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European and International Tax Moot Court Competition - 2014/2015

Memorandum for the applicant
Memorandum for the defendant

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Il presente lavoro nasce dalla partecipazione dell'Università Luiss Guido Carli alla European and International Tax Moot Court Competition organizzata dalla European Tax College Foundation di Lovanio.

Si tratta di una competizione che riproduce un processo, in cui le delegazioni di alcune università europee ed americane si affrontano su uno specifico tema di diritto tributario internazionale e/o comunitario. Simulando tanto la fase scritta quanto il contraddittorio orale dinanzi all'autorità giudiziaria di un ipotetico Stato, le differenti squadre hanno proceduto, in questa edizione, all'analisi di un caso avente ad oggetto gli effetti fiscali dei rapporti intercorrenti tra una società di investimento, una società operativa ed un fondo pensione con sede legale in differenti Stati. Per la soluzione del caso, era necessaria la disamina non solo di questioni poste dai diritti dei singoli Stati coinvolti, ma anche di questioni poste dal diritto internazionale dei trattati, con particolare riferimento alla loro applicabilità nel caso concreto e all'individuazione delle nozioni di *genuine business* e *beneficial owner*.

I capitoli II, III e IV, parte B, n. 1) del *Memorandum for the applicant* ed i capitoli II, III e IV, parte B, n. 1) del *Memorandum for the defendant* sono stati redatti dal dott. Francesco Capogrossi.
Il capitolo IV, parte B, n. 2) del *Memorandum for the applicant* ed il capitolo IV, parte B, n. 2), capoversi 57-85 del *Memorandum for the defendant* sono stati redatti dal dott. Francesco Castro.
Il capitolo IV, parte A, n. 1) e parte B, n. 3) del *Memorandum for the applicant* ed il capitolo IV, parte A, n. 1) e parte B, n. 2, capoversi 86-99 del *Memorandum for the defendant* sono stati redatti dal dott. Alessandro Panici.

Il dott. Giuseppe Giangrande, il dott. Alessio Persiani ed il dott. Federico Rasi hanno assistito gli studenti nella preparazione dei lavori e nella successiva fase orale.
I lavori sono stati diretti dal Prof. Giuseppe Melis e dal Dott. Eugenio Ruggiero quali *team coach* della delegazione LUISS.

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II. STATEMENT OF FACTS

A is a world-known leading investment portfolio company, created in 2000 as a result of a merger of several investment companies and incorporated as a public limited liability company. Since its formation in 2000, its seat and place of effective management have been located in state *A*. It is liable and subject to corporate income tax in state *A*.

B is a small private pension fund, founded in 2002, incorporated as a foundation, and formed and operating in accordance with state *B*'s domestic law. It is considered, for tax purposes, as resident in state *B,* where pension funds are subject to the Corporate Income Tax. Its growth rate is historically higher than comparable pension funds (mainly due to the adoption of a bolder investment strategy).

C is a public limited liability company, founded in 1995, that is resident in state *C* and it is a leading company in its sector. It is in good financial situation and is regarded as one of the drivers of the economy of its region.

Between State *A* and State *B* there has been a tax treaty in force since 1995. It was negotiated and patterned on the 1992 version of the OECD Model. The main deviation is found in article 10(2)(a), under which the applicable tax rate, for dividends, is 0%.

Between State *B* and State *C* there was tax treaty in force between 1995 and 31 August 2014, and was negotiated and patterned on the 1992 version of the OECD Model. It was replaced by another tax treaty that entered into force on 01 September 2014 (already patterned on the 2014 OECD Model). Article 10(2)(a) contains no deviation from the OECD Model. However, there is a deviation in article 11(2), such that the tax rate is 5%.

Company *C* held a shareholding of 26% in company *A*, but because the tax treaty (which provided a deviation at Article 10 (2)(a) the applicable tax rate for the distribution of dividends was 0%) between States *A* and *C* terminated in 2005, in 2006 the new board of directors of *C* (that in the same year was completely replaced) decided to sell its position in *A* to the pension fund *B*.

The board firstly had allowed a payment in instalments; however this proposal, in a second time was rejected. In front of the intention of *B* to seek a bank loan in order to obtain the funds needed to pay for the shares, company *C* decided to offer itself the loan to B, at the same market conditions that a bank would grant. *B* accepted this and obtained the loan (and effectively used the loan to pay the shares).

When the pension fund *B* and company *C* entered into the loan agreement, to determine the conditions of remuneration of the interest from *B* to *C*, have indexed the rate (which in any case is considered by all parties to be at arm's length condition) to the average yield dividends that in the previous five years company *A* had distributed to company *C*.

The negotiations for the purchase of the participation and the loan were held separately, but executives took advantage of the last business trips to negotiate also the conditions for the loan, and although the two transactions were effected in separate documents, they were signed on the same date.

It is agreed that all negotiations started with *C*'s intention to sell its shareholding in *A*; the loan agreement arose as a result of the cash flow needs faced by *B*, due to that acquisition (expressed in the course of negotiations).

It is established that the termination or breach of one of the agreements does not trigger any consequences regarding the other agreement and also the sale of the shareholding by *B* to another subject will not affect the payment of interests.

In particular the deal was structured such that the repayment of interest (by *B*, to *C*) matches, as said, the average historic payment of dividends by *A*, over the last 5 years.; the time of repayment of the loan is 30 years (so it will finish in 2036), except for the verification of two specific conditions: in fact, an additional clause states that if A does not pay dividends, B may defer the payment of interests to C (add one extra year to the total repayment period/years) and that if the amount of dividends paid by A is 3% higher or lower that the amount of the fixed interest stipulated between B and C, the amount of the payable interest must be adjusted to the amount of the dividends (the necessary corrections would be made in the last year(s) of the repayment of the loan). Moreover was stated that the payment of interest must be done within 30 days after the receipt, in B's bank account, of the dividends paid by *A*.

Furthermore in State A, the domestic law states that before paying dividends or interest to a non-resident subject, a corporate resident is obliged to withhold taxes (under domestic law or, if applicable, the relevant tax treaty).

It is important to note that the resident paying agent (in the case A company) must verify compliance with the applicable tax treaty before applying the more favourable conditions contained therein. Resident paying agents are jointly (solidarity principle) responsible for any tax not correctly withheld.

In addition to meeting the requirements under the treaty, non-residents must also provide a certificate of tax residency to the resident paying agent in order to combat tax fraud and avoidance, as well as to ensure international tax transparency

This certificate (required since 2006 by an act of the parliament) must include the following parts: (i) full identification of the company, (ii) statement of its residence for tax purposes and the criterion based on which that classification was based, (iii) statement that for tax purposes, and under the terms of an income tax treaty concluded with a third state, the company is not considered as a resident for tax purposes in a third state, (iv) statement that the company is subject to corporate income tax, without any possibility of option or exemption.

Tax Authorities carried out an audit regarding the payments of dividends between A and B between 2010 and 2014 (as allowed under the domestic statute of limitations). They concluded that A had erroneously applied the A-B tax treaty (the withholding tax rate mentioned therein):

First, the tax authorities noted that the certificate presented (mentioning only the residence of B, due to its seat and place of effective management in state B) was not what is required under domestic law as, namely, (i) it did not mention that B was not a resident of any other state under a treaty signed by state B with another jurisdiction, and (ii) although it mentioned that the company was subject to tax, it did not mentioned that the company was (or not) exempt or had any possibility of option. It has to be said that pension fund B has provided a certificate of tax residency that, despite fulfilled all the requisites required in its state of residency (State B), missed the parts just named of the one requested in State A, but during the proceedings the Tax Authorities acknowledged the evidence presented by A and B that showed that B could never be considered a third state resident and that it was subject to corporate income tax.

Secondly, expressed doubts as to whether the pension fund could be considered entitled to treaty benefits and whether it could even be regarded as the beneficial owner of the income. In an excerpt from the audit report, they mentioned that in order to assess the issue of beneficial ownership, the proper version of the Commentary on the OECD Model to be used is the current (2014) one.

Finally, expressed doubts as to whether this company had sufficient substance in order to be considered a genuine business.

The Tax Payer, on the other hand, asserts that the pension fund is entitled to tax treaty benefits and, therefore, that it has withheld the correct amount of tax so no extra tax or penalty may be imposed.

Moreover it asserts that the pension fund is the beneficial owner and that the standards that should be used for interpretation are those of the version of the Commentary on the OECD Model of the moment when the treaty was being negotiated.

III. ISSUES

The present case involves many juridical questions and topics that can be summarized as follows:

I. PART A: APPLICATION OF THE A-B TREATY TO B PENSION FUND

1. B pension fund is entitled to A-B tax treaty benefits
   1.1. B pension fund must be considered a “person” in the meaning of the term given by OECD Commentary at art. 3 paragraph 1 (2)(3), which comprehends companies and any other entity treated as body corporate for purposes of tax law in their state of residency.
   1.2. B pension fund is resident in state B, because it is formed and operates in accordance to state B domestic law and has its place of effective management there. These circumstances respect the requirements stated by art. 4 of OECD Model Convention about residency.
   1.3. According to State B domestic legislation, in particular the Corporate Income Tax Code, Pension funds are subject to the Corporate Income Tax, whom rate is 10%.
   1.4. B, because is a pension fund formed and operating in accordance with State B domestic law, may refrain from paying corporate income tax, as stated by a special provision for pension funds contained in the Tax Incentives Code.

II. PART B: INTERPRETATION OF THE TERM "BENEFICIAL OWNER"

1. In preliminary order: Use of the OECD Commentary as an instrument of interpretation of tax treaties
   1.1. Given that A-B tax treaty was drafted in 1995 on the base of 1992 OECD Model Convention, despite it is a non binding legal instrument, has to be used the OECD Commentary as a mean of interpretation.
   1.2. State B is not an OECD Member State and it has not taken part to the development of the later versions of OECD Model Convention and Commentary. Secondly, it has to be followed the international law authoritative rule *pacta sunt servanda*, for these reasons the 1992 Version of OECD Commentary must be used to interpret the treaty.

2. B Pension Fund is the beneficial owner of the income derived from the payment of dividends by company A

2.1. B pension fund is subject to the corporate income tax on dividends, according to the Corporate Income Tax Code of State B.

2.2. B pension fund, according to the deal with company C does not have to transfer any dividend to it, but the rate of return of dividends paid by company A to B is only a parameter for the payment of interests of a separate and untrammelled loan contract between B and company C.

2.3. Dividends paid from company A to B pension fund became an item of income of the latter and they are subjected to actions by creditors, on the other hand company C cannot share or enjoy such dividends.

3. <u>B pension fund is a genuine business.</u>

3.1. B is an “open” pension fund, that means that it supports at least one pension plan that is not restricted on membership, it has multiples employers participating in it. Indeed B pension fund has a high growth rate because its bold investment strategy.

3.2. B existed before the agreements for these transactions, in fact it was formed in 2002 and certainly it is not a conduit company exclusively formed for "treaty shopping" purposes.

3.3. B could dispose freely (e.g. to sell) its position in entity A, acquired from entity C (a shareholding 26 %), even before the repayment of the loan obtained from company C.

IV. ARGUMENTS

I. PART A: APPLICATION OF THE A-B TREATY TO B PENSION FUND

1) B pension fund is entitled to A-B Tax Treaty benefits

1. In this part we are going to demonstrate that the taxpayer Company A, that is jointly liable (according to the solidarity principle) with B Pension Fund (hereinafter: B P.F.), has operated in compliance with the law, either the domestic one of State A and the Double Taxation Convention (hereinafter: DTC) signed with the State B, therefore B P.F. is effectively entitled to the A-B Treaty benefits.
2. In order to do that, we must show that for the purposes of the DTC in question, B P.F. is regarded as an "*entity*" that falls under the meaning of the Treaty and as a resident subject according to the same provision.
3. Moving from the text of the OECD Model Convention (hereinafter: OECD MC) and as suggested by the related Commentary, Art. 3 para.1 (2) (3)[1] affirms that the term "*person*" in subparagraph a) is not exhaustive and should be read in a very wide sense. The definition refers to individuals, companies and other bodies of persons. In addition from the meaning given to the term "*company*" in subparagraph b) the term "*person*" includes any entity that is treated as a body corporate for tax purposes.
4. From these premises a foundation falls within the meaning of the term "*person*" and its national status derives from the law in force in the Contracting State as affirmed by para. 9 of the Commentary to Art. 3[2].
5. It being understood that B P.F is considered a "*person*" within the meaning of the DTC between States A and B and the general interpretation of the OECD, and regarding the status of "*company*", B P.F. is treated as a body corporate for tax purposes in the Home State (B),

[1] Art. 3 para. 1 of OECD MC 1992: "*for the purposes of this Convention, unless the context otherwise requires: a) the term "person" includes an individual, a company and any other body of persons; b) the term "company" means any body corporate or any entity which is treated as a body corporate for tax purposes*".

[2] Commentary to Art. 3 para.9: *"[…] by declaring that any legal person, partnership or association deriving its status as such from the laws in force in a Contracting State is considered to be a national, the provision disposes of a difficulty which often arises in determining the nationality of companies. In defining the nationality of companies, certain State have regard less to the law which governs the company than to the origin of the capital with which the company was formed or the nationality of the individuals or legal persons controlling it*".

Art. 4 of the OECD MC about residency is decisive whether B P.F. could be considered an entity than can be entitled to the treaty benefits.

6. Secondly, the evidence of the fact that B P.F. could never be considered a third state resident and that it was subject to CIT was presented during the proceedings and it was acknowledged by Tax Authorities.
7. In fact B P.F. is a taxable entity according to State B domestic legislation and pension funds are considered as taxable persons under the Corporate Income Tax Code (hereinafter: CITC), which provides for a rate (also applicable to dividends) of 10%.
8. A different act from the CITC, the Tax Incentives Code (hereinafter: TIC) states that income received by pension funds, insofar as formed and operating in accordance with domestic law, is exempt from Corporate Income Tax (hereinafter: CIT).
9. It is important to remember the principle of law "*lex specialis derogat generali*", that is a doctrine relating to the interpretation of laws according to which, "*where two laws govern the same factual situation, a law governing a specific subject matter (lex specialis) overrides a law which only governs general matters (lex generalis)"*[3]. The TIC falls under the definition of "*lex specialis*" so it overrides the CITC.
10. In addition B P.F. is a taxable entity according to domestic legislation of State B (following the criteria of "*full tax liability*" established in Art. 4 OECD MC regarding "*residency*" and related Commentary, same rule either in the 1992 and 2014 versions of the OECD MC) and falls under the term "*person*" provided in Art. 3 OECD MC.
11. Thirdly the fact that B P.F. is effectively resident in State B and cannot be considered a third state resident can be deduced by these prerogatives: (i) it has several bank accounts in banks located in State B, (ii) it has normal (qualified) employees, (iii) it has normal gross income and normal net profits for a small pension fund and (iv) its place of effective management (POEM) is located in State B[4].

[3] Principle of resolution of conflicts between dispositions generally accepted both in National either International Law.

[4] *Clarification 8*: B uses different bank accounts for the receivables and payments located in state B. Pension fund B has several bank accounts in banks located in state B. The receivables and payments are made interchangeably from these accounts. There is no specific reason why one account is used for a particular receivable or payment and it was not possible to trace which receivables were used for the payments.
Clarification 22: B has normal (qualified) employees, normal gross income and normal net profits for a small pension fund.
Clarification 29: The fact that the evidence presented by A and B shows that B could never be considered a third-state resident mean that its place of effective management (POEM) is located in State B.

12. Moreover it fulfils, even if it is not asked to, some substantive requirements that are compulsory for entities subject to CIT that are resident in States A[5] and C according their domestic legislation: in fact the domestic legislation of State B does not ask pension funds for particular substance requirements.
13. For these reason there are not any doubts that B P.F. is fully entitled to obtain the benefits and conditions established by the Treaty between State A and B because it is a "*person*" under the meaning of the DTC, it is subject to the CIT in its State of residency and it is not considered, for tax purposes, a third state resident.

II. PART B: INTERPRETATION OF "BENEFICIAL OWNERSHIP" CONCEPT IN THE OECD MODEL CONVENTION

1) In preliminary order: Use of the OECD Commentary as an instrument of interpretation of A-B tax treaty

14. In this part it will be explained how a DTC based on the OECD MC must be interpreted, which means have to be used and that in this case that A-B DTC, signed in 1995, has its natural instrument of interpretation the OECD Commentary available at the time the treaty was signed.
15. When we have to deal with an international treaty, regardless of its matter, even a tax treaty, we must interpret it making reference to the rules that international law provides us.
16. First of all, the main rule that we have to take into consideration is "*Pacta sunt Servanda"*, universally recognised as the basis of every international agreement between States. Secondly, but not less important, we have to refer to the Vienna Convention 23 May 1969 on Law of Treaties (hereinafter: VCLT).
17. A treaty is an agreement between two or more parties, and its interpretation, therefore, has to be based on the insights and the intention of those parties at the time the agreement was concluded.

[5] (i) have a registered address and office in state *A*, (iv) the most significant board decisions are taken in state *A*, (v) the main bank account is located in state *A*.

18. Later developments are in principle irrelevant, because the Contracting States are not able to take these into account and their Parliaments have not the opportunity to approve the agreement in light of these developments.
19. Tax treaties have an extensive effect on third parties[6] and can be viewed as consisting mainly in agreements and clauses on behalf of the residents of the Contracting States: they can be seen as extraordinary tax law, as long has they are not domestic legislation, that determine international tax position of the residents. Taxpayers must have certainty about their future tax obligation, based on the treaty text and on the circumstances existing at the time the treaty text was agreed. It is not possible to change these obligations to their disadvantage unless to that change is accorded by same democratic legitimacy as the treaty itself.
20. DTCs are, as said before, international agreements. In international law, the interpretation of treaties is codified in Articles 31 and 32 VCLT. The general rule of Article 31 (1) VCLT[7] is divided into three main areas:

- the rule of literal interpretation: "*the ordinary meaning of terms of the treaty in their context*";
- the rule of interpretation in good faith;
- the reference to the object and purpose of the treaty.

21. This provision emphasizes, above all, in accordance with the general principle of international law "*pacta sunt servanda"* just mentioned, the interpretation of the treaty in good faith and it is essentially a specification of the principle above mentioned. Then, it indicates as the main means to interpret the research of the common sense of the terms of the Convention having regard to the context in which are inserted and in the light of the object and purpose of the treaty.
22. An exception can be admitted for a specified period if the parties have attributed a special meaning and if it is clearly indicated that it was their intention (paragraph 4).
23. Based on the wording of the provision in question, it is common to state that the use of methods of interpretation different from the literal one is possible only in the case the

[6] P. J. WATTEL and O. MARRES, The Legal Status of the OECD Commentary and Static or Ambulatory Interpretation of Tax Treaties, in European Taxation., 7-8/2003, p. 222

[7] VCLT Art. 31, Para. 1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

interpretation carried out according to said method leads to results obscure, absurd or in conflict with other provisions.

24. However, it is now accepted that very rarely the sole literal method is in itself sufficient to enable a correct interpretation of the rule, and this is for the difficulties of semantic and syntactic nature related to it, and sometimes for the same inaccuracy of the texts to interpret.
25. Art.31, para. 2, makes it clear that: "*In interpreting a treaty, the context includes, in addition to the text, the preamble and annexes including: a) any agreement relating to the treaty which was made between all the parties at the conclusion of the treaty; b) each instrument which was made by one or more parties at the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty*".
26. The interpreter, in addition to the context, must also take into account, in accordance with Art. 31 para. 3, "*any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions" (a), the practical application of the Treaty when there is an apparent agreement between the parties on interpretation (b). Finally, in step c) there is a reference to unspecified "relevant rules of international law, applicable to the relationship between the parts*".
27. In such a conception, preparatory works, in which should be given relevance to the current will of the parties, have a subsidiary or additional function. In fact Art. 32 VCLT allows the usage of all complementary means of interpretation, in particular the preparatory works and the circumstances in which the treaty was concluded.
28. The purpose is to confirm the meaning resulting from Art. 31, or to determine the meaning when the interpretation according to Art. 31: a) leaves the meaning ambiguous or obscure; or b) leads to a result that is manifestly absurd or unreasonable.
29. Basically, the bottom line of the approach followed by the Vienna Convention in the interpretation of treaties can be defined as "textual" or “objective". This means that, in the first place, the "ordinary meaning" of the text of the treaty has to be determined according to the will of the contracting parties.
30. The terms of the Treaty must be interpreted "*in their context*" but in this meaning the notion of "*context*" is used in a very restricted sense. It includes only bilateral agreements and instruments arranged "at the conclusion of the treaty".

31. Art. 31 para. 3[8] specifies that the context includes its preamble and attachments in addition to the text, and that in interpreting a treaty it will be taken into account together with the context: either any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions, as well as any subsequent practice in the application of the Treaty established by the agreement of the parties with respect to the interpretation of the Treaty.
32. These provisions are all intended to determine the ordinary meaning of words used in the framework of a well-defined and delimited context. Art. 31 para. 4[9], however, goes beyond and provides that a term or expression may have a meaning "special" if it is satisfied that this was the intention of the parties.
33. Art. 32 allows the use of "*supplementary means*" of interpretation, in overcoming the constraints contained in Art. 31, only upon the occurrence of certain defined circumstances. The situations considered by that provision are those in which the application of Art. 31 gives rise to an interpretation of the meaning which appears "ambiguous or obscure" or lead to a "manifestly absurd or unreasonable result".
34. Given the structure of the Vienna Convention as well as its authoritative position in favour of a textual interpretation as much as possible, it seems hard to imagine if, despite the intentions expressed by the editors of the Commentary to the OECD MC, this can play, in any capacity, a legally significant role in interpretation of bilateral tax treaties. Scholars[10] have argued that Commentaries could be viewed as "an instrument made in connection with the conclusion of the treaty" and as such relevant under article 31. Another authoritative tenet[11], on the other hand, revises a "loose legal duty" to follow the Commentaries in treaty practice in the recommendations of the OECD Council adopted when a Model Convention is concluded, in which the Committee prescribes to conform to the Model Convention as interpreted by the Commentaries.

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[8] VCLT Art. 31, Para. 3: "*There shall be taken into account, together with the context: (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions; (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation; (c) any relevant rules of international law applicable in the relations between the parties*".

[9] VCLT Art. 31, para. 4: "*A special meaning shall be given to a term if it is established that the parties so intended*".

[10] C. Van Raad, *Interpretatie van belastingverdragen*, MBB 1978, p. 55.

[11] Klaus Vogel, *On Double Taxation Corlventions,* Kluwer, 1991, p. 33.

35. In consideration of the above mentioned, we assume that the relevance of the OECD commentaries interpreting a treaty is in line with the interpretation previously conveyed[12], Art. 31(2) VCLT provides that, in addition to the text of the treaty with its preamble and the annexes, "*context*" within the meaning of the first paragraph of the articles includes: 1) any agreement relating to the treaty which was made among all the parties in connexion with the conclusion of the treaty; 2) any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
36. It follows that since the Commentary came into existence in joint consultation with the member countries, which were given the opportunity to make reservation with respect to its contents, it would be justified to call it a contextual instrument within the meaning of Art. 31(2)(b) of VCLT, in fact the drafting process of the OECD Commentaries allows member States to note their observations to interpretations at the time the commentaries are adopted.
37. Established the authority of the OECD Commentary as an instrument adopted by the parties in connexion with the conclusion of the treaty, it is consequential that a new Commentary is relevant only for treaties signed posteriorly, that are concluded between OECD members or with non member States that have taken a position without reservation or observation on the provision in question.
38. However we have to say that Contracting States are not the ones who draft and agree upon the Commentary, but the governmental representatives of OECD members or even third party countries.
39. Provided that usually a treaty is negotiated and concluded by the same governmental representatives, as a rule, the treaty will only bind their countries after its ratification, usually by way of an approving act of parliament.
40. The executive power to contribute and agree to an update of the Commentary cannot be identified with a contracting State agreeing to something: it lacks the required democratic legitimacy.
41. OECD Commentary does not cover treaties that have actually been concluded. The OECD MC is a model for treaties that have not been concluded yet, it was not drafted with a view to individual, in-force treaties. The Commentary itself states explicitly that it was not drafted

[12] C. Van Raad, note 6.

for inclusion in treaties and that only treaties that are effectively concluded are legally binding.

42. It follows that the Commentary is not necessarily part of the context of a particular tax treaty, but only if the treaty concluded does not deviate from the OECD Model and if it has been made clear that OECD views have been followed.
43. The case law of the Netherlands Supreme Court[13] confirms this approach: it considered the Commentary "of great importance" if the Contracting States have clearly wanted to follow the OECD MC and the provision to be interpreted is identical to the corresponding OECD MC provision. In this case the Court has showed that the Treaty provision was to be interpreted identically to the corresponding provision of the OECD MC, since the Contracting States intended to follow the OECD MC as closely as possible, which could be inferred by the fact that both parties had referred to their intention to follow the OECD MC and that many of the provisions in the treaty also closely followed the OECD MC.
44. The same body drafts model Convention and Commentary, so the latter reflects the intentions of the first one. If the Contracting States follow the OECD MC literally, it is a strong indication that both countries adhere to the commentary at that time, so versions of the Commentary that are posterior to the date of the conclusion of the treaty can never be seen as part of the context of the treaty.
45. Post-treaty changes to the Commentary cannot be considered to meet these criteria: they do not contain agreement about the interpretation of treaties already in force, but rather an interpretation of the OECD Model. Neither post-treaty changes to the Commentary form "*subsequent practice*" in application of the treaty: it can be deduced from application of a particular tax treaty in accordance with the changes in the commentary, but several years have to pass to show such a practice.
46. It is clear from the above that the Commentary that was current at the time the treaty was concluded can be subsumed under "*context*" within the meaning of Art.31 of VCLT provided that it follows the OECD MC and that the executives have been made clear that it is based on OECD insights. Later versions, on the other hand, cannot be considered "*context*" or "*subsequent agreement or practice*" within the meaning of Art. 31(2) of the VCLT, but represent only the development and update of the thought of the members of the

[13] Supreme Court, 5 September 2003, *BNB 2003/380*, para. 3.5, confirmed by the a Supreme Court judgement of 13 May 2005, *BNB 2005/232-235*.

Committee and of the interpretation of certain provisions, provided that they are not changed on the OECD MC (otherwise, if it were also changed the model, they should definitely not be considered).

47. The only way to give importance to the subsequent commentaries is to consider them as "*supplementary means clustering of interpretation*", namely useful means to support or replace the primary interpretation if it leads to absurd or unreasonable results.
48. Scholars[14] argued that the Commentary of the time when the treaty was signed and the more recent ones are very useful aid, but they have two different weights. In fact, the first reflects the interpretation of the provision on which the parties agreed, the other its evolution and its change of approach.
49. As a matter of law, and referring to the principle "*pacta sunt servanda*" we can say that the Commentary at the time the treaty was negotiated is "*context*" if the two conditions explained above are met, on the other hand that the later versions are policy statements that may be invoked by the taxpayers under the principle of legitimate expectations.
50. As said until now, we come to the conclusion that in the case, the Commentary at the time the treaty was negotiated (1992) is "*context*" for the interpretation of treaties with non members, as it is State B, provided that: 1) the treaty follows the OECD MC, 2) it was presented to the parliaments as being in conformity with OECD MC, 3) at the time the treaty was concluded, State B (non member) had taken a position with respect to the OECD MC and Commentary and had not deviated on relevant points.
51. When earlier treaties are applied, post-treaty versions of the Commentary to which a government has agreed within the OECD Council should be regarded as policy regulations, or supplementary means of interpretation, comparable to authoritative literature, so the authority of these versions diminishes depending on whether substantive rather than significant changes are incorporated in the later versions.
52. It also diminishes according to the extent one of the treaty partners is less associated with the OECD, like State B that is a non-member. Moreover no significance can be attached clearly at odds with the version current at the time of treaty conclusion and/or with the wording of the specific treaty to be applied.
53. We come to the conclusion that, as far as examined, we have to take into account the importance that the OECD Commentary covers in the interpretation of tax treaties based on

[14] P. BAKER, *Double Taxation Conventions,* Thomson Sweet & Maxwell, 2007.

the OECD MC the mandatory and basic rule of international law "*pacta sunt servanda*" and the equally compelling rules of interpretation of Art. 31 following the VCLT.

54. Secondly, but equally important, taking also into consideration that one of the countries parties of the treaty (state B) is not a OECD member state, we must not think differently from believing that, because the treaty in question was negotiated and concluded in 1995 on the basis of the OECD MC 1992 unreservedly by both states, it must be interpreted using the model present when the treaty was negotiated, namely that of 1992.

2) B Pension Fund is the "beneficial owner" of dividends paid by A

55. In this section we are going to demonstrate that the deals incurred between Company A and B P.F. do not infringe the provision of the DTC, because B P.F. is the real "beneficial owner" of the income (dividends) received by Company A, and therefore, it is entitled to tax treaty benefits.

56. Regarding the term "beneficial owner", as used in Art. 10 (Dividends) in the case at hand, (also used in Arts. 11 for interests and 12 for royalties), has been subject to a substantial evolution throughout the history of OECD.

57. Since it was first introduced in the 1977 OECD MC and Commentary, it is a common recognition that further clarifications of the concept gave a broader approach and meaning of the term.

58. Prior to the current version of the OECD MC and Commentary, in order to clarify the "beneficial owner" concept, the OECD has considered the term on several earlier occasions: 1) 1986, Conduit Companies Report; 2) 1995, OECD MC and Commentary amendments on the wording of the Dividends, Interest and Royalties; 3) 1999, Partnership Report; 4) 2003, Amendments on Commentary to Arts. 10, 11 and 12.

59. The 1986 Report sought to extend the scope of the concept: "The Commentaries mention the case of a nominee or agent. The provisions would, however, apply also to other cases where a person enters into contracts or takes over obligations under which he has a similar function to those of a nominee or an agent. Thus 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)"[15].

[15] Conduit Companies Report, above fn.13, 14(b) at R(6)-8

60. The wording inserted in 1992 goes on to incorporate the extension of the beneficial ownership concept set out in the 1986 Conduit Companies Report.
61. Para. 12 of the Commentary (1992 version) on Art. 10 para. 2 states that in the State of source (State A) the beneficial owner concept is available only when an intermediary (agent or nominee) is not interposed between the beneficiary and the payer, unless the beneficial owner resides in the other Contracting State[16].
62. Thus, the amended wording introduces some greater subjectivity and uncertainty into the beneficial owner test but does not seem to contemplate a materially different standard than that which had previously existed.
63. This makes clear that the term ''beneficial owner'' as used in the OECD model is not intended to be interpreted based on, or to refer to, any technical meaning that it could have under the domestic law of a specific country; rather, the term should be understood in its treaty context and in light of the object and purposes of the model treaty, including avoiding double taxation and preventing fiscal evasion and avoidance. That additional explanation clearly suggests the need for a treaty-based international approach.
64. For this reason the "beneficial ownership" test in the case in question must focus on a cognitive survey based on whether B P.F. can be regarded as: 1) agent, 2) nominee or 3) conduit company acting on the account of another party.
65. According to Art.1 para. 8 of 1992 OECD Commentary on the "*Improper use of the Convention*" such manoeuvres as they make it possible, through the creation of usually artificial legal constructions, to benefit both from the tax advantages available under certain domestic laws and the reliefs from tax provided for in DTCs. In this way, a person who is resident or not in one of the Contracting States obtains benefits not directly due to it. This is the reason for which it was introduced the beneficial ownership concept. There is not a definitive text and there are not strict recommendations but only suggested benchmarks have been drafted to limit conduit companies proliferation.
66. In the case at hand it is impossible to prove that B P.F. is an artificial legal construction (known commonly as conduit companies, special purpose vehicles, etc.) because it was created in 2002 and incorporated as a foundation, formed and operating in accordance with

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[16] 1992 OECD Commentary, Art.10, Para.12: "*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 [...]*".

the domestic legislation of B Contracting State, and it has normal (qualified) employees, normal gross income and normal net profits for a small pension fund[17].

67. According to Art. 1 para. 13 of the 1992 Commentary, the solution to the problem it is the following: firstly the non-recognition of the treaty benefits to the company that is not owned by residents of the same State; secondly, that the Contracting States would establish in bilateral negotiations how to determine the residency issue[18]. The case only refers to the fact that in B P.F. "more than 50% of its pension premium's income comes from State C". Given that the foundation is a separate legal entity and does not have "shareholders", State A and B treat normally foundations as opaque / non-transparent entities[19].
68. B P.F. is a small private pension fund, incorporated as a foundation, and even if its employers are resident in State C have not any right to manage and own, directly or indirectly, the foundation. They are not the owners, so B can legally enjoy the treaty benefits. Moreover there is not any other criterion included in the A-B Tax Treaty.
69. Also para. 17 of the Commentary on Art. 1 refers to this power to manage or control such company to identify a conduit situation, it provides that: "general subject-to-tax provisions provide that treaty benefits in the State of the source are granted only if the respective income is subject to tax in the State of residence".
70. This situation is the same of the case at hand: dividends paid from Company A to B P.F. are subject to CIT according to the domestic legislation of State B.
71. This corresponds basically to the aim of tax treaties, namely to avoid double taxation. For a number of reasons, however, the OECD MC does not recommend such a general provision. While this seems adequate with respect to a normal international relationship, a subject-to-tax approach might well be adopted in a typical conduit situation[20].

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[17] *Clarification 22*: B has normal (qualified) employees, normal gross income and normal net profits for a small pension fund.

[18] Art. 1, par. 13, of the 1992 OECD Commentary: "*A solution to the problem of conduit companies would be to disallow treaty benefits to a company insofar as the company is not owned, directly or indirectly, by residents of the Sate of which the company is a resident…Contracting States wishing to adopt such a provision may also want, in their bilateral negotiations, to determine the criteria according to which a company would be considered as owned or controlled by non-residents*".

[19] *Clarification 35*: The foundation is a separate legal entity and does not have "shareholders". State A and B treat normally foundations as opaque / non-transparent entities. The relevant differences in treatment are mentioned in the case.

[20] A safeguarding provision of this kind could have the following wording on the Commentary Art.1 para.17: "*Where income arising in a Contracting State is received by a company resident of the other Contracting State and one or more persons not resident in that other Contracting State a) have directly or indirectly or through one or more companies, wherever resident, a substantial interest in such a company, in the form of a participation or otherwise, and b) exercise directly or indirectly, alone or together, the management or control of such a company, any provision of this*

72. As above said, according to domestic legislation of State B, B P.F. is subject to CIT and this is the ordinary rule. The fact that TIC, which is a special provision in relation to CITC, exempts B P.F. from CIT is not relevant, this approach is sustained by a *bona fide* provision in the treaty to provide for the necessary flexibility[21].
73. In addition, para. 21 Lett. a) of the Commentary on Art 1 provides that: "*The foregoing provisions shall not apply where the company establishes that the principal purpose of the company, the conduct of its business and the acquisition or maintenance by it of the shareholding (...) from which the income in question is derived , are motivated by sound business reasons and thus do not have as primary purpose the obtaining of any benefits under this convention*"; and according to Lett. b) of the same paragraph: "*The foregoing provisions shall not apply where the company is engaged in substantive business operations in the Contracting State of which it is a resident and the relief from taxation claimed from the other Contracting State is with respect to income which is connected with such operations*".
74. It is self-evident that B P.F. did not put at the base of the transactions the only and mere obtainment of tax advantages, but simply enjoys a favorable condition given by its domestic law for all its income, not only for the one coming from states with which it was concluded a DTC.
75. The Tax Authorities must take into account the intense economic activity of B P.F., who is engaged in substantive business operations, in fact its growth rate is historically higher than comparable ones, mainly due to the adoption of a bolder investment strategy.
76. The logic of this deal has to be found in this good investment strategy and not in an undue fiscal advantage: it rewards the pension fund, which manages to amortize the cost of capital borrowed by Company C through the receipt of dividends by Company A. Even if B P.F. can already freely enjoy the income of dividends without any bond, when it will finish to pay the loan, which has a predetermined duration, B P.F. will find in any case the participation in company A which will distribute an income as dividens for B P.F. only benefit.

Convention conferring an exemption from, or a reduction of, tax shall apply only to income which is subject to tax in the last mentioned State under the ordinary rule of its tax laws".

[21] OECD Commentary 1992, Art. 1 para 18: "*[...] It will, however, be necessary to supplement this provision by inserting bona fide provisions in the treaty to provide for the necessary flexibility [...]*".

77. Art. 10 para. 8 provides that this article "deals only with dividend paid by a company which is resident of a Contracting State to a resident of the other Contracting State". According to Art. 3 B P.F. is resident in one of the Contracting State. We should not consider to the origin of the nationality of the individuals controlling it, if the criteria that need to be followed is the "full tax liability" principle.
78. B P.F. is a pension fund that operates correctly under the domestic legislation of the State in which it is resident and was constituted exclusively to administer or provide pension or other similar benefits. A business activity as is the investment in shares in order to ensure a better pension falls into the concept of "administration".
79. B P.F., was created in 2002, it has always implemented a "bolder investment strategy" and has every characteristic of an "open pension fund"[22]. Whereas the Tax Authorities use the latest version of the Commentary they cannot assume that B P.F. is a conduit and then deny a relief as required by para. 12.3 of the Commentary to the Art. 10[23], in fact it states that tax benefits cannot be granted if, through an agency or nominee relationship, simply acts like a conduit with very narrow powers which make it a fiduciary or administrator of another person, who indeed practically receives the income.
80. The conduit is a simple intermediary specially created to enjoy the benefits of the Treaty to another party who actually receives the income. In the *Indofood case,* an SPV was created in order to enjoy treaty benefits that would have not been granted if the real company had invested, in addition the SPV established in Netherlands did not have any physical substance. In the present case the B P.F. is the owner of the income that it receives from the Company A and itself benefits from it[24].
81. Furthermore, in Art. 10 para. 12.5 of the 2014 Commentary, it is stated that not every time the notion of B.O. agrees with cases of treaty shopping "Whilst the concept of "beneficial owner" deals with some forms of tax avoidance (those involving the interposition of a

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[22] *Clarification 13*: B is an "open" pension fund. This means that it supports at least one pension plan that is not restricted on membership. For instance, that the fund has multiples employers participating in it.

[23] *OECD Commentary 2014, Art.10, Par. 12.3*: "*It would be equally inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned. For these reasons, the report from the Committee on Fiscal Affairs entitled "Double Taxation Conventions and the Use of Conduit Companies" concludes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties*".

[24] Indofood International Finance Ltd v. JP Morgan Chase Bank NA London Branch, High Court of Justice Chancery Division [2006] EWCA Civ. 158 and Court of Appeal [2006] STC 1195.

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”. For example in the *Prèvost Car Inc. v. R (2008) 10 ITLR 736 (Tax Court Canada)*, the SPV had evident economic purpose of acting as a corporate nexus for two distinct investors.

82. There is not an intermediary, such an agent or nominee, between the beneficiary and the payer in the Moot case because B P.F. directly receives dividends from its subsidiary. B P.F. is the B.O., it has the sole right to enjoy and dispose of them.
83. Given that the investors of B P.F., as stated before, cannot be regarded as beneficial owners and that B P.F. could never be considered a conduit company, the last cognitive research involves the relationship with the previous owner of the subsidiary Company A, which is Company C from State C.
84. Art. 10, para. 25 of the Commentary either the version of 1992 or the 2014 is decisive: it emphasizes the economic risk, that is based on the fact that the payment of dividends depends on the success of the enterprise itself. This must be identified case by case. In the text we find a number of examples, including: 1) the loan very heavily outweighs any other contribution to the enterprise’s capital (or was taken out to replace a substantial proportion of capital which has been lost) and is substantially unmatched by redeemable assets; 2) the creditor will share in any profits of the company; 3) repayment of the loan is subordinated to claims of other creditors or to the payment of dividends; 4) the level or payment of interest would depend on the profits of the company; 5) the loan contract contains no fixed provisions for repayment by a definite date.
85. Since the loan agreement of B P.F. does not outweighs very heavily any other contribution of the enterprise’s capital and Company C does not share any profits of the Company A as it is possible to acknowledge given the arm’s length conditions of the loan[25].
86. The repayment of the loan is not subordinated to the payment of the dividends as the clause contained in the deal is only related to a parameter (3% range of the amount of dividends, which is adjustable) for a separate and untrammelled loan contract.
87. The repayment of interests for the loan has a definitive date, 30 years as specified in the deal and in the clarifications No. 17,18 and 19[26], then we can automatically exclude that the

[25] The tax authorities assessed the interest rate at arm’s length condition (last sentence in regarding these deals).

[26] *Clarifications 17, 18, 19*: “The repayment period is of 30 years. There is no provision in the contract providing a

lender C participates in the economic risk. In fact, negotiations were held separately, they were effected in separate documents and termination or breach of one of the agreements does not trigger any consequences regarding the other agreements (1st ,2nd and 4th dash of regarding these deals).

88. The latest version of Commentary (2014) on Art. 10 para. 12.4[27] explains why in the examples in para. 12.2 and 12.3 - which describes situations in which an item of income is paid to a person acting in the capacity of an agent or nominee, or as a conduit for another person who in fact receives the benefits of the income concerned – the recipient of the income is not the beneficial owner if he does not have the full right to use and enjoy the dividends received.
89. Therefore, in the case in question B P.F has the full right to use, enjoy and dispose of the income and moreover to sell, at any time, the shares acquired from Company C.
90. There is not any obligation (contractual, fiduciary or other duty) to pass on the payment received to another entity or person[28].
91. International treaties are concluded with the intent to generate and implement cross-border transactions. The purpose is to promote exchange of goods and services, as said in Art.1 para.7 OECD Commentary 1992[29], as it is deductible from the Preamble to the Convention. B P.F. has legitimately enjoyed an own right on the possibility to invest in State A.

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possibility of B to buy back the position in A. The loan is not convertible in shares or other equity-related instruments. B has to repay the loan. There are no abnormal penalties for contract breach regarding similar loans of the kind and note that termination or breach of one of the agreements does not trigger any consequences regarding the other agreement."

[27] OECD Commentary 2014, Art.10 para. 12.4: In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the direct recipient of the dividend is not the "beneficial owner" because that recipient's right to use and enjoy the dividend is constrained by a contractual or legal obligation to pass on the payment received to another person. Such an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person. This type of obligation would not include contractual or legal obligations that are not dependent on the receipt of the payment by the direct recipient such as an obligation that is not dependent on the receipt of the payment and which the direct recipient has as a debtor or as a party to financial transactions, or typical distribution obligations of pension schemes and of collective investment vehicles entitled to treaty benefits under the principles of paragraphs 6.8 to 6.34 of the Commentary on Article 1. Where he recipient of a dividend does have the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person, the recipient is the "beneficial owner" of that dividend. It should also be noted that Article 10 refers to the beneficial owner of a dividend as opposed to the owner of the shares, which may be different in some cases.

[28] E. Barret, *The changes introduced by the 2014 update to the OECD Model Tax Convention*, Bulletin for International Taxation, 2014 (vol. 64) no.10.

[29] OECD Commentary 1992, Art. 1 para. 7: "*The purpose of double taxation conventions is to promote, by eliminating international double taxation, exchanges of goods and services, and the movementi of capital and persons; they should not, however, help tax avoidance or evasion. True, taxpayers have the possibility, double taxation conventions being left aside, to exploit the differences in tax levels as between States and the tax advantages provided by various countries taxation laws, buti t is for the States concerned to adopt provisions in their domestic laws to counter possible*

92. It is clear from para. 10 of Art.10 where it is stated: "a lower rate (5 per cent) is expressly provided in respect of dividends paid by a subsidiary company to its parent company. If a company of one of the Contracting States owns directly a holding of at least 25 per cent in a company of the other State, it is reasonable that payments of profits by the subsidiary to the foreign parent company should be taxed less heavily to avoid recurrent taxation and to facilitate international investment."
93. According to para. 20 Art. 10 of the Commentary is not specified if the tax relief must be guaranteed by the State A in view of the fact that dividends should be taxed in the State B. Such a clause it is a matter of law of the two Contracting States in their bilateral negotiations. Since nothing is contained in the agreement there is no rule of reason or practical reasons to do not grant to B P.F. tax relief.
94. In broad terms, challenges of tax authorities on the applicability of treaties on the basis of the beneficial ownership test tend to consist of two main approaches: firstly, a challenge may be made based on the physical substance of the direct investor (offices, number of staff, etc.). Secondly, there may be a challenge based on the economic position of the direct investors.
95. The two approaches would lead to the same result: B P.F. is the beneficial owner of the dividends transferred by Company A.

3) B Pension Fund is a Genuine Business

96. We assume that B P.F. is a genuine business, which means that it operates only to achieve a better economic position with valid commercial reasons, and not to circumvent the provisions of the A-B DTC.
97. B is a small private (multi-employee, multi-employer) pension fund. According to the clarification number 13: "this means that it supports at least one pension plan that is not restricted on membership. For instance, that the fund has multiples employers participating in it."
98. If B P.F. has multiple employers, this means that is irrelevant what is their State of residency. They have not influence and decisive power on the investment strategy of the fund because "pension funds are independent legal entities that are established and

manoeuvres. Such States will then wish, in teir bilateral double taxation conventions, to preserve the application of provisions f this kind contained in their domestic laws".

managed mainly for the purpose of providing retirement… to the members of a pension plan"[30].

99. Being an independent legal entity, B P.F. has not any relation with Company A or Company C in terms of control, ownership or contributions to B P.F.. In fact, it is a pension fund carried out by different and multiple employers, and the employees of Company C have had their pension plans there before the transmission of Company A shares from Company C to entity B[31].

100. As stated in Clarification no.26[32] there was not an ownership interest between B P.F. and Company C at the moment of the transactions *sub judice*. The only interest in this transaction is the economic reason given by the favourable conditions under A-B Tax Treaty.

101. To reinforce this thesis it is important to remember the clarification number 8: B P.F. uses different bank accounts for receivables and payments and it has several bank accounts in banks located in State B. This means that B P.F. is totally independent at the moment of the repayment of interest to Company C.

102. Money is a fungible asset and B P.F. can dispose freely of it so it is not possible to trace which receivables were used for the payments. B P.F. has a growth rate that is historically higher than comparable pension funds (mainly due to the adoption of a bolder investment strategy). Due to that fact, and to the slightly higher returns offered, it receives (pension) premium funds from many countries.

103. The termination of the A-C Tax Treaty in 2006 was one of the reasons that led the board of Company C to sell its position in A. This position was bought by B P.F. which can take advantage of the tax benefits granted by A-B Tax Treaty. In this way B P.F. ensures to residents of State C slightly higher returns of the other pension funds.

104. Thanks to this strategy, B P.F. encourages the residents of State C to invest in it. This is one of the objectives of international tax treaties: to promote cross-border investments. Therefore, obtaining the benefits given by the A-B convention is in accordance with the object and purpose of the provisions of that convention.

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[30] Survey of Investment Regulation of Pension Funds, OECD Secretariat.

[31] *Clarification 25*: B Pension Fund did not have any relation whatsoever with company A or company C – i.e. in terms of control, ownership or contributions to B as a pension fund carried out by the employers or the employees of company C- before the transmission of company A shares from company C to company B.

[32] *Clarification 26*: There Was not any ownership interest between B and C at the moment of the transactions sub judice

105. "No or low taxation is not per se a cause of concern, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it"[33].

106. Companies should not be seen to be abusing Treaty benefits where a genuine business, like in this case, is set up. The example C provided in The Action 6 of B.E.P.S. project (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances)[34] is in line with this opinion.

107. It is clear that B P.F. is not a conduit company[35] exclusively formed for treaty shopping purposes. It was created in 2002, before the transaction *sub judice*, it can dispose freely its position in Company A also before repayment of loan obtained from Company C to buy the shares and it bears the economic risk of a value decrease of the shares of Company A, being obliged to continue to repay the loan even if the shares lose their value. It was clarified that B P.F. has an effective management located in State B, the State of its residence, and not in another country.

108. This means that it has own managers, and that it is not affected in its decisions by third parties because pension fund is an independent legal entity with its decisional autonomy. Moreover B P.F. can independently decide its investment policy, has no restrictions of any kind with other parties and it is not a wholly artificial arrangement.

109. For these reasons there is not any doubt about substance requirements of B P.F. that finally has to be considered a genuine business.

110. So, since it has been demonstrated that B P.F. is the real and only beneficial owner of the dividends received by Company A and that it is, without any doubts, a genuine business seen its substance features, it must be entitled to the A-B tax treaty benefits; therefore the tax payer Company A has rightfully abided by the treaty and applied the favorable conditions (0% withholding tax rate) to the dividends distributed.

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[33] Action Plan on *Base Erosion and Profit Shifting*, Chapter 1, Introduction, p.10.

[34] *OECD/G20 Base Erosion and Profit Shifting Project Preventing the Granting of Treaty Benefits in Inappropriate Circumstances,* page 72: RCo, a company resident of State R, is in the business of producing electronic devices and its business is expanding rapidly. It is now considering establishing a manufacturing plant in a developing country in order to benefit from lower manufacturing costs. After a preliminary review, possible locations in three different countries are identified. All three countries provide similar economic and political environments. After considering the fact that State S is the only one of these countries with which State R has a tax convention, the decision is made to build the plant in that State. In this example, whilst the decision to invest in State S is taken in the light of the benefits provided by the State R-State S tax convention, it is clear that the principal purposes for making that investment and building the plant are related to the expansion of RCo's business and the lower manufacturing costs of that country. In this example, it cannot reasonably be considered that one of the principal purposes for building the plant is to obtain treaty benefits.

[35] *OECD Glossary of Tax Terms*: Company set up in connection with a tax avoidance scheme, whereby income is paid by a company to the conduit and then redistributed by that company to its shareholders as dividends, interest, royalties, etc.

V. List of Abbreviations

Art.	Article
Clarif.	Clarification
Commentary	OECD Commentary on the Model Convention
DTCs	Double Taxation Conventions
ECJ	European Court of Justice
EoI	Exchange of information
EU	European Union
Lett.	Letter
Model	OECD Model Convention
OECD-based Tax Treaty	Tax Treaty based on the OECD Model Convention
OECD MC	OECD Model Convention on Income and Capital
Para.	Paragraph
SPV	Special Purpose Vehicle
TIEA	Tax Information Exchange Agreement

European Tax Moot Court Competition 2014/2015

MEMORANDUM FOR THE DEFENDANT

Registration number: C/001

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- U.S. 465, *Gregory v. Helvering*, 293 (1935);

II. Statement of facts

A is a world-known leading investment portfolio company, created in 2000 as a result of a merger of several investment companies and incorporated as a public limited liability company. Since its formation in 2000, its seat and place of effective management have been located in state *A*. It is liable and subject to corporate income tax in state *A*.

B is a small private pension fund, founded in 2002, incorporated as a foundation, and formed and operating in accordance with state *B*'s domestic law. It is considered, for tax purposes, as resident in state *B,* where pension funds are subject to the Corporate Income Tax. Its growth rate is historically higher than comparable pension funds (mainly due to the adoption of a bolder investment strategy).

C is a public limited liability company, founded in 1995, that is resident in state *C* and it is a leading company in its sector. It is in good financial situation and is regarded as one of the drivers of the economy of its region.

Between State *A* and State *B* there has been a tax treaty in force since 1995. It was negotiated and patterned on the 1992 version of the OECD Model. The main deviation is found in article 10(2)(a), under which the applicable tax rate, for dividends, is 0%.

Between State *B* and State *C* there was tax treaty in force between 1995 and 31 August 2014, and was negotiated and patterned on the 1992 version of the OECD Model. It was replaced by another tax treaty that entered into force on 01 September 2014 (already patterned on the 2014 OECD Model). Article 10(2)(a) contains no deviation from the OECD Model. However, there is a deviation in article 11(2), such that the tax rate is 5%.

Company *C* held a shareholding of 26% in company *A*, but because in 2005 the tax treaty (which provided a deviation at Article 10 (2)(a) the applicable tax rate for the distribution of dividends was 0%) between States *A* and *C* terminated, in 2006 the new board of directors of *C* (that in the same year was completely replaced), decided to sell its position in *A* to the pension fund *B*.

The board firstly had allowed a payment in instalments; however this proposal, in a second time was rejected. In front of the intention of *B* to seek a bank loan in order to obtain the funds needed to pay for the shares, company *C* decided to offer itself the loan to B, at the same market conditions that a bank would grant. *B* accepted this and obtained the loan (and effectively used the loan to pay the shares).

When the pension fund *B* and company *C* entered into the loan agreement, to determine the conditions of remuneration of the interest from *B* to *C*, have indexed the rate (which in any case is

considered by all parties to be at arm's length condition) to the average yield dividends that in the previous five years company *A* had distributed to company *C*.
The negotiations for the purchase of the participation and the loan were held separately, but executives took advantage of the last business trips to negotiate also the conditions for the loan, and although the two transactions were effected in separate documents, they were signed on the same date.
It is agreed that all negotiations started with C's intention to sell its shareholding in A; the loan agreement arose as a result of the cash flow needs faced by B, due to that acquisition (expressed in the course of negotiations).
It is established that the termination or breach of one of the agreements does not trigger any consequences regarding the other agreement and also the sale of the shareholding by B to another subject will not affect the payment of interests.
In particular the deal was structured such that the repayment of interest (by B, to C) matches, as said, the average historic payment of dividends by A, over the last 5 years.; the time of repayment of the loan is 30 years (so it will finish in 2036), except for the verification of two specific conditions: in fact, an additional clause states that if A does not pay dividends, B may defer the payment of interests to C (add one extra year to the total repayment period/years) and that if the amount of dividends paid by A is 3% higher or lower that the amount of the fixed interest stipulated between B and C, the amount of the payable interest must be adjusted to the amount of the dividends (the necessary corrections would be made in the last year(s) of the repayment of the loan). Moreover was stated that the payment of interest must be done within 30 days after the receipt, in B's bank account, of the dividends paid by A.
Furthermore in State A, the domestic law states that before paying dividends or interest to a non-resident subject, a corporate resident is obliged to withhold taxes (under domestic law or, if applicable, the relevant tax treaty).
It is important to note that the resident paying agent (in the case A company) must verify compliance with the applicable tax treaty before applying the more favourable conditions contained therein. Resident paying agents are jointly (solidarity principle) responsible for any tax not correctly withheld. In addition to meeting the requirements under the treaty, non-residents must also provide a certificate of tax residency to the resident paying agent in order to combat tax fraud and avoidance, as well as to ensure international tax transparency.

This certificate (required since 2006 by an act of the parliament) must include the following parts: (i) full identification of the company, (ii) statement of its residence for tax purposes and the criterion based on which that classification was based, (iii) statement that for tax purposes, and under the terms of an income tax treaty concluded with a third state, the company is not considered as a resident for tax purposes in a third state, (iv) statement that the company is subject to corporate income tax, without any possibility of option or exemption.

Tax Authorities carried out an audit regarding the payments of dividends between A and B between 2010 and 2014 (as allowed under the domestic statute of limitations). They concluded that A had erroneously applied the A-B tax treaty (the withholding tax rate mentioned therein):

First, they noted that the certificate presented (mentioning only the residence of B, due to its seat and place of effective management in state B) was not what is required under domestic law as, namely, (i) it did not mention that B was not a resident of any other state under a treaty signed by state B with another jurisdiction, and (ii) although it mentioned that the company was subject to tax, it did not mentioned that the company was (or not) exempt or had any possibility of option. It has to be said that pension fund B has not yet provided this qualified tax residency certificate, despite having been asked several times by the tax authorities, but gave only a simple tax residency certificate that is not considered adequate for the purpose and even if during the proceedings the Tax Payer presented the evidence that B could never be considered a third state resident and that it was subject to corporate income tax, in any case the proper certificate was missing.

Secondly, expressed doubts as to whether the pension fund could be considered entitled to treaty benefits and whether it could even be regarded as the beneficial owner of the income. In an excerpt from the audit report, they mentioned that in order to assess the issue of beneficial ownership, the proper version of the Commentary on the OECD Model to be used is the current (2014) one.

Finally, expressed doubts as to whether this company had sufficient substance in order to be considered a genuine business.

The Tax Payer, on the other hand, asserts that the pension fund is entitled to tax treaty benefits and, therefore, that it has withheld the correct amount of tax so no extra tax or penalty may be imposed.

Moreover it asserts that the pension fund is the beneficial owner and that the standards that should be used for interpretation are those of the version of the Commentary on the OECD Model of the moment when the treaty was being negotiated.

III. ISSUES

The present case involves many juridical questions and topics that can be summarised as follows:

PART A: STATE A DOMESTIC LEGISLATION

1. A did not have to apply the favourable conditions established by A-B Tax treaty to dividends distributed to B Pension Fund.
   1.1. The resident paying agent Company A had not verified the compliance of B Pension fund (a non resident subject) with the conditions of state A domestic legislation before applying the more favourable conditions contained in the tax treaty.
   1.2. Despite Tax Authorities of State A have been stably asking for it, B Pension fund did not present the proper tax residency certificate that, according the 2006 act of Parliament, has to be given by a non resident.
   1.3. According to the Incentives Tax Code of State B, pension funds have the possibility of being exempt from corporate income tax in their country, so if the conditions of the treaty are granted to B pension fund there is a double non taxation.

PART B: INTERPRETATION OF THE TERM "BENEFICIAL OWNER"

1. In preliminary order: Use of the OECD Commentary as an instrument of interpretation of tax treaties
   1.1. Given that A-B tax treaty was drafted on the base of OECD Model Convention, as a mean of interpretation has to be used the OECD Commentary.
   1.2. OECD is clear on the fact that the treaties previously signed have to be interpreted on the basis of the latest version of the Commentary, as set out in paragraph 35 of the introduction to the OECD Model Convention.

2. B Pension Fund is not the beneficial owner of the income derived from the payment of dividends by company A

2.1. According to the clauses included in the loan contract between B pension fund and company C, B is obliged to pay interests to C depending on the effective payment and the rate of return of dividends received from A.
2.2. B pension fund is not entitled to be the "beneficial owner" of dividends received from A because the conditions established in the loan contract reflect the ones stated in paragraph 25 of Art.10 of OECD Commentary.
2.3. According to the substance over form principle, B pension fund cannot be regarded as the beneficiary of the Treaty because the two contracts between B and C, although separated and released from each other, have been negotiated and signed by the executives on the same dates.
2.4. Indeed for the same principle (substance over form), a loan term of 30 years is comparable to a right of ownership of the lender on dividends that B received from A.
2.5. B pension fund could have been considered entitled to treaty benefits only if it operated exclusively to administer or provide pension or other similar benefits, provided that more than 50% of the premiums benefits are owed by individuals resident in its contracting state, as confirmed in the Action Plan 6 (Treaty Abuse) of B.E.P.S. project. In this case more than 50% of pension premiums are paid to residents of state C and not to residents of state B.
2.6. There are several substantial elements to affirm that this is a situation of treaty shopping: Company C, resident in a third country, attempts to obtain benefits that A-B tax treaty grants to the residents of the contracting states.
2.7. As a deduction, considered those certain circumstances already declared, it highlights that there is not any economic risk on B pension fund, but it is taken on behalf of company C.
2.8. Since the economic purpose must be the object of the transactions, rather than the obtainment of tax benefits, that should not have been achieved in the substance of facts, it is implied the non-genuine business carried on throughout the deals.

IV. ARGUMENTS

I. PART A: STATE A DOMESTIC LEGISLATION

1) Company A did not have to apply the favorable conditions established by A-B Tax Treaty to dividends distributed to B Pension Fund.

1. State A and State B signed a Tax Treaty that entered into force in 1995.It was negotiated and patterned on the 1992 OECD Model Convention (hereinafter: OECD MC), in which we can find a deviation in Art. 10 (2)(a) (Dividends) that provides a tax rate of 0% in the source State.
2. In order to comply with the correct application of the A-B Tax Treaty, and in addition to meeting the requirements under the Treaty, the domestic legislation of State A provides, with an Act of Parliament entered in force into 2006, a certificate of tax residence that non-residents (B Pension Fund) must provide to the resident paying agent (Company A).
3. This certificate must include the following:

(i) full identification of the company,

(ii) statement of its residence for tax purposes and the criterion based on which that classification was based,

(iii) statement that for tax purposes, and under the terms of an income tax treaty concluded with a third State, the company is not considered as a resident for tax purposes in a third State,

(iv) statement that the company is subject to corporate income tax, without any possibility of option or exemption.

4. This is a Limitation of Benefits clause (hereinafter: LOB) provided in order to counteract the incorrect application and any distortion of the Treaty.
5. It has to be remembered that the whole procedural document is missing, despite that tax authorities have been stably asking for it[36]. It is a fundamental act, required by a domestic provision (act of Parliament of 2006) in order to prevent that persons who do not meet the requirements above mentioned can unduly enjoy treaty benefits.
6. State A stated a general anti abuse rule in order to comply with the purpose of the Double Taxation Conventions (hereinafter: DTCs).

[36] *Clarifications 32-34*: Tax authorities have been stably asking for the certificate, as it is a formal requirement mentioned in the law and without it tax benefits cannot be obtained.

7. The certificate presented (mentioning only the residence of B P.F., due to its seat and place of effective management in State B) was not what is required under domestic law because requirements iii) and iv) were missing. Although requirement iii) was acknowledged by the Tax Authorities during the proceedings, the iv) one is not fulfilled yet, and in any case the proper certificate was missing.
8. According to point iv) the non-resident company (B P.F.) has to be subject to Corporate Income Tax (hereinafter: CIT) without any possibility of option or exemption.
9. The Tax Authorities acknowledged that B P.F. is a taxable subject according to the CIT Code of State B, although Tax Incentives Code (hereinafter: TIC), a different act of State B, states the exemption from CIT for incomes received by pension funds.
10. According to para. 5 of Art. 26 OECD MC "*The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant to secure the correct application of the provisions of the Convention or of the domestic laws of the Contracting States concerning taxes of every kind*".
11. In planning their national tax maneuvers, if States do not take sufficiently into account the effect of the rules of other countries, the interaction of groups of rules applied by each country creates friction and gaps, especially in cases where the income of the companies is not taxed, both in the country of origin and the country of residence.
12. The absent or low tax is not in itself a matter of concern, but it becomes so when it is associated with practices that artificially dissociate the taxable income from activities that generate it. What creates worries of fiscal policy is that the income from cross-border activities can be transferred anywhere without being taxed or being taxed in small part.
13. The BEPS action plan provides fundamental modifications to the actual mechanisms and the adoption of new approach based on consensus, including anti abuse rules, in order to counteract base erosion and profit shifting.
14. BEPS problems can rise from some loopholes like gaps, contrasts or inadequacies in the interaction in domestic tax law of various countries. It is necessary to integrate existing rules that are finalized to the elimination of double taxation with other instruments in order to eliminate double non taxation.
15. Income derived from a distorted use of the mechanisms provided by individual States may not be subject to taxation in any of the countries in which a company operates.

16. In this context it can also be difficult to determine which country has lost tax revenue, because the laws of each country concerned were followed and there is a reduction of the total tax paid by all parties involved, which harms competition, economic efficiency, transparency and fairness.
17. One of the sources of the worries of the BEPS project is the possibility to create associated non-resident taxpayers and to transfer income of a resident enterprise through the associated non-resident taxpayer. Therefore CFC rules and other anti-deferral rules have been introduced in lot of countries to address this problem.
18. The existing national and international tax rules should be amended in order to align more closely the distribution of income with economic activity that generates it. Nowadays, the abuse of the Treaties is one of the most important matters of concern for the BEPS cases. The Commentary on Article 1 of the OECD MC includes a number of examples of provisions that could be used to address treaty abuses that may lead to double non-taxation. The agreements with anti-abuse clauses in conjunction with the use of the right to tax under national laws will help to restore taxation. In fact, tax treaties are not intended to be used in generating double non-taxation and once they have identified the fiscal policies of a country, States should consider every aspect and relapse before deciding to sign a tax treaty with another State.
19. In the case at hand, the Tax Authorities of State A carried out an audit regarding the payments of dividends between Company A and B pension fund (hereinafter: B P.F.) between 2010 and 2014, in order to contrast the situation of double non taxation. It came out that Company A had erroneously applied the A-B Tax Treaty because, first of all, the certificate presented by B P.F. was not the one that is required under the LOB clause but only a simple tax residency certificate. The resident paying agent (Company A) had to verify compliance with the proper provision before applying the 0% withholding tax rate, and it is jointly liable according to the solidarity principle.
20. Secondly, looking at the mere facts, even if B P.F. gave the evidence that it theoretically respects the conditions required in accordance with the certificate, in any case, taking into account only the formal and procedural aspect, the treaty benefits should not have to be granted without the proper certificate.
21. Indeed if we want to leave out the formalistic approach and prefer a substantial one, according to the *substance over form principle*, and so we apply the treaty to B P.F., it

could not pay de facto neither the withholding tax in State A nor the CIT in State B. Therefore B P.F. takes advantages of these distortions between the domestic legislations of both States and the provisions of the DTC in an unfair manner, it is self-evident that this is a case of double non-taxation, so B P.F. must not be entitled to A-B treaty benefits

II. PART B: INTERPRETATION OF "BENEFICIAL OWNERSHIP" CONCEPT

1) Use of the OECD Commentary as an instrument of interpretation of A-B tax treaty

22. In this part will be shown that to evaluate correctly the facts arising from the audit that was completed this year against the company A about the relations between it and B P.F. in the period 2010-2014, the interpretation of the treaty between State A and state B signed in 1995 on the basis of the OECD Model of 1992, must be carried out in light of the current version of the Commentary (2014).
23. In order to understand which means of interpretation have to be used to read a tax treaty based on the OECD MC, we must consider that: a tax treaty is an international agreement, so it is subject to the rules stated by the Vienna Convention on the Law of the Treaties (hereinafter VCLT), and that the OECD Committee combines every Model Convention with a Commentary.
24. The role of the Commentary on the OECD Model Convention on Income and Capital (hereinafter: Commentary) for interpreting tax treaties is discussed. According to the Committee on Fiscal Affairs, the changes to the Commentary are normally applicable to the interpretation of tax treaties concluded before their adoption. However, firstly, we must take into account the general rules for the interpretation of treaties, and so we must refer to the VCLT and the relevance that the OECD commentary has in the resolution of a dispute on a Tax Treaty.
25. How the Commentary and other related documents might interact with the Vienna Convention is still subject to debate, especially about the changes in the OECD commentaries.
26. The Australian Taxation Office (hereinafter: ATO) took this position: "*the Commentaries provide important guidance on interpretation and application of the OECD model and as a matter of practice will often need to be considered in Double Taxation Agreements, at least where wording is ambiguous, which is inherently more likely in treaties than in general*

domestic legislation"[37]. "*Unless it is apparent that the substance of the OECD model, or unless the Commentaries make clear that a former interpretation has actually been substantively altered, rather than merely elaborated, the ATO considers it appropriate, as a matter of practice, to consider, at least, the most recently adopted/published OECD Commentaries as well as others which may have been available at the time of negotiation*"[38].

27. In other words the office followed the position that already the OECD Committee held, as explained below, namely that if there are not relevant changes in the more recent Commentary, but only clarifications and simplification of the meaning of provisions, the most recent commentary has to be used.
28. Tax treaties are international agreements under public international law[39], so subject to international law principles, and since the rules for the interpretation of international agreements are given by the VCLT, we must carry out an analysis of Articles 31-33 in order to evaluate also the role of the Commentary in the process of interpretation.
29. The High Court of Australia, in case *Thiel*[40] argued that Double Taxation Conventions are to be interpreted in accordance of the rules codified in the VCLT, because the provisions reflect the customary rules for the interpretation of treaties.
30. Art.31 (1) VCLT establishes the general rule of interpretation saying that: "*a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose*".
31. The term "*context*" is defined in Art.31 (2) VCLT[41] as an agreement made by the parties of a Convention related to the treaty connected to its conclusion, or made by one or more parties and accepted from the others as an instrument related do the convention.
32. Moreover Art. 31 (3) VCLT[42] says that have to be taken into consideration in addition to the "context", firstly any subsequent agreement reached by the parties regarding the

[37] ATO TR 2001/13, para 104.
[38] ATO TR 2001/13, para 108.
[39] Vogel K., *Klaus Vogel on Double Taxation Conventions (1997)* Introduction MN28.
[40] *Thiel v. FCT* 90 ATC 4717.
[41] Art.31 (2) VCLT: "[...]*any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty; [...] any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty*".

interpretation of the treaty or the application of its provisions, secondly any subsequent practice in the application of the convention that states the agreement of the parties on its interpretation, and thirdly relevant rules of international laws that are applicable between the parties.

33. Art. 31 (4) VCLT adds that a term may have a "*special meaning if it is established that the parties so intended*". Art. 32 VCLT allows also "*supplementary means of interpretation"* to be taken into account, however the recourse to this material in admitted when the interpretation according article 31 remains obscure and not certain.
34. According to Art.31 VCLT, which is based on a textual approach, the treaty should be interpreted in good faith and in accordance with the ordinary meaning given to terms in their context and in light of their object and purpose.
35. It has also to be assumed that the text of a treaty is correspondent to the willingness of the parties and the expression of their intentions. Regarding the contrast that Art. 31 (4) VCLT makes between "*ordinary meaning*" and "*special meaning*" considered as "*unusual meaning*", such "*ordinary meaning*" is to be derived from the context in which a provision occurs and in consideration of the treaty as a whole.
36. Moving from these premises, we must consider the fact that a tax treaty is generally based on the OECD MC and consequently, an interpretation in good faith, as stated by Art.31 VCLT, would require the use of the Commentary prepared by the OECD in the interpretation process.
37. The principle of good faith can be explained like: "*one party should be able to place confidence in the words of the other, as a reasonable man might be taken to have understood them in the circumstances"*[43].
38. So, if the contracting States chose to follow the OECD MC when they were drafting the provisions, it would be reasonable to assume that they intended such provisions to have the meaning they have in the OECD MC, as outlined and defined in the Commentary.

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[42] Art. 31 (3) VCLT: "[...] *any subsequent agreement between the parties regarding the interpretation f the treaty or the application of its provisions, any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation [...] and any relevant rules of international law applicable in the relation between the parties*".

[43] Cheng B, *General Principles of Law as applied by the International Courts and Tribunals* (1953) p. 107.

39. On the other hand, this does not imply that the OECD MC and the Commentary have the same weight as the treaty itself: they do not form part of the treaty.
40. Since 1977, continuing in 1992 and 2003, amendments to the commentary have always become more frequent and this practice raises the question of whether these amendments affect the interpretation of double taxation conventions previously concluded.
41. As briefly mentioned above, the OECD Committee on Fiscal Affairs took the following position on the issue: "*Changes or additions to commentaries are normally applicable to the interpretation and application of conventions concluded before their adoption, because they reflect the consensus of OECD member countries as to the proper interpretation of existing provisions and their application to specific situations*"[44].
42. In 1992, while the Model remained unchanged in Article 17, the Commentary was extensively amended about the same provision. The question was how the change in the Commentary should affect the interpretation of the treaty drafted on the basis of a previous version (1977).
43. When the Commentary was changed between 1963 and 1977 the Committee on Fiscal Affairs took the position that "*existing conventions should, as far as possible, be interpreted in the spirit of the revised commentaries, even though the provisions of these conventions did not yet include the more precise wording of 1997 Model Convention*"[45]. The same approach was maintained in the Introduction, at para. 33 of 1992 Model Convention as regards prior treaties.
44. This type of interpretation is defined "*ambulatory*" and it has several arguments in its favour. First, although a tax treaty is based on the circumstances present at the time in was concluded and often refers to the law applicable at that time for its interpretation, circumstances as well as national law are continually changing, especially in the area of taxes: technological developments, political insights, national tax policy and international and supranational legal developments are constantly in movement.
45. An interpretation of a treaty based on references to provision, insights or assumptions, which are old and obsolete, no longer permissible, or not applicable anymore would be extremely difficult.

[44] OECD Commentary, Introduction para 35.
[45] 1977 Convention, Introduction para 30.

46. Secondly and extremely important, it would lead to an unreasonable or unsatisfactory outcome or to results that offend the contemporaneous policies of international organizations. In other words, a static interpretation would not do justice to needs of the present period.
47. This point of view is confirmed in the case *Matthews v. UK*[46] in front of the European Court of Human Rights: "*That the Convention is a living instrument which must be interpreted in the light of present-day conditions is firmly rooted in the Court's case-law. The mere fact that a body was not envisaged by the drafters of the Convention cannot prevent that body from falling within the scope of the Convention. To the extent that Contracting States organise common constitutional or parliamentary structures by international treaties, the Court must take these mutually agreed structural changes into account in interpreting the Convention and its Protocols*".
48. In addition, the principle of equality among taxpayers requires that, as much as possible, identical treaty provisions (provisions based on an international model convention and which are identical to it) should not be interpreted differently depending on when they where concluded, namely before or after a clarification in the Commentary to the model.
49. Moreover, thinking about the nature of the commentary, as a mean of interpretation, and in considerations of what is stated in Art. 31 VCLT regarding the "*good faith*" principle, the analysis has to be fitted to the case taken into exam.
50. In fact, scholars believe that the revised commentary is an interpretative aid and considerable authority where a static interpretation leads to indecisive, implausible, unacceptable or absurd results[47].
51. Specifically, the article in question (10 about Dividends) had not been changed in the two Model Conventions taken into consideration (1992 and 2014), but there has been a significant expansion of paragraph 12 of the Commentary to this article. In fact, it has been clarified the concept and meaning of beneficial owner, since it is not a well-defined legal concept.
52. The formulation of 1992, that is much more concise than the current one, could lead to interpretations that are not perfectly in line with the spirit and purpose of the treaty, that is to

[46] *Matthews v. United Kingdom*, ECtHR, 18 February 1999, nj1999, 515.
[47] Wattel P.J. and Marres O. *The Legal Status of the OECD Commentary ad Static or Ambulatory Interpretation of Tax Treaties.* European Taxation July/August 2003, p. 223.

avoid situations of tax evasion and avoidance as well as abuse of the right, besides the avoidance double taxation.

53. Taking into consideration the provision, the Committee disagrees with any form of *a contrario* interpretation that would necessarily infer from a change to an article of the Commentary, the previous wording resulted in consequences different from those of the modified wording. Moreover it affirms and considers that many amendments are intended to simplify, not change, the meaning of the Commentaries, and an *a contrario* interpretation would clearly be wrong in those cases[48].
54. In fact when the Committee changes or adds dispositions to the Commentary that are a direct result of the amendments to the MC, they are not relevant for the interpretation or application of previously concluded conventions where the dispositions of those conventions are different in substance from the amended articles of OECD MC, however other changes to the Commentary are normally applicable to the interpretation and application of treaties concluded before their adoption, because they reflect the consensus of the OECD Member countries, like State A is, to the proper interpretation of existing provisions and their application to specific situations.
55. In this particular situation, the other party of the treaty, state B, is not an OECD Member: this fact does not change in any way the situation, in fact, making a more general discussion, we can assume that the treaties in whom these countries take part are in conformity with the OECD Model and no specific position has been taken, the non member also accepted the provisions of the OECD Model and consequently its Commentary as an interpretative aid. In fact, in the Introduction to the section "*Non member Countries positions*" of the Commentary states: "*These countries generally agree with the text of the Articles of the Model Tax Convention and with the interpretations put forward in the Commentary*".
56. For the reasons mentioned so far, namely:

- the OECD Commentary is legitimated to be an authoritative mean of interpretation of treaties based on the OECD model either for the purpose for which the Committee has prepared, either referring to the authoritative rules of CVLT;
- the fact that there has not been a substantial change or reversal in the commentary, but simply a significant expansion in order to clear things in paragraph 12 of the commentary on Article 10 of the Model;

[48] OECD MC 2010, Introduction (n. 339) 16, para. 36.

- the certainty that the committee encourages the use of the latest version of the commentary because of its greater correspondence to the needs of today as outlined by the OECD member states;
- The fact that despite the State B is not a OECD member this does not constitute an impediment to comply to updated commentaries provided its intention to stipulate the tax treaty on the basis of the OECD model;

  we cannot do otherwise than assume that for the interpretation of the Treaty in relation to the present case we must surely refer to the version of the Commentary issued in 2014.

2) Meaning of term "Beneficial Owner"

57. In this second part it will be demonstrated why, despite all argumentations about the formal non-fulfillment just explained, B P.F. must not be considered the real beneficial owner of the dividends received by Company A and that it is definitely not a genuine business.
58. The domestic legislation of State A entered into force in order to combat treaty abuse. The majority of treaty abuse situation come from the usage of an interposed person or entity between the payer of the income and the real beneficial owner of it.
59. Para. 12.5 of the 2014 Commentary on Art. 10 states that the fact that the recipient of a dividend is considered to be the beneficial owner of that dividend does not mean, however, that the limitation of tax provided for by paragraph 2 must automatically be granted. This limitation of tax should not be granted in cases of abuse of this provision (see also paragraphs 17 and 22).
60. As explained in the section on "*Improper use of the Convention*" in the Commentary on Article 1, there are many ways of addressing conduit company and, more generally, treaty shopping situations. These include specific anti-abuse provisions in treaties, general anti-abuse rules and substance-over-form or economic substance approaches.
61. 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.
62. Para.12.4 of the 2014 Commentary on Art. 10 affirms that in these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the direct recipient of the

dividend is not the "beneficial owner" because that recipient's right to use and enjoy the dividend is constrained by a contractual or legal obligation to pass on the payment received to another person.

63. 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.
64. The fact that the Tax Authorities challenge the attribution of the quality of beneficial owner to B P.F. must be taken into account to support and strengthen this argument.
65. B P.F. has sought for a bank loan in order to obtain the funds needed to buy the shares in Company A, and Company C (the previous owner) decided to offer the loan to it and the deal was structured such that the repayment of interests (by B P.F., to Company C) matches the average historic payment of dividends by Company A, over the last 5 years.
66. The loan would be repaid in 30 years, except for the verification of the conditions of the following two additional clauses: i) if Company A does not pay dividends, B P.F. may defer the payment of interest to C (add one extra year to the total repayment period / years); ii) if the amount of dividends paid by Company A is 3% higher or lower that the amount of the fixed interest stipulated between B P.F. and Company C, the amount of the payable interest must be adjusted to the amount of the dividends (the necessary corrections would be made in the last year(s) of the repayment of the loan).
67. In the light of the facts and the deals above mentioned it is clear that B P.F. is not the only entity that shares the economic risk.
68. Therefore tax authorities can apply para. 25 of the Commentary on Art. 10[49] to affirm that also Company C shares the risk and this is another reason to not consider B P.F. as the beneficial owner.
69. Two aspects have to be noted: i) the loan would be repaid in 30 years: this is a very long lapse of time and; ii) the additional clause according to with interests will be adjusted to dividends. Although B P.F. could sell its shares before the repayment of the loan and deals were effected in separate documents, although contracts were signed on the same date, and

[49] OECD Commentary on Art.10, para.25: "*[…] deals not only with dividends as such but also with interest on loans insofar as the lender effectively shares the risks run by the company, i.e. when repayment depends largely on the success or otherwise of the enterprise's business*".

termination or breach of one of these does not trigger the other, it is difficult not to consider this a case of treaty shopping made by a hybrid mismatch arrangement.

70. Hybrid mismatch arrangements are cross-border arrangements that take advantage of differences in the tax treatment of financial instruments, asset transfers and entities to achieve "double non-taxation" or long term deferral outcomes which may not have been intended by either country.
71. In fact B P.F. is entitled to receive dividends from Company A, but it is obliged to pay interests parameterized on those dividends received, and then there would not be, in the substance of matter, a full right to enjoy and dispose of them, given that the duration of the loan, although it is defined, is overly long.
72. In light of the judgments "*Indofood*"[50] and "*Bank of Scotland*"[51], in which prevails the substantial orientation (substance over form), beneficial owner would therefore be Company C, which is the one that, indirectly, participate to the business risk.
73. In the *Indofood case* the Indonesian Directorate-General for Taxation (hereinafter: DTG), on 7 July 2005, issued a circular letter in which it identified "*beneficial owner*" with "*the actual owner of income…either individual taxpayer or business entity taxpayer that has the full privilege to directly benefit of the income"* and, therefore*, "special purpose vehicle"* in the form of *"conduit company", "paper box company", "pass-through company"* or other similar that are not included in the *"beneficial owner"* definition[52].
74. Again, in the same case the Court looked at the "substance of the matter". Since both loans were tied and the intermediate company (in the case in question B P.F.) has to pay that which it receives, in practical terms it is impossible to conceive of any circumstances in which the interposed company could derive any direct benefit.
75. In *Re v. SA. case*[53] the Swiss Federal Tax Appeals Commission concluded that a company which transfers to a third person, in the form of deductible interest and charges, the dividends it receives without having the power to fully dispose of them is not the "beneficiary" of the income concerned.

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[50] High Court of Justice Chancery Division, *Indofood International Finance Ltd v. JP Morgan Chase Bank NA London Branch*, [2006] EWCA Civ. 158 and Court of Appeal [2006] STC 1195
[51] *Conseil d'Etat*, 29 December 2006, *Ministre de L'Economi, des Finances et de L'Industrie v. Societe Bank of Scotland*, no.283314.
[52] A. Martin Jimenez, *Beneficial Ownership: Current Trends*, World Tax Journal, 2010 (vol.2) No.1.
[53] *Re v SA*, case no JAAC65.86 of 28th February 2001 4 ITLR 191.

76. The *ratio decidendi* in all the cases (Spanish AN, the Swiss Federal Commission, Indofood) is that payments received and made were so closely tied that the intermediate company (B P.F.) had to pay "*that which it received*".
77. A National Court should not look at whether B P.F. is paying with its own money or the money of others, instead it has to consider the deal from a contractual perspective (the one stipulated by B P.F. and Company C) so that will light the substance over form, and, in addition, it has to consider the deal in the light of the object and purpose of the DTC between State A and State B.
78. The assessment of the existence for the beneficiary of the income of the status of the beneficial owner should be made with reference to the substance of the transactions undertaken, thus doing away with assessment of mere formal elements.
79. Substance over form doctrine is the doctrine which allows the tax authorities to ignore the legal form of an arrangement and to look to its actual substance in order to prevent artificial structures from being used for tax avoidance purposes. It is developed by national courts and the first case law in which it is possible to find it is "*Gregory v. Helvering*, 293 U.S. 465 (1935)"
80. According to this concept "the test should go further and require an examination of the commercial sense of and reason for the transaction, of its real substance and purpose. If its purpose is only to achieve an objective that allows the availing of tax benefit it will be regarded as being simulated"[54].
81. States increasingly focus their attention on the principle of the substance over form in order to eliminate tax avoidance and tax evasion. This is one of the aims of the BEPS project.
82. In the BEPS Action Plan number 6 it can be found the example in which a company pays interest in relation to dividends received. The OECD Committee considered this subject as a vehicle and an operation of this kind is due to "treaty shopping", therefore it cannot be attributed to it the notion of beneficial owner as it is demonstrated by the circumstances of the case (keeping in mind that B P.F. pays these interests to Company C, who is not a resident entity in the Contracting States).
83. Having come to these conclusions it cannot be said differently that B P.F. is not the real beneficial owner of the dividends paid by Company A, and it is therefore justified the

[54] P. DACHS and B. du PLESSIS, "The interpretation of substance over form" 2012, ESN in Practice.

request of the Tax Authorities to apply a withholding tax rate of 30% like any other subject not entitled to the treaty benefits.

84. In order to be considered entitled to treaty benefits, a pension fund should meet the following characteristics: "ii) was constituted and is operated exclusively to administer or provide pension or other similar benefits, provided that more than 50 per cent of the beneficial interests in that person are owned by individuals resident in either Contracting State, or; iii) was constituted and is operated to invest funds for the benefit of persons referred to in subdivision ii), provided that substantially all the income of that person is derived from investments made for the benefit of these persons"[55].
85. To clarify the meaning of the term "*beneficial interests in that person*" under subdivision ii) it should be understood to refer to the interests held by persons entitled to receive pension benefits from the fund[56].
86. B P.F. adopts a bolder investment strategy, and it does not just manage pension benefits. This means that also point iii) provided in the B.E.P.S. Action plan N. 6 is not met.
87. B P.F. is an entity that operates in accordance with State B domestic law, so it is considered, for tax purposes, as resident in State B. It receives many premiums from State C, such that more than 50% of its pension premium's income comes from State C. In the light of the fact the requirement under point ii) is missing. Therefore residents of State C can enjoy undue of the benefits under A-B Tax Treaty. This is a treaty abuse situation.
88. States try to prevent granting treaty benefits in inappropriate circumstances and Action Plan N.6 provides that the OECD MC should be amended to include provisions to prevent treaty abuse.
89. The treaty abuse usually occurs by exploiting differences in the treaties concluded between the various States or by the interposition of an entity resident in a third State in the income flow from the source State to the State of the beneficial owner.
90. Generally, the practices of treaty abuse are made by abusing the terms of the treaty against double taxation governing: the cross-border taxation of royalties, interest, dividends, the concept of residence and permanent establishment and the granting of tax credits.

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[55] Preventing the Granting of Treaty Benefits in Inappropriate Circumstances ACTION 6: 2014 Deliverable, para.20, p. 38.

[56] Preventing the Granting of Treaty Benefits in Inappropriate Circumstances ACTION 6: 2014 Deliverable, para.20, p. 38.

91. A specific feature of treaty abuse is treaty shopping which is the inappropriate use of tax treaties by residents of third countries. It generally refers to a situation where a person, who is resident in one country (say the "home" country) and who earns income or capital gains from another country (say the "source" country), is able to benefit from a tax treaty between the source country and yet another country (say the "third" country). This situation often arises where a person is resident in the home country but the home country does not have a tax treaty with the source country.
92. The OECD has previously examined the issue of treaty shopping in different contexts, particularly from the time the concept of beneficial owner was introduced in the OECD MC because treaty shopping arrangements frustrate the bilateral and reciprocal nature of tax treaties.
93. In the light of the definition of treaty shopping it is possible to note that the board of Company C decided to sell its position in A due to the termination of the A-C tax treaty. This position was bought by B P.F., Company C explained to its shareholders that the main reason for selling the position in A was the termination of the A-C tax treaty, which would increase the tax burden on the dividends received.
94. It is also important to keep in mind that there has been a tax treaty in force since 1995 between State A and State B that was negotiated and patterned on the 1992 version of the OECD Model. The main deviation is found in article 10(2)(a1), under which the applicable tax rate is 0%.
95. In the light of these facts and deals, Company C tries to benefit of the A-B Tax Treaty unless it does not meet the requirements under the A-B Convention because it is resident in State C, that is a third country.
96. Thanks to these arrangements with B P.F., Company C tries to decrease the tax burden on the dividends received after the termination of Tax Treaty between State A and State C in which the corporate income tax rate is 30% instead 0 % under A-B Tax Treaty.
97. It is also possible to assume that there is not any economic risk on B P.F. The meaning of economic risk can be divided into two parts:

i) the risk related to breach of contract by the counterparty, is therefore a risk that the counterparty of the transaction will not perform in the manner and time stipulated in the contract;

ii) the risk that the debtor does not fulfil even in part its obligations of repayment of capital and interest payment within the credit operations.

98. Both these conditions are not satisfied, keeping in mind the structure of the loan contract between B P.F. and Company C, particularly clause i) if A does not pay dividends, B may defer the payment of interest to C (add one extra year to the total repayment period/years), and the fact that the loan would be repaid in 30 years.
99. For these reasons it must be recognised that B P.F. does definitely not carry on a genuine business and that in the case must not be entitled to treaty benefits, therefore Company A has to apply the withholding tax to dividends, as stated by domestic law, with a 30% rate.

V. List of Abbreviations

Art.	Article
Clarif.	Clarification
Commentary	OECD Commentary on the Model Convention
DTCs	Double Taxation Conventions
ECJ	European Court of Justice
EoI	Exchange of information
EU	European Union
Lett.	Letter
LOB	Limitation of Benefits
Model	OECD Model Convention
OECD-based Tax Treaty	Tax Treaty based on the OECD Model Convention
OECD MC	OECD Model Convention on Income and Capital
Para.	Paragraph
SPV	Special Purpose Vehicle
TIEA	Tax Information Exchange Agreement