by jurisdictions, an alternative version designed for developing countries ought not to be ignored.

2.1.3. The concept of beneficial ownership in the UN Model

> *Many developed countries tolerate or encourage treaty-shopping, even if it is unintended, improper or unjustified, for other non-tax reasons, unless it leads to a significant loss of tax revenues.*[29]

If the OECD counts only 34 members to date, its Model of tax treaties stands out even for non-OECD members as representing the vision of developed countries for tax matters. On the other hand, the United Nations (193 nations) promotes a Model tax convention that reflects the views of the developing countries and allows them to speak for themselves.

Seen as an alternative to the OECD Model for developing countries, the UN Model is nevertheless similar in its structure to its counterpart. It is noteworthy that the UN Model has incorporated the relevant portions of the OECD Model Commentaries in its own Commentaries. Therefore, the UN Model and its Commentaries have been sporadically updated to face the changes in a globalised world. The first UN Model was published in 1980,[30] revised in 1999[31]

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26 Para 12, *OECD Model: Commentary on Article 10* (2003), Emphasis added.

27 R Collier, 'Clarity, Opacity and Beneficial Ownership' [2011] BTR 684, 690.

28 Du Toit (n 17) 504.

29 M Butani, 'Tax Treaty Interpretation' [2004] APTB 56, 60.

30 *UN Model Tax Convention on Income and on Capital* (1 January 1980), Models IBFD.

31 *UN Model Tax Convention on Income and on Capital* (1 January 2001), Models IBFD.

and a new update was released in 2011.[32] However, the lack of updates could be explained, in part, by the number of countries involved in the United Nations making a consensus harder to achieve.

It is well-known that the UN Model is focused on source-based taxation i.e. taxation in the country of investment rather than taxation in the country of the investors.[33]

As mentioned in a renowned Indian case:

> *Overall, countries need to take, and do take, a holistic view. The developing countries allow treaty-shopping to encourage capital and technology inflows, which developed countries are keen to provide to them. The loss of tax revenues could be insignificant compared to other non-tax benefits to their economies.*[34]

That is especially relevant when dealing with the concept of beneficial ownership as one would assume that developing countries apply a narrow and technical approach to spot evident cases of treaty-shopping.[35]

The concept of beneficial ownership was first introduced in the UN Model in 1980 at Articles 10, 11 and 12. The 1980 Commentaries already identified this concept to preclude agents and nominees from benefitting from the treaty-withholding tax.[36] When the Model was revised in 1999, it was readjusted to fit with the OECD Model of that time. However, hardly any changes were made in connection with the concept of beneficial ownership.

The OCED Commentaries incorporated the notion of conduit companies in connection with the concept of beneficial ownership only in the 2003 revision,[37] even though the Conduit Company Report was released in 1986.[38] However, as the UN Model does not get updated regularly, it is only the 2011 revised version and its Commentaries that added that notion. Therefore, a 1986 report has actually been taken into account in 2011 by the UN Model.

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32 *UN Model* (1 January 2011), Models IBFD.

33 See generally Panayi (n 4) 1-32.

34 Union of India and another v. Azadi Bachao Andolan and another, [2003] 6 ITLR 223.

35 S Sharma and SS Rauniyar, 'Compatibility with the International meaning of Beneficial Ownership' [2013] APTB 91, 95.

36 Commentary on the paragraphs of Article 10, *UN Model Tax Convention on Income and on Capital* (1 January 1980), Models IBFD.

37 Para 12.1 *OECD Model: Commentary on Article 10* (2003).

38 (n 21)

This can be a drawback for the UN Model: it does not respond quickly enough to any relevant change in the OECD Model. This explains in part why many governments would rather use the updated OECD Model. Accordingly, some academics[39] have expressed their wish to see the UN Model being updated more often, maybe as often as the OECD Model itself. Though one would think that if the UN Model was to be updated as often and to be copying the OECD Model, then the UN Model would lose its ambition of being an alternative Model.

Similarly, with the OECD implementation of a definition for the concept of beneficial ownership in 2014, the way things are going, it would be conceivable that the UN Model would incorporate such a definition in 2020. The aim of consistency[40] called upon by the UN Model would be seriously tarnished.

It must be mentioned, nonetheless, that the 2011 UN Model and Commentaries revision followed Philip Baker's Report[41] as the concept of beneficial ownership was not extended to Articles other than Articles 10 to 12 while the OECD 2003 update was incorporated in the relevant paragraphs in the UN Commentaries.

Finally, it is interesting to see the developing countries' views on the concept of beneficial ownership. Indeed, countries like India tend to follow a 'form-over-substance approach'[42] which can be seen in contrast with the traditional civil law notion of 'substance-over-form.'[43]

These practices are, once again, understandable as developing countries are trying to attract investors by allowing them some treaty-shopping as long as some form of taxes is still paid to the treasury. That is the main difference with the OECD Model as OECD members are more focussed on eradicating treaty-shopping and all forms of tax avoidance or tax evasion rather than actually attracting investment.

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39 BJ Arnold, 'Tax Treaty News: An Overview of the UN Model (2011)' [2012] Tax Treaty Monitor 523, 529.

40 Introduction, para 2 at VI, *UN Model* (2011), Models IBFD.

41 P Baker, 'Report Possible Extension of the Beneficial Ownership Concept' (www.un.org 2008) <http://www.un.org/esa/ffd/tax/fourthsession/EC18_2008_CRP2_Add1.pdf> accessed 15 January 2016.

42 See an application of that principle in Moody's Analytics Inc, USA., In re [2012] 24 taxmann.com 41 (AAR).

43 'Substance over form' defined as an 'anti-avoidance doctrine under which the legal form of an arrangement or transaction is ignored, tax being levied in accordance with the economic substance. The legal form refers to the legal conditions used to define a tax rule and typically includes private law concepts. Although the doctrine is generally associated with common law legal systems, similar concepts exist in civil law countries', in *Form and substance in tax law*, (IFA Cahiers de droit fiscal international, The Hague, Vol. 87a 2002) 180.

As Rohatgi summed up 'for them, treaty shopping is like a tax incentive.'[44] Therefore, it is decisive that the UN Model keeps its independence with its alter ego the OECD Model.

Conclusively, one would think that the UN Model should try and elaborate its own solutions with the concept of beneficial ownership (even if it means removing it completely). Developing countries should state loud and clear, without fear that they authorise and foster tax competition; even though developed countries rise up against it, especially in times of economic recession.

The interests of developing and developed countries, with regard to tax matters, are and will remain diverging. Therefore, it is important to maintain different solutions and a level playing field between them.

After delving into the origin of the obstacles to interpret the concept of beneficial ownership, it is necessary to explore in depth the case law around this concept in order to seek a pattern in its use.

2.2. The different judicial solutions

It has been said that academics prescribe an international fiscal meaning rather than a domestic understanding of the meaning of beneficial ownership.[45] Yet, it is to be noted that such an international meaning has been difficult to interpret uniformly by courts in different jurisdictions without a formal definition. These difficulties will be analysed through three well-known cases: *Indofood* (interests), *Prévost* (dividends) and *Velcro* (royalties). Two Danish Cases will also be closely looked at since Denmark is a civil law jurisdiction.

2.2.1. United Kingdom, *Indofood* [46]

> *Since March 2006 we do have a Court of Appeal case on the meaning of beneficial ownership, though some would doubt whether it has done much to clarify our understanding of the meaning of the term.*[47]

An Indonesian company set up a subsidiary in Mauritius that issued a loan (Issuer), with JP Morgan acting as a trustee for the bondholders so as to avoid a 20%

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44 R Rohatgi, *Basic International Taxation*, Vol 2 (2nd, BNA International Inc., London 2007) 167.

45 Baker (n 19) para. 10B-14.

46 Indofood International Financial Ltd v JP Morgan Chase Bank NA, London Branch [2006] EWCA Civ. 158.

47 P Baker, 'Beneficial Ownership: After *Indofood*' [2007] 6 Grays Inn Tax Chamber Review 1 15, 18.

withholding tax under domestic law in case of a direct loan. This is what one would call a 'typical back-to-back loan structure.'[48] An early redemption, for tax reasons (domestic law or treaty-related changes), was provided for in the loan notes for the issuer, though it was required to try to limit any supplementary tax liability by 'taking reasonable measures available to it.'[49]

The loan was channelled through Mauritius to obtain the 10% withholding tax under the Indonesia-Mauritius Tax Treaty. After the termination of such a Tax Treaty by Indonesia, the issuer demanded the redemption of the loan, stating no other tax options were available.

This was challenged by the trustee. It is to be noted here that it was in the Issuer's favour to redeem the loan to take out a new one with a more attractive interest rate while the trustee only wished this agreement to remain as it was.[50] Therefore, the trustee maintained that a Dutch company (Newco) could have replaced the Mauritius subsidiary thus, allowing the 10% withholding tax benefit under the Netherlands-Indonesia Tax Treaty to apply.

Consequently, two main issues arose. The first one being whether Newco would be recognised as resident in Netherlands for tax purposes and the second, whether Newco would be identified as 'beneficially entitled' to the interest paid within the meaning of the Netherlands-Indonesia Tax Treaty. As the parties chose that any dispute arising between them would be solved by English Courts, it was left to the Chancery division[51] and to the Court of Appeal to decide such a case. A noteworthy fact is that these are civil Courts and not tax-related. Therefore, none of the judges were experienced in the tax field.[52]

Judge Evans-Lombe J, in the first instance, came to the conclusion that NewCo would be entitled to treaty benefit if the Indonesian tax authorities would have found the Mauritius subsidiary entitled itself.[53]

On the other hand, the Court of Appeal allowed the appeal, with Sir Andrew Morritt leading judgement.[54] Indeed, he took the view that Newco, as was the

48 Du Toit (n 17) 505.

49 condition 6 (iii) of the loan notes.

50 Baker (n 47) 20.

51 Indofood International Financial Ltd v JP Morgan Chase Bank, NA, London Branch [2005] EWHC 2103.

52 Baker (n 47) 22.

53 (n 51) [50].

54 (n 46) [69].

Mauritius issuer, would only be a conduit company, and for that reason Newco would not be the beneficial owner of the interest payable by Indofood.[55]

The Court, after citing Philip Baker's work and the OECD position, emphasised the international fiscal meaning of the concept. Thus, the fact that Newco would not 'have the full privilege to directly benefit from the income'[56] lead them to regard Newco as a conduit company.

A serious weakness with this reasoning, however, is the use of the domestic meaning through the circular letter from the Director General of Taxes in Indonesia.[57]

The key problem with this explanation is that it is antithetical: an international meaning cannot be found by using domestic documentation. Although, it is worth noting that the judgement is based on specific facts as the English Court had to find out whether an Indonesian Court or Indonesian tax authorities would find a company to be a conduit company or not (i.e. entitled to treaty benefit).

Another problem with this judgement appeared to be that, the Court specified that the concept of beneficial ownership should not 'be limited by so technical and legal approach' but on the contrary 'regard is to be had to the substance of the matter.'[58] This analysis has been criticised by a number of academics.[59]

However, despite these criticisms, few would deny that this case is of relevance for an understanding of the meaning of beneficial ownership because it is made by a common law Court though based on fact-intensive issues. Although not a watershed, this landmark decision has to be balanced with the document released by Her Majesty the Queen, Revenue and Customs.[60] Although some have commented that the only purpose of such a document was to 'provide comfort to potential claimants for treaty relief',[61] it seems to clarify the impact of *Indofood* in the UK.

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55 The Court exposed that the Mauritius entity was totally ignored in reality as the Indonesian company was directly paying the interest to the noteholders through the trustee. See (n 46) [40].

56 (n 46) [42].

57 (n 46) [18].

58 (n 46) [44].

59 P Baker, AM Jiménez, C Du Toit.

60 HMRC International Tax Manual INTM332040 to INTM332080.

61 R Fraser and JDB Oliver, 'Beneficial Ownership: HMRC's Draft Guidance on Interpretation of the Indofood Decision' [2001] BTR 39, 40.

One criticism arises where HMRC notes that the interpretation of the concept of beneficial ownership by the Court of Appeal, 'as far as it relates to Double Taxation Conventions (DTCs), is now part of UK law.'[62] One of the limitations with this approach is that the outcome of *Indofood* is so fact-oriented.

The key problem in assessing the relevance of this case is the high-interaction with Indonesian law and the specific facts component. Indeed, a UK interpretation of the concept of beneficial ownership was awaited for so long; *Indofood* appeared actually to be a good jurisprudence. Instead of finding a strict and undisputed solution to the problem, it seems that the decision has further opened the already ajar Pandora's Box.

2.2.2. Canada, the *Prévost* approach extended in *Velcro* in 2012

The *Prévost*[63] case was the first Canadian case dealing with the interpretation of the concept of beneficial ownership.[64] In this case, a Swedish Company, Volvo, bought 100% of a Canadian company called Prévost. Volvo transferred all the Prévost shares in a Dutch company, Holdco. After a while, a UK company, Henlys, acquired 49% of the shares in Holdco. A shareholder agreement was concluded between Volvo and Henlys so that both Prévost and Holdco would distribute 80% of their profits to the shareholders. Therefore, Prévost did a first distribution of its profits to Holdco minus 5% corresponding to the withholding tax under the Canadian-Netherlands Tax Treaty. The Holdco then proceeded to distribute the dividends to its shareholders (Volvo and Henlys) according to the shareholder agreement.

The Canadian Tax Authority challenged the scheme and stated that Holdco was not the beneficial owner of the dividends paid by Prévost. Therefore the company was denied the preferred withholding tax. Indeed, the withholding tax under the Canada-UK Tax Treaty and the Canada-Sweden Tax Treaty were less favourable (i.e. 10% of withholding tax and 15% withholding tax respectively).

The Tax Court of Canada, through RIP, J. rejected the idea of an international meaning for the concept of beneficial ownership and applied Article 3(2) of the Canada-Netherlands Tax Treaty instead. In conclusion, he found that for 'both common law and civil law, the persons who ultimately receive the income are the owners of the income property.'[65]

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62 HMRC International Tax Manual INTM332050, 1.

63 Prévost Car Inc. v. The Queen, 2008 TCC 231.

64 G Watson and S Baum, 'Beneficial ownership as a treaty anti-avoidance tool?' [2012] Canadian Tax Journal 149, 159.

65 (n 63) [99].

It should be noted that the OECD material was considered as background but not really analysed by the Court. By considering the legal relationship between the parties and the Dutch corporate law, the Court decided that Holdco was the beneficial owner of the dividends and thus entitled to the treaty benefit. Indeed, Holdco was not held to be an agent, a nominee or a conduit company as no strong evidence was shown. As a result, the Court refused to pierce the corporate veil.

The Federal Court of Appeal[66] upheld the first instance judgment and confirmed that Holdco was the beneficial owner. Although this time, the judges focussed on the issue of using new Commentaries to existing treaties.[67] On that point, it was held that 'later Commentaries can guide the treaty interpretation when they represent a fair interpretation of the words of the Model Convention and do not conflict with Commentaries in existence at the time a specific treaty was entered.'[68] While the tax authorities use of the concept of beneficial ownership as an anti-treaty shopping proviso was swept away by both Courts in this case, it is noteworthy to see that the approach used by the Courts are somewhat different from other jurisdictions. Indeed, Canada can be seen as both a common and civil jurisdiction (for the region of Quebec, where the Prévost Company resided). Therefore, the Canadian Court analysis has been scrutinised by numerous academics.

If the Canadian concept of beneficial ownership seemed already innovative compared to the English version, it was extended further with the recent *Velcro* case.[69]

Velcro was a group of companies that were in the business of manufacturing and selling Velcro fastening products. The Canadian Velcro company entered into a licensing agreement with another company in the group, Industries BV, resident in the Netherlands, for all the Intellectual property rights of the group (including patents, trade secrets, copyrights, know how…). Velcro was paying periodic royalties to the BV based on a percentage of net sales.

After a reorganisation in 1995, Industries BV became a resident of the Netherlands Antilles. Therefore, a Holding BV was set up in the Netherlands which concluded an agreement with Industries BV. In the agreement, Industries BV was to be replaced by Holding BV in the previous agreement and Velcro would then pay the royalties to the new Holding BV.

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66 Prévost Car Inc. v. The Queen, 2009 FCA 57.

67 This point will be discussed in 2.3.3 and 2.3.5.

68 (n 66) [11].

69 Velcro Canada Inc. v. The Queen, 2012 TCC 57, released February 24, 2012.

In exchange, contractually, the Holding BV would pay royalties to Industries BV equivalent to those paid by Velcro minus an arm's length price within 30 days after receipt of them from Velcro.

The Court applied the same test as in *Prévost*. Interestingly, the Court stated that the beneficial ownership concept relied on four features: possession, use, risk and control.[70] To examine the facts of the case, the Court held that some evidence was more relevant, such as flow of funds, the legal agreements, the bank and the financial statements of the Holding BV. All four elements were dealt with very carefully with a full legal definition for each and then an application to the factual evidence of the case. The Court found that the Dutch Holding was the beneficial owner of the royalties.[71]

It followed an analysis of the Holding BV to determine whether it could be considered as being an agent, a nominee or a conduit company for Industries BV, the Netherlands Antilles Company. The Court cited the OECD work and especially the 1986 report and the 2003 Commentaries.[72]

One question that needs to be raised, however, is whether the Court also thought through such material, as one has argued[73] that no analysis had been done when the Court concluded '[it] is quite obvious that though there might be limited discretion, [Holding BV] does have discretion.'[74] This statement seems to be in contradiction with the Conduit report where the emphasis was on the 'very narrow powers' with regard to the income.

Indeed, Holding BV was contractually obliged to pass on the royalties to Industries BV within 30 days though, during these 30 days it had theoretically the possibility to use it as it wished.

Thus, the Canadian Court is contracting its original vision of the concept of beneficial ownership to its bare minimum as only agents, nominees or conduit companies having unquestionably no discretion over the amount of dividends, interests or royalties received, would be denied treaty benefit.

70 (n 69) [29].

71 (n 69) [57].

72 (n 69) [23-26].

73 BJ Arnold, 'Tax Treaty Case Law News - A Trio of Recent Cases on Beneficial Ownership' [2012] BIT (Volume 66), No.6.

74 (n 69) [52].

Finally, the main limitation of the Canadian approach might be the Discussion Draft and further 2014 update that departs completely from that narrow vision. Indeed, the OECD is broadening the concept instead of narrowing it down: step-by-step the concept is heading to the direction of an anti-avoidance rule rather than an attribution-of-income rule.[75]

2.2.3. Denmark, two cases involving the concept of beneficial ownership

The Landsskatteretten (Danish National Tax Tribunal) rendered two decisions in cases where the capacity of being the beneficial owner by the holding company was disputed.[76]

In the first case,[77] a US Parent company was holding a Bermuda company ('BermudaCo'), itself having a Danish subsidiary (DanishCo). If the latter were to distribute dividends to its shareholder (BermudaCo), it would have triggered a 28% withholding tax under Danish domestic legislation. Hence, it was decided to interpose a Cypriot company between BermudaCo and DanishCo. Under this structure, DanishCo distributes an exempt dividend under the European Parent Subsidiary Directive or the Danish-Cyprus Double Tax Treaty to its Cypriot shareholder which would then repay interests to BermudaCo through a profit participating loan.

The issues at stake were for the Danish National Tax Tribunal to confirm (i) whether the Cypriot interposed company may be considered as the beneficial owner of the dividends received from DanishCo and (ii), if these dividends could be exempt under the European Parent Subsidiary Directive.

The Tax Tribunal established that actually the Cypriot company was a real conduit based on the 1986 Report and the OECD Commentaries update in 2003. Hence, the Cypriot company could not be considered as the beneficial owner of the dividend distribution and so the treaty benefit between Denmark and Cyprus was denied. An interesting point here is that the Double Tax Treaty between Denmark and Cyprus entered into force on 18 May 2010 which explains why the OECD Commentaries update in 2003 were taken into account by the Danish Tribunal.

The Tax Tribunal further examined the opportunity for the DanishCo to still exempt the dividend distribution based on the European Parent Subsidiary Directive. On this point, it established that the Directive only includes a possibility

75 AM Jiménez, 'Beneficial Ownership: Current Trends' [2010] WTJ 35.

76 Thomas Booker, 'Beneficial Ownership' [2013] ET 164

77 Landsskatteretten, 16 December 2011, Case NO. 10-02772, SKM2012.26LSR, Tax Treaty Case Law IBFD.

to add an anti-avoidance rule when the Member States transposed it. It is noted that Denmark did not chose to include such an anti-abuse rule in its domestic legislation. Thus, since under domestic law the Cypriot Company was genuine (i.e. real seat in Cyprus, liable to tax there and even though it did not have any employees) then the Directive protection should be awarded and the dividend distributions made by the DanishCo were found correctly, to be free of any withholding tax.

One would note that first of all, the result would be different now since as from 1 January 2016 an anti-abuse rule has been inserted[78] in the European Parent Subsidiary Directive and Denmark together with all the other Member States had to transpose this into domestic law before 31 December 2015. Secondly, Denmark did not have a strong theory and practice in the concept of Abuse of law which is the reason why the Tax Tribunal in the present case could not deny access to the Directive on domestic grounds – contrary to other European Member States.[79]

An evolution can be seen after this case, visible in particular with the second case where access to a Double Tax Treaty and to the European Parent Subsidiary Directive were denied in a similar situation.

In the second case,[80] a Group with a Bermuda Parent company decided to set up an ownership chain of subsidiaries with two Luxembourg companies holding in turn two Danish Subsidiaries, forming a straight line of ownership. The Bermuda Parent lent money all the way through the chain to the bottom Danish Subsidiary with very similar terms at each level, except for a small spread left to be taxed in Luxembourg.

The issue at stake was once again for the Danish National Tax Tribunal to confirm whether the last Luxembourg Company may be considered as the beneficial owner of the interests received from the Danish entity.

The Tax Tribunal denied access to the double Tax Treaty between Denmark and Luxembourg, concluding that the Luxembourg Company was not the beneficial owner of the interests since they were passed on straight away up the chain to the Bermuda Parent company, which is why the latter was judged to be the ultimate beneficial owner (and hence a 25% withholding tax would apply).

78 EU Parent-Subsidiary Directive - recast (2011): 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 (recast), OJ L 345/8, (2011).

79 See Part 3 for the example of France.

80 Landsskatteretten, 23 November 2012, Case NO. 11-0298261, Tax Treaty Case Law IBFD.

Interestingly, the Tax Tribunal also made clear that the Luxembourg entity could not be considered to be the beneficial owner of the interests received from the Danish Company under domestic Danish law, even though the Luxembourg entity was registered and established in Luxembourg and liable to tax there.

The same approach was applied to dividends paid by the Danish entity to its Luxembourg shareholder: once again the treaty benefit was denied by the Tax Tribunal and the Bermuda Parent was considered the ultimate beneficial owner.

After setting out the facts of the above two Danish cases, we can see a pattern. Both situations were clear conduit structures. Yet, the first case tolerated the application of an exemption of withholding tax under the Parent Subsidiary Directive due to the lack of transposition of the anti-avoidance provision at that time by Denmark where the Tax Tribunal reached a different decision nearly a year later in the case involving the Luxembourg structure. The discussions on the inclusion in the European Parent Subsidiary Directive of a mandatory anti-avoidance rule to be implemented by 31 December 2015 and the general tax climate at the time may also have impacted the second above-mentioned case.

Finally, it is interesting to note that jurisdictions lacking a strong anti-avoidance or Abuse of law practice can be weaker when facing clear conduit companies' structure (as seen in the first case). This is no longer the case with the anti-avoidance rule injected in the different European Directives. At this stage it is already possible to see the positive effects of such "anti-avoidance rules" or GAAR (general anti-avoidance rule) compared to the blurred concept of beneficial owner.

Analysing the decisions reached by different jurisdictions and the itinerary followed by the Courts confirmed how arduous a harmonised interpretation of the concept of beneficial ownership is.[81] A solution had to be found to settle the issue. As an attempt to resolve this issue, the OECD prepared a Discussion Draft (2011) and its revised proposals (2012) to finally arrive to the 2014 Update to the OECD Model Tax Convention, although one would be cautious to celebrate such a solution too quickly.

2.3. The recent OECD additional work on the concept of Beneficial Ownership

We have now established that the concept of beneficial ownership is, indeed, an extremely perplexing puzzle. Thinking that only one true solution was achievable

81 RS AVI-YONAH and CHJI Panayi, 'Rethinking Treaty-Shopping lessons for the European Union' [2010] University of Michigan Law School, Working Paper No.182.

is probably over-ambitious and utopian. However, a short term solution was urgently needed to minimise the uncertainty for taxpayers. The recent development proposed by the OECD appears to be the best solution available though not entirely satisfactory.

OECD 2011 Discussion Draft[82], its revision [83] and the 2014 Update.[84] A general discussion on the concept of beneficial ownership has been put in place to try to improve, clarify and bring along some more certainty to taxpayers. A Discussion Draft was published on 29 April 2011. Furthermore, a revised draft was released at the end of 2012. The final wording and changes in the Commentaries to Articles 10 to 12 were included in the 2014 Update.

The changes appear to focus on two points: interpretation on an autonomous meaning basis and a proposed definition of the concept of beneficial ownership; both of which needs to be analysed separately as both cause their own share of difficulties.

Guideline to the interpretation of the concept of beneficial ownership. If only one 'benefit' from the case law was to be expressed, it would be the difficulties that the Courts come across to interpret the notion. Indeed, the OECD materials are only guidelines for the judges. The special facts of the cases and the domestic legislations are more likely to influence the Courts. That is why a 'final' and clear-cut opinion on how Courts of different jurisdictions must interpret the notion was much needed.

When the first proposal, in 2011, expressed a preference for an autonomous meaning over a domestic one, the 2012 revision draft and 2014 Update are even more radical. Indeed, the final paragraph 12.1 contains the following sentence:

> *Since the term 'beneficial owner' was added to address potential difficulties arising from the use of the words 'paid to … a resident' in paragraph 1, it was intended to be interpreted in this context and* ***not to refer to any technical meaning that it could have had under the domestic law*** *of a specific country (in fact, when it was added to the paragraph, the term did not have a precise meaning in the law of many countries).*[85]

82 OECD, Discussion Draft entitled 'Clarification of the Meaning of "Beneficial Owner" in the OECD Model Tax Convention' [2011].

83 OECD, 'Revised Proposals Concerning the Meaning of 'Beneficial Ownership' in Articles 10, 11 and 12' [2012].

84 OECD, '2014 Update to the OECD Model Tax Convention' (2014 Update)

85 (n 84) (emphasis added).

However, the 2014 Update goes further as the reference to the domestic meaning at the end of paragraph 12.1 of the Commentaries on Article 10, has been erased. It is to be noted that the wording in the first Discussion Draft (2011), was far from clear and the language was judged 'unfortunate.'[86] Surely, it seems antithetic to state, initially, that a 'technical meaning' under the 'domestic law of a specific country' must not be used to interpret the term of beneficial ownership while the end of the same paragraph was actually allowing such a use, if it was consistent with the 'general guidance included in this Commentary.'[87] This was seen as a half-measure, of which the only purpose was to accommodate every OECD member. The deletion of the reference to a domestic meaning is thus welcomed.

Consequently, this deletion limits the confusion on which interpretation must be preferred and seems to be in harmony with the findings of different Courts, for example in *Indofood* or *Prévost*. Furthermore, it is consistent with the fact that a contextual interpretation should prevail, an idea extensively accepted by academics[88] and confirmed in the 2014 Update.[89] One of the main arguments in favour of a contextual interpretation (i.e. an 'international fiscal meaning'[90] and the object and purposes of the Model[91]) is that a domestic meaning would intensify the risks of diverting interpretation and might lead to double taxation. A decision had to be taken regarding the way to interpret this notion as the lack of an irrevocable position on this question was the root of interpretation issues.

The proposed definition of beneficial ownership. Another major point that is dealt with by the OECD in the Discussion Draft and in the revised proposals is the previous lack of definition of the concept of beneficial ownership.

Although the drafters strived hard to provide one, a general definition has been put forward in paragraph 12.4 of the Commentaries on Article 10:

> *In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the direct recipient of the dividend is not the*

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86 See Dr R Danon, 'Clarification of the Meaning of "Beneficial Owner" in the OECD Model Tax Convention - Comment on the April 2011 Discussion Draft' [2011] BIT 437, 438.

87 (n 82) end of paragraph 12.1.

88 (n 9).

89 (n 84) paragraph 12.1. "The term 'beneficial owner' is therefore not used in a narrow technical sense (such as the meaning it has under the trust law of many common law countries), rather, it should be understood in its context, in particular in relation to the words 'paid … to a resident', and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance".

90 Baker (n 47) 23.

91 (n 89).

> *beneficial owner' because that recipient's right to use and enjoy the dividend is constrained by a contractual or legal obligation to pass on the payment received to another person. Such an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person.*[92]

The 'full right to use and enjoy the dividend' has been turned solely into a 'right to use and enjoy.' Indeed, as stated in the revised proposals, 'a number of commentators argued that the phrase was overly broad and could catch a number of legitimate situations.'[93] As the 'full right' test was giving rise to too many difficulties (i.e. for derivative instruments or other situations involving a legitimate contractual obligation), a new test was introduced: the 'related' and 'unrelated' payments received. This new test 'appears to have introduced a further layer of confusion'[94] as the new paragraph 12.4 gives examples of the meaning of this new test but these are ambiguous and will most likely provoke more uncertainty.

However, such a definition was more than awaited and seems to be welcomed.[95] It is now possible to see that the OECD is heading in the right direction with this concept, although it must be noted that it might be too late. Indeed, including a definition 37 years after the inclusion of the notion in the OECD Model can be seen as antiquated (1977-2014). Moreover, most jurisdictions have attempted to find a meaning to this concept so it will probably be hard for some countries to actually implement the new wording. It is patent that some countries have been interpreting the concept differently because no definition was available.

Finally, in fairness to B Arnold, such a discussion 'does little to clarify the meaning of the concept'. Indeed, unsurprisingly several tax authorities are unwilling to use the revised OECD Commentaries on this specific notion as they are using it 'as a potential weapon against treaty abuse.'[96] This is notably the case in France where the Tax Authorities have a static interpretation of the Commentaries (i.e. only Commentaries existing at the time of signature of the

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92 (n 83) Point E, para. 12.4, 5 (emphasis added).

93 (n 83) Point 12, 6.

94 P Radcliffe, 'Analysis - OECD's revised proposals on "beneficial ownership"' [2012] TJ 27, 28.

95 Edward Barret, 'The Changes Introduced by the 2014 Update to the OECD Model Tax Convention' [2014] BIT 529.

96 Arnold (n 39) 528.

Double Tax Treaty can be used in Court or in case of dispute with the tax authorities).[97]

> **Relationship between beneficial ownership and other anti-abuse rules**
>
> Whilst the concept of 'beneficial owner' deals with some forms of tax avoidance (i.e. those involving the interposition of a recipient who is obliged to pass on the dividend to someone else), it does not deal with other cases of treaty shopping and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases.[98]

This new Commentary is to be seen in the light of Article 1 and its Commentaries. Entitlement to treaty benefits is of specific importance in Articles 10, 11 and 12 and is tackled by the inclusion of the concept of beneficial ownership in these Articles and their Commentaries.

On the other hand, treaty abuse might be dealt with by specific general anti-abuse rules (GAAR) contained in some tax treaties or specific domestic legislations. Indeed, some countries tend to use domestic legislation and doctrines to deal with the problems of treaty-shopping or more generally, of improper use of tax treaties.[99]

The new paragraph 12.5 of the Commentaries on Article 10 aims to clarify the OECD position regarding these other kinds of provisions. This paragraph 12.5 is straight forward and tends to see these anti-abuse provisions as other ways to deal with tax avoidance.

Therefore, the concept of beneficial ownership and other anti-abuse rules are not to be seen in competition but are rather complementing the shortcomings of the other. Indeed, the concept of beneficial ownership deals specifically with agents, nominees, and conduits while general anti-abuse rules are, as the name suggests, more general.

It is now relevant to assess the impact of all the recent cases and changes in the OECD Model can potentially have on the current international tax practice.

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97 See further Part 3.

98 (n 84) paragraph 12.5.

99 See in-depth example of France, in Part 3.

2.4. International implementation issues

After delving into the recent OECD material, it seems of utmost importance to assess its usefulness. One argument put forward was that the OECD Model success was partly owed to its continuous updates – which were revealed to be one of the main drawbacks to the UN Model.

One issue remaining is the importance of such updates and its use for interpretation by the Courts. Indeed, some jurisdictions tend to refuse to apply recent Commentaries to existing tax treaties. Therefore, a change in the Commentaries, and *a fortiori* the inclusion of a definition, might not be implemented easily and immediately by tax authorities and judges, even though an ambulatory approach is to be preferred.[100]

An example of such an issue can be seen in Canada, since the adoption of the 2014 Update. Indeed, as it has been demonstrated, Canada uses the concept of beneficial ownership as an attribution-of-income rule (and not an anti-avoidance rule) which would only aim to determine who should be taxed and who should obtain treaty benefits. In the Court of Appeal judgement for the *Prévost* case, it has been stated that new Commentaries could only be used if they are consistent with the 'Commentaries in existence at the time a specific treaty was entered.'[101] Therefore, the definition of beneficial owner as it is would seemingly be set aside by a Canadian Court.

This issue illustrates how an apparent treaty solution might cause more drawbacks than advantages. Going even further, one would fear that this would trigger discrepancies between jurisdictions. A possible consequence might be that taxpayers may consider adding a clause in shareholder agreements or license agreements to give jurisdiction in case of a dispute to more favourable countries.[102] This would give rise to more uncertainty, less harmonisation and probable 'forum shopping'.[103]

A potential utopian answer to this issue would be to have an international Court dealing with tax treaty issues. An example of a specialised international Court can be found in the World Trade Organisation Court that deals with international

100 Para 9 of the introduction, *OECD Model: Commentary* (2003).

101 (n 68).

102 Same principle as in *Indofood*, but giving jurisdiction to a Canadian Court instead as the Canadian view on the concept of beneficial ownership could be advantageous.

103 Panayi (n 4) 36.

intellectual property rights disputes.[104] This would provide more certainty for taxpayers, be fair and allow harmonisation of the case law. One drawback would be that in the WTO system, only Member States that are party to the organisation can bring disputes to a panel. Therefore, if such a system was to be applied to the OECD, a higher membership tally would be required for effectiveness.

In an international ambit, the meaning of beneficial ownership seems difficult to grasp. Although the consistent work of the OECD to improve understanding must be recognised, it is still burdensome for Courts to understand and apply the concept.

Finally, the current environment of uncertainty reveals issues yet to be tackled. That is the reason why some countries are trying to deal with the inconsistencies of the concept of beneficial ownership by using domestic and more general legislations mainly for consistency and predictability purposes. The following case study of French practices will give a good overview of alternative mechanisms put forward and the rationale for such methods.

3. The French domestic approach to treaty-shopping: *Abus de droit* and General Anti-Abuse Rule

> *The conversations I have had with continental lawyers left me with the impression that Abus de droit is regarded as a dangerous expedient which should only be utilized to prevent manifest injustice […]. [Abuse of rights] resembles a drug which at first appears to be innocuous, but may be followed by very disagreeable after effects. Like all indefinite expressions of an ethical principle it is capable of being put to an infinite variety of uses, and it may be employed to invade almost any sphere of human activity for the purpose of subordinating the individual to the demands of the State.*[105]

For most Common Law lawyers, the concept of Abuse of rights (*Abus de droit*)[106] seems stamped on an ethical and moral basis, rather than the law. On the other hand, civil law countries rely on such a concept for a variety of situations.

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104 See generally WTO, 'Understanding the WTO: Settling disputes, a unique contribution', <http://www.wto.org/english/thewto_e/whatis_e/tif_e/disp1_e.htm> accessed 15 January 2016.

105 HC Gutteridge, *Abuse of Rights*, (Cambridge L.J., 1935) 44.

106 Abuse of rights would be the best translation for the French concept of *Abus de droit*. However, most French Academics seems to prefer the use of Abuse of law instead. For the purpose of this research, the French term and its translation as Abuse of rights will be used.

An overview of the relevant principles of French law will be given to obtain a better understanding of the French practice toward its singular solution against treaty-shopping (3.1.). Finally, an extensive analysis of the case law related to this use should allow a full comprehension of the topic (3.2.).

3.1. French principles and legislation

Summarising the French legal system in a paragraph would be impossible, that is why a focus is given to the relevant French legislation only. Although the French approach is not so different from others, its use of the concept of Abuse of rights has been extended in a unique way.

3.1.1. General considerations about the French legal system

A hierarchical domestic structure. The French legal system is based on a hierarchical structure that sets the French Constitution at the top of the domestic law. The current French Constitution of the Fifth Republic was adopted on 4 October 1958. As it is a written constitution it is not amended as easily as an unwritten one; although it has already been amended twenty-four times since 1958.

The French system has been influenced by Montesquieu's tripartite system based on the Ancient Greece and Rome vision of the theory of separation of powers. Indeed, following this theory, the political power must be divided into a legislature, an executive and a judiciary so that, no one can seize the political power as a whole. The main consequence is that in France, only the legislature can legislate directly, although the executive can also legislate in some circumstances.[107] Another major point is that the judiciary power cannot legislate; judges are not competent to create new laws through case law. Courts are only applying the law and interpreting it. Therefore, case law is not a source of law in France.

International Agreements as source of law. According to Article 53 of the Constitution, international Agreements are part of the French legal system once they have been ratified by an act of Parliament. Indeed, France follows a monist system: international Agreements, therefore, prevail over French domestic laws after ratification.

As tax treaties are international Agreements, they have to be ratified by both of the French chambers: the National Assembly and the Senate. They are subject to reciprocity, following Article 55 of the Constitution. As Tax Treaties were considered as special international Agreements, their interpretation was entrusted

107 See Articles 24 and 34 of the French Constitution (1958).

to the Ministry of Foreign Affairs; this tradition stopped when the *Conseil d'État*[108], in a 1990's decision[109], recognised that it could itself handle the interpretation of tax treaties.

An overview of the French tax system. The territorial principle is of the utmost importance in France. In fact, the French Revenue can only levy tax within the territorial jurisdiction of France. Therefore, France has the right and only the right, to tax all persons, properties and economic activities within its borders. This principle implies a source taxation of income.[110]

The fact that Tax Treaties prevail over domestic law has another consequence: the 'principle of subsidiarity' must apply. Therefore, in case of a cross-border income, its taxation must first be analysed under French domestic law so as to ascertain if the tax should be levied and under which classification. Then, only if domestic law indicates that the cross-border income should be taxed under French taxation, the tax treaty's provisions would apply to see if the right to tax is attributable to France. The significance of this principle has a major consequence: domestic anti-abuse provisions and especially the *Abus de droit* principle can be characterised first by the use of domestic law to defeat an abuse of tax treaty.[111]

Recently, emphasis has been added to the exchange of information between tax authorities as well as tackling tax avoidance and tax evasion. The French Income Tax Code lists an ever increasing number of anti-avoidance provisions; among which a Controlled Foreign Company (CFC) rule at Article 209B, a "rent-a-star company" rule at Article 155A and thin capitalization rules (Article 212). French advocacy against tax avoidance and tax evasion finds its origin in the Declaration of the Rights of the Man and of the Citizen (1789), Article 13: 'For the maintenance of the public force, and for administrative expenses, a general tax is indispensable; it must be equally distributed among all citizens, in proportion to their ability to pay.'[112] The equality in taxation is a core principle in France which is even more essential in times of economic difficulty. Furthermore, the fight against tax evasion is actually a constitutional objective. Once again, this is very relevant since the French Constitution is at the top of the hierarchy of legal norms.

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108 French High Administrative court.

109 CE, 29 June 1990, GISTI, no.78519, publié au recueil Lebon.

110 IBFD Glossary.

111 For more information, see S Austry, M Collet, *Tax treaties and tax avoidance: application of anti-avoidance provisions* (IFA Cahiers de droit fiscal international, The Hague, Vol.95a, 2010) 311.

112 Conseil Constitutionnel, 'Declaration of Human and Civil Rights of 26 august 1789' (2002) http://www.conseil-constitutionnel.fr/conseil-constitutionnel/root/bank_mm/anglais/cst2.pdf (accessed on 15 January 2016.)

This overview of the French legal system is relevant to understanding the French practice to challenge treaty-shopping, or *Abus des conventions fiscales* (Abuse of tax treaties).

3.1.2. A strong and commonly agreed theory of Abuse of rights and the creation of a GAAR

Following the principle of subsidiarity, the domestic law must apply first even in an international environment with the implication of a tax treaty. Therefore, it is essential to have a close look at the French domestic treatment of the concept of Abuse of rights to understand the similarities of reasoning in an international ambit.

The origin of the principle: A 19th century private law concept. The first draft of the Napoleonic Code established an Article on the *Abus de droit civil* at Article 147 but it was withdrawn from the 1804's Code.[113] Although not included in the Code directly, the doctrine of *Abus de droit* first appeared in France as a tool to prevent individuals to use their rights in a way that harms other individuals. Several cases from the second part of the nineteenth century were referring to that concept; but it is only in 1915 with the famous *Clement Bayard*[114] case that the doctrine blossomed. Indeed, in this case, a landowner decided to set up a 16 metres high fence with the particularity of having metal spikes at the top. The only aim of such a fence was to prevent hot-air balloons from flying over the property, as an airfield was situated close-by. One day, what was bound to happen actually happened: a balloon flying over the property was punctured. Following this incident, the landowner sued the balloonist for damages. A counterclaim was filed stating that such a fence was a danger. The *Court de Cassation* ruled in favour of the balloonist as the sole purpose of the fence was to harm the airfield's customers; this was an obvious *Abus de droit,* Abuse of rights. It is to be noted that such an abuse can give rise to damages under the French Civil Code at Articles 544 and 1382. After this famous case, the concept of Abuse of rights was extended to other fields of law, such as contract law, company law, employment law and family law. Therefore, the Abuse of rights can be defined as 'the use of a right to an end that is contrary to that defined by the legislator.'[115]

113 O Fouquet, 'Fraude à la loi et abus de droit', Dr. Fisc. 2006, n°47, 65; see generally Z and J Prebble, 'Comparing the General Anti-Avoidance Rule of Income Tax Law with the Civil Law Doctrine of Abuse of Law' [2008] BIT 151, 159.

114 Cour de Cassation (High Court for civil maters), Chambre des requêtes, du 3 août 1915, 00-02.378.

115 AH Capitant and L Julliot de la Morandière, *Traité de Droit Civil* (1953).

Turning point of the concept: the specific tax legislation.[116] In 1941, a significant piece of law entered into force to 'simplify, coordinate and reinforce the French Income Tax Code.'[117] By this, the lawmakers specifically and expressly authorised the French Tax Administration to dismiss any legal act aimed at hiding an income or a benefit, and to re-establish the genuine characteristics of the transaction.[118]

An ad-hoc Committee was put in place to give legal opinions, only at the French Tax Authorities'[119] request, not the taxpayer. An opinion in accordance with the FTA had the power to shift the burden of proof to the taxpayer. No specific penalty was foreseen but fraudulent intention was punished by a 100% additional charge. Therefore, at first, the *Abus de droit* in tax was intended to be a new tool for the FTA to shift the burden of proof to taxpayers.

Although not used for at least 10 years, this special procedure was amended several times. A drastic amendment, in 1963[120], increased the penalty to 200%, restricted the procedure to agreements and not legal acts, extended it to registration fees and turnover taxes and the Committee was not consulted compulsorily. Indeed, the FTA could consult it in order to shift the burden of proof, but could decide not to and present the proofs directly to the Courts. This last point has been misunderstood and an amendment in 1987 rendered the seizure of the Committee open to the taxpayer. Since then, the FTA has to give the taxpayer the opportunity to seize the Committee but if it does not do it, this would have the effect of making the procedure irregular.[121]

In 2009 the Article L 64 LPF[122] was amended so as to extend the *Abus de droit* to *fraus legis*. Indeed, as a General Anti-Abuse Rule (commonly named GAAR), it had to be consistent with the EU notion of Abusive practices.

Therefore, for identifying an abuse under the Article L 64 LPF, two alternative criteria must be found: the contracts, conventions or any legal arrangements have to be 'fictitious' or 'artificial' (objective criterion) **or** the only motivation of such

116 Fouquet (n 113).

117 Law from the 13 January 1941, published in *Journal Officiel*, 3 Fevrier 1941.

118 Recodified at Article 244 du Code General des Impôts (CGI, French Income Tax Code) after a change in the law on 9 December 1948.

119 Further referred to as FTA.

120 Law n°63-1316 from 27 December 1963, Article 1649 quinquies B of the French Income Tax Code.

121 Loi Aicardi, n◦87-502, 8 July 1987.

122 Livre des Procédures Fiscales (LPF, Tax Procedural Code).

arrangements is to avoid or reduce the tax burden of the tax payer **and**, in addition, 'the taxpayer seeks to benefit from a literal application of legal provisions or decisions in contradiction to the objective set forth by the draftsman' (also referred to as *fraus legis* or fraud to the law, which is a 'hybrid' test mixing an objective and a subjective criterion).[123] Furthermore, the GAAR is now extended to every tax benefit and may trigger an 80% penalty, reduced to 40% if the taxpayer did not initiate the abuse. The burden of proof lies on the FTA unless the Committee gives an opinion in its favour. The taxpayer, under the Article L 64 LPF can ask the opinion of the Committee, if the FTA does not provide for such a possibility; the procedure is considered irregular.[124]

The main difference between the civil law concept of Abuse of rights and the tax concept included in Article L 64 LPF is that the former can be repaired by damages while for the latter, the consequence is a non-invocability of the legal act by the FTA or the Court.[125]

Relationship between the common principle of *Abus de droit* and the GAAR. Since 1941 and the existence of the GAAR, academics, tax authorities and Courts had different views on the relationship of the two concepts. Indeed, both seemed similar but had different origins and purposes. No clear-cut answers were found before case law of 2004 onwards. As a matter of fact, the tax authorities tried not to use the general concept of Abuse of rights, as the question of the relationship between the two remained unanswered.

A definition of the abuse censored by the Constitutional Council. The 2014 Financial Act attempted to extend the definition of the abuse in the GAAR. Indeed, the wording of Article L 64 was proposed to only consider the "principal motive" rather than the "only motivation". The Constitutional Council explained that this would widen the FTA's powers of assessment, especially when the consequences are so important for the taxpayer (i.e. up to 80% penalty). Hence, in its decision of 29 December 2013, the Constitutional Council censored the proposed amendment to Article L 64 on the basis that a wider definition was against the principle of lawful punishment and as such against the French Constitution. Such a decision was welcomed[126] and seems to reflect the current trend in France.

123 See generally E Robert and D Tof, 'The Substance Requirement and the Future of Domestic Anti-Abuse Rules within the Internal Market' [2011] ET 436, 439.

124 See Bulletin Officiel des Finances Publiques, CF Procédure de rectification et d'imposition d'office – Procédure de répression des abus de droit, BOI-CF-IOR-30-20141124 [2014], in French.

125 The FTA can re-characterize the legal act so as to establish the genuine characteristics of the transaction and tax it accordingly under the Judge vigilance.

126 See Blanluet, Austry and Ayrault, 'Encadrement de la lutte contre la fraude et l'evasion fiscale', Dr. Fisc. 2015, n°39, 582.

Another consequence of the principle of subsidiarity is that the international concept of treaty-shopping will be treated in France first at a domestic level, under the GAAR or under the *Abus de droit* principle, and not as related to the concept of beneficial ownership and its hazardous interpretation. This particular domestic solution is allowed by the Commentaries in Article 1 of the OECD Model, paragraph 9(1) and (3). It seems that such a solution is actually an efficient alternative to the concept of beneficial ownership, at least in a civil law environment.

3.2. The French Courts approach

To understand plainly the French practice, it is essential to acknowledge the domestic solutions that are mostly jurisprudential to then have a more comprehensive vision of the French answers to cross-border cases.

3.2.1. Court focus and extension of its understanding of the *Abus de droit* concept and the conditions to apply the GAAR

First relevant 'GAAR' case: Conseil d'État, 10 June 1981. In 1981[127] the *Conseil d'État* had dealt with a case regarding the application of the concept of abuse of rights in an internal setting.

A couple and their eight children were the owners of a vineyard that constituted a civil partnership whose purpose was to take such a vineyard on a lease and to operate it. The father was the manager of the partnership and he and his wife inhabited the mansion as a lodging pertaining to an office. Some work was done on the mansion, so the manager decided to deduct such expenditure against the partnership's property income. The FTA did not allow such a deduction, as it considered that the use of such a partnership was made only to be able to deduct expensive works that had been done on the mansion. Using the Article L 64 LPF to prove its point, the FTA had the burden of proof. It is precisely on this point that the *Conseil d'État* did not follow the FTA and gave a decision in favour of the taxpayer. Indeed, according to the judges, the FTA did not show enough evidence that such an action was fictitious, or if not, at least had only the motive of intending to avoid or decrease the tax owed. For them, the civil partnership was legally constituted, its functioning was proper and effective, the lease was an activity that entered in the purpose of the partnership; therefore no abuse of rights was found.

The emphasis, by the Court, on the fictitious purpose of the taxpayer actions or, if none was found, the tax avoidance or limitation of tax purposes shows that in an

127 CE, 10 June 1981, no.19079, publié au recueil Lebon.

internal setting, the conditions to recognize an abuse of rights were very strict so that the FTA could not use that argument without solid proof. In this case, only the specific tax legislation was used by the FTA but it seems inevitable that the FTA would still have failed if using the general principle of *Abus de droit*.

Welcomed clarifications since 2004.[128] If it is clear that 'taxpayers may choose to structure their business so as to limit their tax liability',[129] the diving line between 'aggressive tax planning' and 'acceptable' planning is tenuous. That is why, in two landmark cases,[130] the *Conseil d'État* broke new ground by introducing a corporate substance test within the 'solely tax driven' criterion. Indeed, in both cases a structure in a low tax jurisdiction (Luxembourg) was used to 'transform' taxable interest into tax free dividends. The conclusion of the *Conseil d'État* was that the Luxembourg structure had failed the corporate substance test as such a structure had no employees and the shareholders never came to the shareholders meetings. It was a scheme that had only one purpose: avoid tax through an artificial arrangement, revealing, according to the *Conseil d'État* an Abuse of rights. Going further in one of the cases (*Sagal*), the Court noted that such a decision was consistent with the European Union Freedom of Establishment,[131] as the Abuse of rights Article (i.e. the GAAR, Article L 64 LPF) was considered to limit the risk of tax avoidance which is an overriding justification of public interest. These two decisions are both consistent with other domestic decisions and the Court of Justice of the European Union's case law.

The relationship between the general concept of *Abus de droit* and the GAAR: finally dealt with by the *Conseil d'État* in 2006.[132] In the jurisprudence *Janfin*, the judges had to consider the issue of the *Avoir fiscal* that was used for a tax scheme to limit companies' corporation tax. Although this tax credit was put in place in 1965 and removed in 2004, it seems that the FTA waited until the mid-90's to challenge this kind of tax planning which probably explains the reason for the failure of the argument.

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128 Austry (n 111) 314.

129 Case 255/02 Halifax and Others [2006], ECR I-01609, para. 73; See also CE, 16 June 1976, no.95513 and the acknowledgement of this principle by the FTA by administrative guidelines D.Adm. 13L-1531, no.18.

130 CE, 18 February 2004, Min. c/ Societe Pleiade, no.247729 and CE, 18 May 2005, SA Sagal, no.267087. In both cases, the taxpayers were investors of the same transaction.

131 Consolidated Version of the Treaty on European Union [2008] OJ C115/13, Article 49.

132 CE, 27 September 2006, Janfin, no.260050; Opinion of the prosecutor L Olléon can be found in French in Dr. Fisc. 2006, n°47, comm. 744.

Indeed, the FTA based its whole reasoning on the Article L 64 LPF. The taxpayer therefore argued that the *Avoir fiscal* is not a tax included in the scope of this Article and the Committee had not been consulted.

The *Conseil d'État*, following the prosecutor's opinion, held in favour of the taxpayer as the Article L 64 LPF could not be invoked in the present case and the FTA did not put forward any other line of defence. In saying so, the Court implicitly confirmed that, if the FTA had put forward the argument of the general theory of *Abus de droit* and had proved it, it could have won the case.

However, it seems striking that the FTA did not raise the *Abus de droit* theory as an alternative argument. Nonetheless, as prosecutor Olléon mentioned in his opinion, there is very little doubt that the FTA would have failed on the *Abus de droit* line of argument as it would have been impossible to prove a deliberate fictitious act. A later case[133] confirmed the position of the prosecutors as the *Conseil d'État*, in a very similar case (i.e. where the FTA actually shifted its argumentation from Article L 64 to the *Abus de droit* principle) concluded in favour of the taxpayer, as the FTA had failed to prove the abuse. In that recent case, the Court used the *Travaux préparatoires* to the *Avoir fiscal* legislation so as to deal with the intention of the lawmakers which gives even more clarity on the test contained in the general concept of *Abus de droit*.[134]

Altogether, the *Janfin* case, the Prosecutor's Opinion and the subsequent *Axa* case, clarified the last uncertainties around the duality of notions of a general principle, the *Abus de droit*, and its legislative counterpart contained in the GAAR at Article L 64 LPF. This is a major improvement for the taxpayer that can now easily recognise the diving line between aggressive tax-planning that is forbidden and the protection of its own economic interest, entirely legally.

It is now possible to see that the FTA can tackle any abuse in an internal or in an international setting either by using the *Abus de droit* as a general principle which authorises a re-characterisation without penalty, unless the taxpayer is proven to have acted with a fraudulent intention; or by using the Article L 64 LPF following a strict procedure in case of a reassessment and for certain type of taxes only, with the possibility for the FTA and the taxpayer to seize a committee for an opinion, following a fraud to the law or a fictitious arrangement that would give rise to a penalty of 40% or 80%.

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133 CE, 8e et 3e ss-sect., 7 September 2009, min. c/ SA Axa, no.305586.

134 O Fouquet, 'Fraude à la loi: l'explication du critère "subjectif" ' Dr. Fisc. 2009, n°39, 287.

In order to challenge any abuse by a taxpayer the FTA has been given a large arsenal of measures that, in the end, have proven to be both effective for the Administration and fair for taxpayers as both the *Abus de droit* and the Article L 64 LPF allow guarantees and certainty for the taxpayer while permitting the FTA to act against aggressive illegal tax planning.

If such a domestic arsenal has been proven right, one would then be curious to see the outcome of a cross-border issue. Doubtless, in cross-border situations, problems usually arise when France is the Source State. In a majority of cases, questions come to light where, by all appearances, there is a 'clash' between a domestic provision and the international concept of beneficial ownership. Indeed, as several measures are available at a domestic level one can question their relationship with international solutions and especially with the concept of beneficial ownership.

3.2.2. In a cross-border environment, which principle should prevail?

> *In other terms, I think that the concept of beneficial ownership is a narrow one, which may not justify a substance-over-form approach, but this does not imply that such techniques cannot be applied.*[135]

As it has been demonstrated, the French position is based on the civil principle of *Abus de droit*. However, with the principle of subsidiarity already presented, the French practice seems to focus on its domestic provisions while never ignoring an international solution if it is put forward by the taxpayer.

1st case dealing with passive income in an international setting: The Diebold Case.[136] A French company (Diebold) had paid royalties for the lease of computer hardware to a Dutch partnership, domiciled in Amsterdam that was transferring part of the royalties to a Swiss Company based in Zurich.

Under French law, Diebold should have withheld a tax on the royalties but the France-Netherlands Tax Treaty made the royalties only taxable in the Netherlands and without withholding tax in France subject to: the royalties must be paid to a resident of the Netherlands (Article 12 France-Netherlands Tax Treaty).

It is to be noticed here that the main question was whether the Netherlands entity could be defined as a partnership and under which law that question should be

135 IFA, *The OECD Model Convention – 1998 and beyond; The concept of beneficial ownership in tax treaties* (Kluwer, October 2000) 24. Quotation from B Gouthière.

136 CE, 13 October 1999, No.191191, 8° and 9° s.-s., min. c/ Diebold Courtage SA, RJF 12/99, No.1492.

answered.[137] The *Conseil d'État*, after stating that the Netherlands entity was a partnership and the partners were taxed in the Netherlands, recognised that such an entity was entitled to treaty benefit. Therefore, the partnership was recognised as the beneficial owner of the royalties.

The Court did not deal with the Swiss company that might have been receiving partly or wholly the royalties, as the Netherlands tax authorities did not give enough information that would have convinced the judges that the Swiss Company was actually the beneficial owner of the royalties.

Though dealing mostly with the partnership issue, this is nevertheless a landmark case in the French jurisprudence as the Court explicitly did not deal with the beneficial ownership question related to the Dutch and Swiss company. Indeed, the Court stopped its reasoning a step earlier as it recognised the Dutch partner to be the beneficial owner of the royalties and therefore those who would have to pay the tax *in fine*. Yet, it needs to be noticed that the France-Netherlands Tax Treaty did not mention the concept of beneficial ownership[138] but the Court assumed, using an ambulatory approach to the OECD Model, that the treaty must be read as implicitly having such a concept.[139]

Another important point here is the fact that the FTA withdrew its *Abus de droit* argument. One reason found[140] would be that this was under the influence of another case[141] which made clear that the FTA cannot challenge a company's interposition to obtain tax advantages using the *Abus de droit* doctrine. As long as it is acting in the course of the company's activity and non-tax reasons can be stated to support this structure.

Although it is obvious that it was only at an early stage, this is the first French case dealing with the problem of beneficial ownership and it helped the high Court to build a singular understanding of the concept.

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137 For a discussion on the partnership issue, see JP Le Gall, 'L'arrêt diebold: un incident ou un cataclysme?', Dr. Fisc. 2000, n°15.

138 See wording of article 12 of the France-Netherlands Income and Capital Tax Treaty of 16 March 1973.

139 This was reinforced by an opinion from the Conseil d'État, Section des finances, Avis n°382.545, 31 March 2009, available in French at <http://www.conseil-etat.fr/media/document/avis/382545.pdf> accessed on 15 January 2016. Indeed, the Court recognised that if a tax treaty entered into force after the introduction of the concept of beneficial ownership in the OECD Model without including it directly, it might indicate that the treaty partners meant this concept not to be included in the Treaty. It would only be an indication.

140 C Acard, Dr. Fisc. 1999, n°52, commentaire 948.

141 CAA Nancy, 14 mars 1996, SARL Inter Séléction, no.93729.

The breakthrough case: Bank of Scotland.[142] The French Bank of Scotland case is well known around the world. The facts were as follows; a US company made an 'usufruct agreement' for a three-year period with the Bank of Scotland so that the Bank would obtain the shares in the US nearly wholly-owned French subsidiary (so the dividends). When the UK bank asked the FTA to obtain part of the withholding tax back (25% domestic rate had been applied) and the *Avoir fiscal*, the FTA refused. Indeed, the FTA treated such an operation as a disguised loan. The contract itself was written so that the Bank would receive the French dividends with a reduced withholding tax (France-UK tax treaty) of 15% and would furthermore obtain the refund of the *Avoir fiscal* (tax credit, now abolished), therefore 'making the burden of the credit interests on the French Public treasury.'[143]

In the first instance, the FTA won, but contrary to the prosecutor's opinion[144] the Court of Appeal[145] gave a judgement in favour of the taxpayer, arguing that the FTA failed to prove that the agreement was a genuine loan. Séners, the prosecutor in this case, gave a very interesting opinion based principally on a clear analysis of the 'usufruct agreement' itself. Indeed, when revising a contract, the FTA and then the *Conseil d'État* have to base their decision on facts, and prove their point as the burden of proof is on them.

Article 6 of the contract gave an enviable number of guarantees to the Bank though these guarantees were under a best effort obligation and not an absolute obligation. That is why Articles 7 and 8 were crucial as they were allowing the Bank to terminate the contract in an impressive number of situations. Additionally, in case of termination, the US Company would have to pay the promised dividends instead of its subsidiary. As stated, this scheme 'constitutes an ingenious operation but had for only purpose to offer to the legitimate dividends beneficiary a cash-flow advance and to the banker a comfortable remuneration.'[146]

In sharp contrast with the Court of Appeal[147] that had seen in these articles objective economic financial operations, the *Conseil d'état* refused to carry out such a reasoning and considered the contract to be a disguised loan.

142 CE, 29 December 2006, min c/ Sté Bank of Scotland, no.283314, RFJ 3/07 no.322.

143 F Séners, Opinion du commissaire au gouvernement, under O Fouquet, 'Un contrat de treaty-shopping qualifié de fraude à la convention fiscale franco-britannique', published in Dr. Fisc. 2007, n°4 (author translation).

144 Contrary to the prosecutor's opinion.

145 CAA Paris, 23 May 2005, Bank of Scotland, no.014068, RJF 5/06, no.569.

146 Séners (n 143).

147 (n 145).

More controversial is the question as to why the *Conseil d'État* applied the concept of Fraud to the law without actually naming it.[148] Indeed, an informed writer would have recognised in the Bank of Scotland reasoning the two criteria to characterize the Fraud to the law formulated for the first time in the *Janfin*'s case (i.e. the objective aim of the scheme was to obtain a tax advantage and the fact that such an advantage would be contrary to the purpose of the provisions of the France-UK Tax Treaty). As it has been pointed out[149], the concept of fraud to the law only emerged implicitly without being enunciated loud and clear by the *Conseil d'État*.

Similarly, another criticism of this case is the fact that, by converting the 'usufruct agreement' to a loan, the Court identified the US Company to be the beneficial owner of the dividends. Such an analysis seems incorrect. One would even go further and say that it is antithetic, as if there is a loan between the US Company and the UK Bank then the concept of dividend and with all the more reason, the beneficial ownership test, cannot be the focus anymore. In other words, the consideration paid by the French subsidiary to the UK Bank should have been seen as interest on the loan, and not dividends (i.e. use of Article 11 of the convention and not Article 10) which would have the consequence that there would not have been any withholding tax at all in France.

As a result, the *Conseil d'état* lacks a conclusion from the conversion of the contract into a loan, which can be viewed as a strong point that has been completely missed out by the Court.[150]

Despite these criticisms, few would deny that the *Bank of Scotland* case is a turning point in the beneficial ownership jurisprudence. Indeed, though it is not a concept that works by itself, combined with the GAAR and its Fraud to the law part, it is an effective anti-treaty-shopping method that the FTA can use to combat aggressive tax planning, tax avoidance and tax evasion.

Focus on a definition of Beneficial Ownership in the France-USA Tax Treaty.[151] France has recently started to renegotiate its tax treaty network with treaty partners in order to update the conventions and especially to make them consistent with both OECD Model updates and European Union requirements. It is

148 Fraud to the law being one of the two parts of the GAAR as it has been extended by in *Janfin*.

149 Le Mentec, La Semaine Juridique Entreprise et Affaires nº12, 22 March 2007.

150 Le Mentec (n 149) conclusion.

151 Technical explanation of the protocol signed at Paris on January 13, 2009 available at http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/tefranceprot09.pdf (Accessed on 15 January 2016).

a fact that some treaty partners have strong views as to how to tackle treaty shopping. The United States of America have their own Model and tend to use it with all its partners, although each tax treaty is amended to reflect the views of both partners.

In the technical explanation, it is to be noted that:

> *The term 'beneficial owner' is not defined in the Convention, and is, therefore, defined under the internal law of the State granting treaty benefits (i.e., the source State). The beneficial owner of the dividend for purposes of Article 10 is the person to which the dividend income is attributable for tax purposes under the laws of the source State.*[152]

The position of the US regarding the concept of Beneficial Ownership is said to be consistent with Article 10's commentary, paragraph 12 of the OECD Model.

The new tax treaty with the US went through numerous changes albeit the beneficial owner test stayed rather similar. The test is very detailed with percentages of capital or voting rights that are used to reduce the withholding tax. An advanced reader would not be surprised as this is consistent with the US practice. These precisions, although rather prescriptive, might be another alternative to an undefined beneficial ownership treaty term.

The pressure of Treaty partners to add a beneficial ownership test as a solution to treaty shopping is consistently high. On the other hand, France prides itself in dealing with these international concepts with extra care.

As prophetically summarised by Ward in 1993:

> *There seems to be support and authority in international law to give recognition to the abuse of rights principle and the widespread use of domestic anti-abuse principles by most countries which leads one to believe that these principles could be recognized internationally as the appropriate principles to be used in the interpretation and application of tax treaties.*[153]

The French position, as an example of Ward quotation, lies on a duality of notions that are complementary rather than antithetic (i.e. the general principle of *Abus de droit* and the GAAR, Article L 64 LPF). These principles should be seen as efficient tools for the French Tax Administration to tackle treaty-shopping in international situations.

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152 (n 151) Article II, regarding paragraph 2 of Article 10 of the Tax Treaty.

153 DA Ward, 'Abuse of tax treaties' in HH Alpert & K Van Raad, *Essays on International Taxation* (Kluwer, Deventer/Boston 1993) 408.

Furthermore, these provisions are clear, specific and they safeguard taxpayers in a way that provides more certainty for them. The French case law developed by the *Conseil d'État* is welcomed as it gives clear guidelines on how taxpayers can structure their business in an efficient and legal way.

These domestic provisions are consistent with the international concept of beneficial ownership. Naturally, the *Conseil d'État* does not hesitate to engage itself with the International concept when necessary (i.e. *Bank of Scotland*[154]) or to clarify its position on this concept (i.e. through opinions[155]).

4. Conclusion

> *The desire to escape taxation is normal. It is even inconceivable that the taxpayer could have a different attitude. What one would think of a taxpayer who in the course of a commercial transaction would start by wondering what he can do to pay the highest amount of taxes? It is not natural that he asks the reverse? And in doing so, one must admit that he will act as a good pater familias in the Latin sense of the word, i.e. as a 'prudent man'.*[156]

As it has been said, 'the desire to escape taxation is normal.' The main danger in setting rules to deal with treaty-shopping or more generally improper use of tax treaties, is to create more uncertainty for taxpayers. The UN, the OECD and countries such as France, are increasingly aware of this issue.

The OECD's constant updates can create uncertainties for taxpayers. However, a majority of the OECD works tends to clarify treaty concepts. The beneficial ownership notion is among them. Its evolution between 1977 when it was first introduced in the OECD Model and 2014, when the definitive Commentaries to

Articles 10, 11 and 12 was released shows the tenacity of the OECD to always improve its Model. Thirty seven years later, a proper definition of the concept of beneficial ownership made a colossal step forward in that direction.

The UN Model's desire to be an outstanding alternative to the OECD Model is not yet satisfied. Nevertheless, the ambition of the UN to update its Model more frequently should be recognised. On the other hand, the United Nations should not

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154 (n 142).

155 (n 139).

156 Speech given on the 3rd of March 1962 by Professor Victor Gotho, conference at 'l'école Supérieure des Sciences Fiscales'

fear to take their own stance. The UN Model should be an effective though deviating alternative to the OECD Model.

Finally, France and its *Conseil d'État* are little by little giving details of the conditions for applying the principle of Fraud to the law included in the GAAR. The *Conseil d'État*'s position vis-à-vis the relationship between the *Abus de droit*, the GAAR and the beneficial ownership test is now steady and offers certainty to taxpayers.

After dissecting meticulously the topic, it seems indisputable that no solution stands out to tackle the abuse of tax treaties related to passive incomes. If in the past it seems that each country could find its own way to deal with this issue, the OECD and G20 Base Erosion and Profit Shifting Project (BEPS) may be a game changer.

Action 6 of BEPS is dedicated to the Abuse of tax treaties and gave rise to a publication entitled 'Preventing the Granting of Treaty Benefits in Inappropriate Circumstances' in September 2015. In this publication, the concept of Beneficial Ownership only mentioned twice as a potential tool to combat treaty-shopping in relation to passive income. However, BEPS advocates for a more global solution and tends to favour the Limitation on Benefit (LoB) clauses in the tax treaty ambit. The influence of the United States on the BEPS Project has never been so deliberate since the LoBs is a strong component of the US arsenal to avoid treaty abuse. Only time will tell if BEPS will be game-changing or time-wasting.