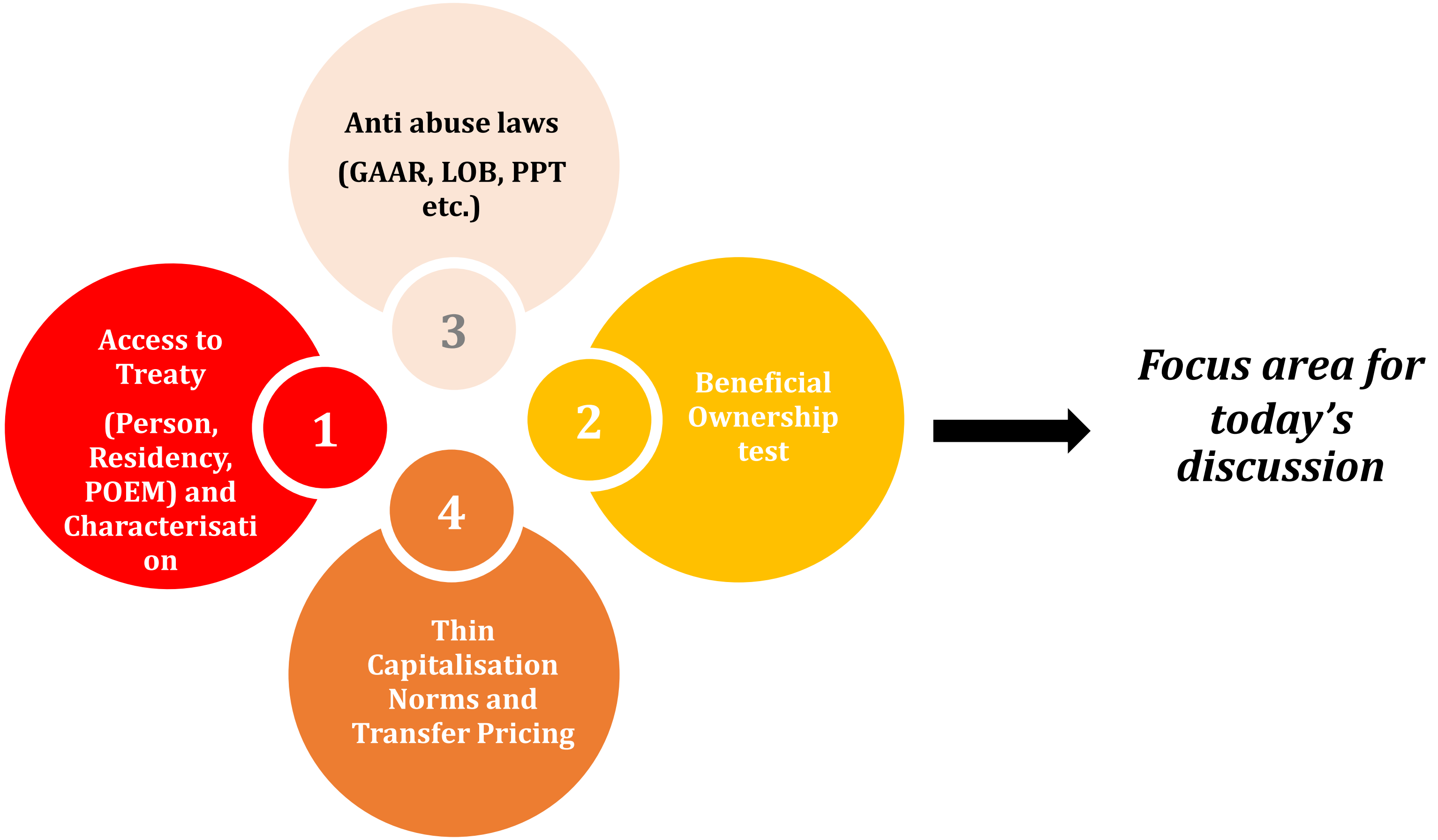
Beneficial Ownership
- CA K Prasanna

Key Considerations

Key considerations for structuring a transactions is as follows



Beneficial Ownership under the Act

Parameters	Section 2(22)(e)	Section 79	4th proviso to Section 139	Section 94(3)	Section 45(2A)
Section/ Clause/ Rule	Provided that dividend includes any payment by a company, not being a company in which the public are substantially interested, of any sum by way of advance or loan to: • **A shareholder, being a person who is the beneficial owner of shares** (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than 10% of the voting power, or • to any concern in which such shareholder is a member or a partner and in which he has a substantial interest • or any payment by any such company on behalf, or for the individual benefit, of any such shareholder to the extent to which the company in either case possesses accumulated profits	Notwithstanding anything contained in this Chapter, where a change in shareholding has taken place in a previous year,— (a) in the case of a company not being a company in which the public are substantially interested and other than a company referred to in clause (b), no loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year, unless on the last day of the previous year, the shares of the company carrying not less than **fifty-one per cent of the voting power were beneficially held by persons who beneficially held shares of the company carrying not less than fifty-one per cent of the voting power on the last day of the year or years in which the loss was incurred**;	A person, being a resident and ordinarily resident in India, who is not required to furnish a return under section 139(1) and who at any time during the previous year,— (a) **holds, as a beneficial owner or otherwise, any asset (including any financial interest in any entity) located outside India** or has signing authority in any account located outside India; or (b) **is a beneficiary of any asset (including any financial interest in any entity) located outside India,** shall furnish, on or before the due date, a return in respect of his income or loss for the previous year in such form and verified in such manner and setting forth such other particulars as may be prescribed	Notwithstanding anything to the contrary contained in this Act, • where, in any previous year, the assessee has received or credited any sum from any person located in a notified jurisdictional area and • the assessee does not offer **any explanation about the source of the said sum in the hands of such person or in the hands of the beneficial owner (if such person is not the beneficial owner of the said sum)** or • the explanation offered by the assessee, in the opinion of the Assessing Officer, is not satisfactory, then, such sum shall be deemed to be the income of the assessee for that previous year	Where any person has had at any time during previous year any beneficial interest in any securities, then, any profits or gains arising from **transfer made by the depository or participant of such beneficial interest in respect of securities shall be chargeable to income-tax as the income of the beneficial owner of the previous year in which such transfer took place** and shall not be regarded as income of the depository who is deemed to be the registered owner of securities by virtue of sub-section (1) of section 10 of the Depositories Act, 1996, and for the purposes of— (i) section 48; and (ii) proviso to clause (42A) of section 2, the cost of acquisition and the period of holding of any securities shall be determined on the basis of the first-in-first-out method.

Beneficial Ownership under the Act

Parameters	Section 2(22)(e)	Section 79	4th proviso to Section 139	Section 94(3)	Section 45(2A)
Meaning of 'beneficial owner'	Not defined However, substantial interest has been defined to mean: • <u>In case of a Co</u> – Person who is beneficial owner of shares carrying >=20% of voting power • <u>In any other case</u> - Person beneficially entitled to >=20% of income at any time during the previous year	Not defined	Explanation 4.—For the purposes of this section **"beneficial owner" in respect of an asset means an individual who has provided, directly or indirectly, consideration for the asset for the immediate or future benefit, direct or indirect, of himself or any other person.** Explanation 5.—For the purposes of this section "beneficiary" in respect of an asset means an individual who derives benefit from the asset during the previous year and the consideration for such asset has been provided by any person other than such beneficiary.	Not Defined	Explanation.—For the purposes of this sub-section, the expressions "beneficial owner", "depository" and "security" shall have the meanings respectively assigned to them in clauses (a), (e) and (l) of sub-section (1) of section 2 of the Depositories Act, 1996 As per section 2 of the Depositories Act, 1996, • **"beneficial owner" means a person whose name is recorded as such with a depository; and** • "depository" means a company formed and registered under the Companies Act, 1956 (1 of 1956) and which has been granted a certificate of registration under sub-section (1A) of section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 1992)

Beneficial Ownership under Indian Context

- Indian tax law (ITL) incorporate requirement for BO in a few sections – however, no definition or provisions on BO in domestic law related to tax-treaty benefits

- ITL largely looks at **legal ownership** (e.g. deemed dividend)

- Similar to the OECD Model Tax Convention (MTC), India's tax treaties include BO requirement for dividend, interest and royalty income

- Concept of BO is **not defined in ITL** – OECD MTC and judicial precedents to be relied upon (India being a common law country)

- Recently, the **Supreme Court in Engineering Analysis Centre** has held that reliance can be placed on the OECD Commentary for provisions of OECD MTC used without any substantial change by bilateral DTAAs

- While India's tax treaties do not include a requirement for BO in the context of capital gains, **Indian judiciary generally assesses BO requirement for treaty benefit on capital gains** *[Tiger Global International – AAR/ Blackstone (MumbaI ITAT's observations)/Aditya Birla Nuvo – Bom HC/Blackstone – Delhi HC*

Beneficial Ownership under Indian Context

Observations from various Indian precedents

- Company incorporated in tax favourble jurisdiction should be able to prove **economic, commercial, and business expediency**
- It should not be a **mere agent or nominees** working on behalf of the parent company under their instruction
- It should be proved that the company enjoys the **fruits of the ownership** and has the **ability to dispose** of it for its own benefit
- The Company should have **exclusive possession and control** over the income received
- The Company should have **free voting power** without the control of other shareholder/ultimate common parent.

Relevant Articles under the Tax Treaty

Dividends

1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.
2. However, dividends paid by a company which is a resident of a Contracting State may also be taxed in that State according to the laws of that State, but if the **beneficial owner** of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed…

Interest

1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.
2. However, interest arising in a Contracting State may also be taxed in that State according to the laws of that State, but if the **beneficial owner** of the interest is a resident of the other Contracting State, the tax so charged shall not exceed…

Royalties and FTS

1. Royalties and fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.
2. However, such royalties and fees for technical services may also be taxed in the Contracting State in which they arise and according to the law of that State; but if the **beneficial owner** of the royalties or fees for technical services is a resident of the other Contracting State, the tax so charged shall not exceed…

Other Income

1. Subject to the provisions of paragraph 2 of this Article, items of income **beneficially owned** by a resident of a Contracting State, wherever arising, other than income paid out of trusts or the estates of deceased persons in the course of administration, which are not dealt with in the foregoing Articles of this Convention, shall be taxable only in that State

Beneficial Ownership under Treaty

- At times, cross-border structures are designed to minimize taxation by using beneficial provisions of tax treaties
- Income recipient must be a 'beneficial owner' of the income –the term not defined in the Act and tax treaties
- Objective of introducing the concept of 'BO' in tax treaty is
  - *Expunge treaty benefits granted to recipients who act as 'bare nominees' of income and claim favourable treaty benefits by resorting to treaty shopping*
  - *Ensure that mere residence in another jurisdiction should not require the source state to relinquish completely / partially its taxation rights*

Dictionary meaning of 'Beneficial Owner':

- ***Klaus Vogel*** - Beneficial owner is a person who is free to decide:
  - Whether or not the capital/assets should be used/made available for use by others;
  - On how the yields from them should be used; or
  - Both
- ***Webster's Dictionary*** - One who is entitled to receive the income of an estate without its title, custody or control
- ***Black's Law Dictionary*** - One recognized in equity as the owner of something because use and title belongs to the person, even though legal title may belong to someone else
- ***Law Lexicon*** - One who, though not having apparent legal title, is in equity entitled to enjoy the advantage of ownership

Beneficial Ownership under Treaty

OECD commentary - **when recipient's right to use and enjoy the income is constrained by a contractual or legal obligation to pass on the payment received to another person;**

- Recipient is not an agent, or nominee or conduit company acting as a fiduciary or administrator on behalf of interested parties;
- Recipient should have the entire rights to decide upon usage of the income so received;
- Recipient should not be obligated to pass on such income to a third party by way of agreement or otherwise;
- Recipient should have the right and independence to make decisions in relation to the income and not be dependent upon or acting upon the directions of the controlling persons
- Shareholder should bear economic risk associated with the income;

Key ownership attributes

Right to disposal of income

+

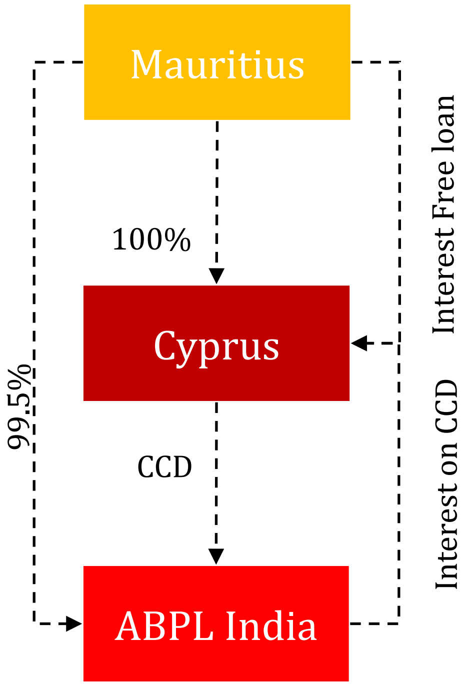
Risk attached to the income

+

Possession and control over the income

Golden Bella Holdings Limited

Structure is pre amendment to the India-Mauritius Treaty



Cyprus received interest free loan one week before investing into CCD in ABPL India

Department

- The taxpayer merely acted as a conduit for passage of funds given back-to-back funding by Parent Co
- The taxpayer did not carry out any business activities in Cyprus and was merely a 'name plate' company. It had outsourced its corporate secretariat and management function to an institution al service provider
- The taxpayer did not exercise any control over the CCDs as most companies incorporated in Cyprus and other tax havens; they do not have independent officers / employees to carry out business activities

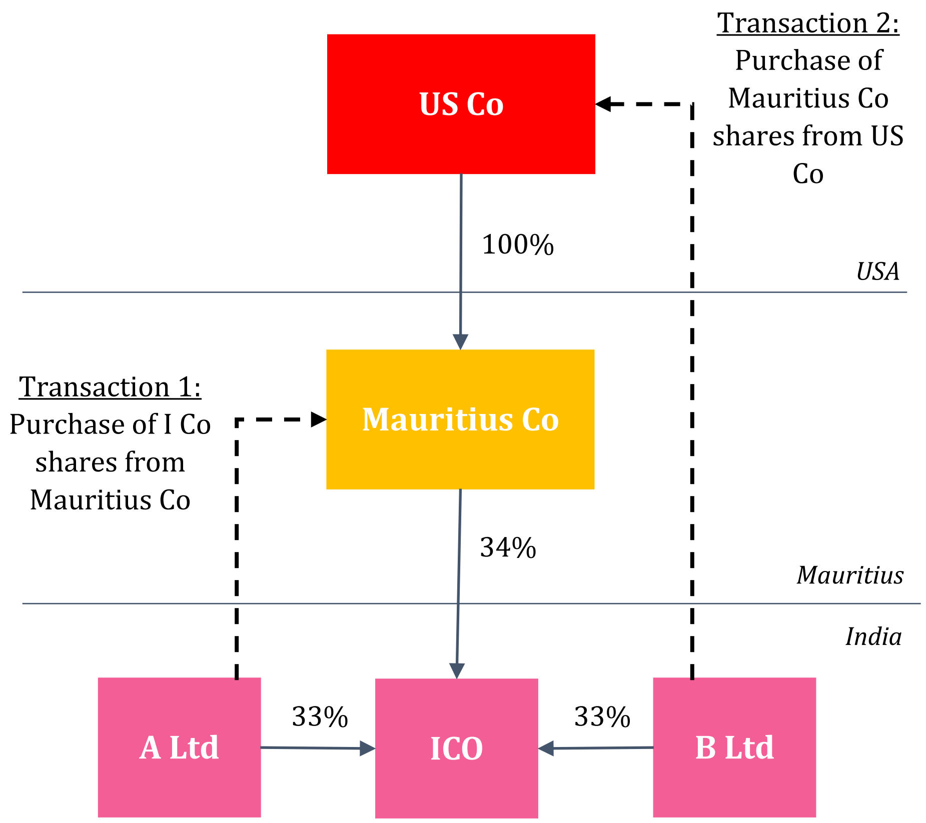
Taxpayer

- Interest free loan plus share capital was utilized. Cash was also retained after investment in CCD. Hence not back to back arrangement.
- No contractual or legal or economic compulsion to invest loan in ABPL. Investment was made after independent application of mind.
- CCDs were different from pure loan and it did not merely on lend the funds
- The taxpayer was risk bearing entity and not mere conduit as interest free shareholder loan is denominated in USD as against CCD which is INR

Tribunal

- The taxpayer invested in CCDs and received interest income for its own exclusive benefit, and not for or on behalf of any other entity
- Meaning of BO given in OECD Commentary was relied upon ("recipient of interest has the right to use and enjoy interest unconstrained by legal and contractual obligations...") and tax authorities failed to prove how the taxpayer did not meet the said definition
- Taxpayer maintained foreign exchange risk on the CCDs and the counter-party risk on interest payments from the CCDs

Aditya Birla Nuvo Limited

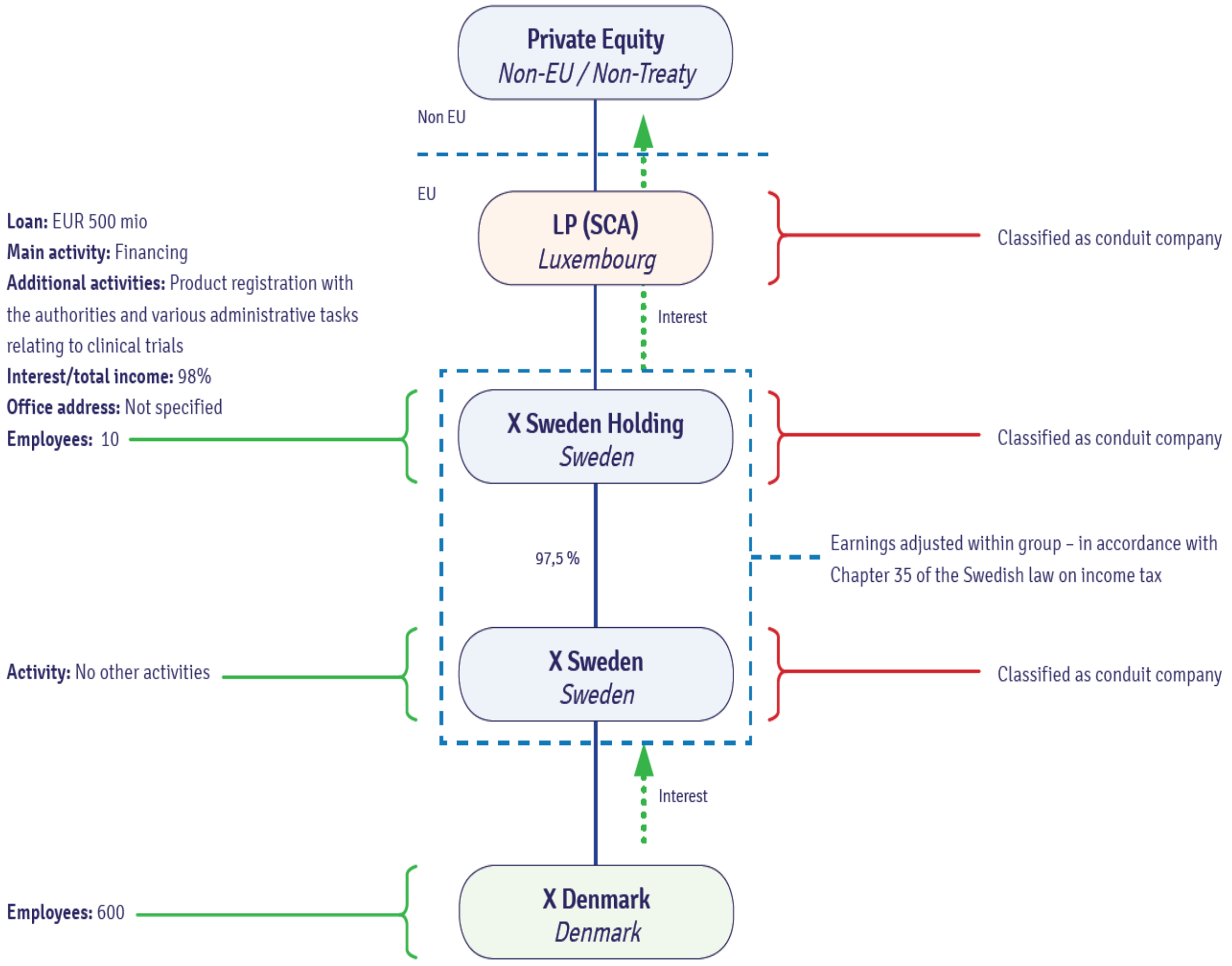


Refer Delhi HC observation in Blackstone Capital Partners (Singapore) – W.P. (C) 2562/ 2022

Facts

- An Indian Group and US Co entered into a Joint Venture Agreement ('JVA') to incorporate ICO for carrying out telecommunication business in India
- JVA allowed Indian Group and US Co to hold shares in ICO through a permitted transferee who would be a wholly owned subsidiary; however, all rights and obligations pertaining to ICO shares would vest with the JV partners, who would be the owner of ICO shares
- Accordingly, 49% shares in ICO were held by Mauritius Co (designated as the permitted transferee of US Co) and balance 51% were held by A Ltd (the permitted transferee of the Indian Group)
- Later, B Ltd was inducted as the third JV partner
- Subsequently, US Co decided to exit the venture and accordingly,
- **Transaction 1:** A Ltd acquired ICO shares from Mauritius Co; A Ltd did not withhold any tax in light of capital gains tax exemption under the India-Mauritius DTAA read with Circular 789; Mauritius Co remitted the consideration received to US Co by way of dividend and repayment of loans
- **Transaction 2:** Post Transaction 1, B Ltd acquired shares of Mauritius Co from US Co and paid consideration to US Co

Danish Court Ruling



Pic Source – Novio Tax

Facts

- X. SCA is the group's ultimate parent entity, and it is a general investment firm registered as SICAR, which is exempt from income tax on income originating from its investment in securities (dividend and capital growth)
- X SCA holds 100% in 100% in X Sweden Holding, which in turn owns 97.5% of X Sweden. X Sweden had 100% in X Denmark entity.
- X SCA and X Sweden holding does not have business operations other than holding investments
- X SCA obtained a loan (EUR 500 Mio) and passed on its subsidiary, and finally, it was provided to X Denmark. X Denmark did not withhold any taxes and treated X Sweden as the beneficial owner of the loan
- Whether X Sweden a beneficial owner?

Danish Court Ruling

Key Indicators of abuse from the Rulings

(1) If the group structure is put in place to obtain a tax advantage,

(2) that all or almost all of the dividends or interest are passed on by the company that has received it to entities that do not fulfill the conditions for the application of the Interest and Royalties Directive and the Parent-Subsidiary Directive,

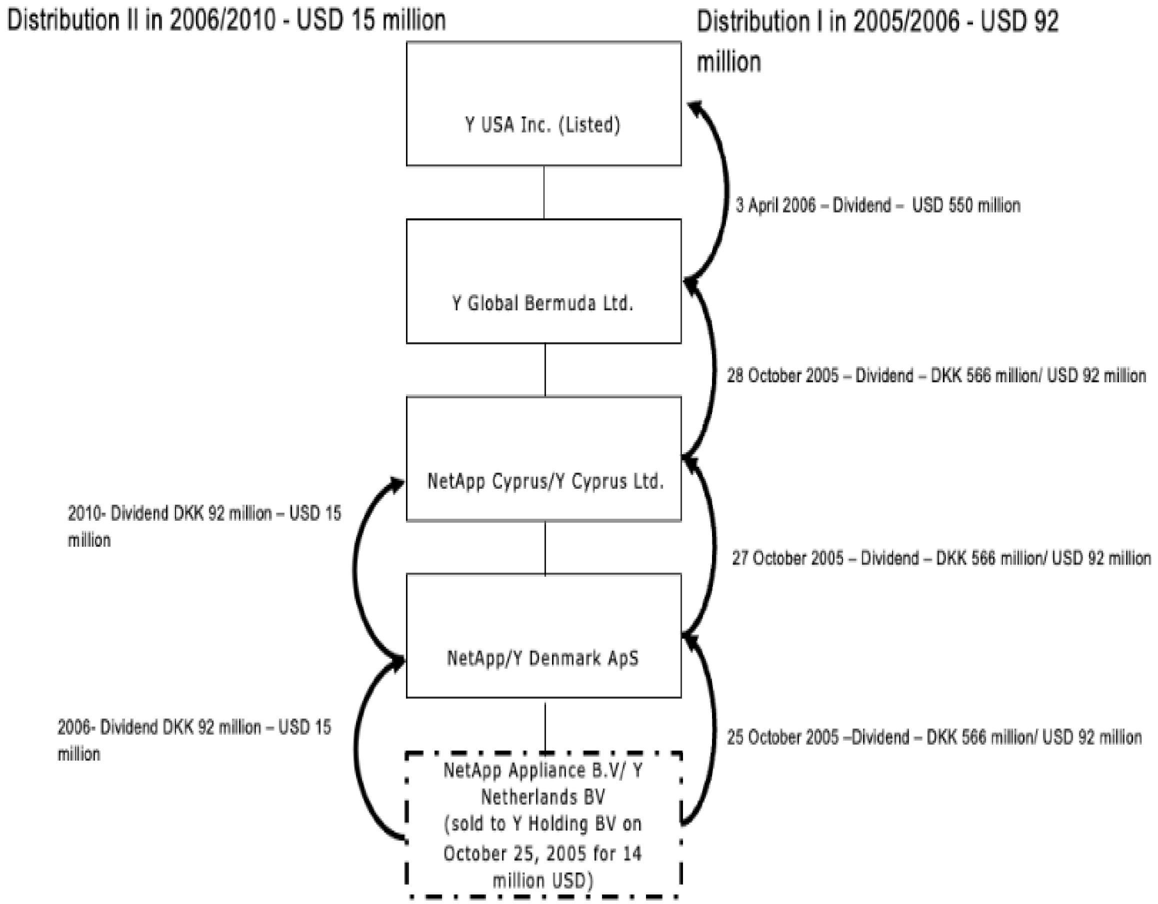
(3) if the interposed holding company has an insignificant income due to the redistribution of the dividends or interest,

(4) if the sole activity of the holding company is to redistribute the dividends or interest based on the lack of management, balance sheets, expenses, employees, and office facilities,

(5) if the contractual obligations (both legal and actual) render the holding company unable to enjoy and use the dividend or interest,

(6) if there is a close connection between the establishment of complex financial transactions and structures and new tax legislation.

Net App – Danish Supreme Court



Pic Source – Linkedin

Facts

- NetApp/Y Denmark ApS is a Danish subsidiary and part of the NetApp Group, with the ultimate global parent being a listed US corporation with its head office in Silicon Valley. Net App Group produces and sells hardware and software to network systems.
- It involves NetApp Denmark's distribution of dividend to Cyprus Parent. Cyprus entity received a loan from Bermuda entity and used the dividend to repay the loan to Bermuda. The loan was intended to acquire Denmark and currently, Cyprus has no office or employees and it operate as a holding company.
- After incorporation in 2000, Denmark acquired shares in Netherlands by a group contribution from Bermuda Ltd.
- Until Sep 2005, Bermuda owned Denmark directly and Cyrpus was interposed by way of an intra-group restructuring.
- Whether Cyprus is a beneficial owner of share?

Beneficial Ownership – Capital Gains

View 1 – Beneficial Ownership is not applicable

- Beneficial ownership is included in dividends, interest, Royalties, and FTS. It is not included in Capital Gains. Hence, the condition of BO cannot be included for capital gains purposes.
- VCLT – Article 31 – "Treaty shall be interpreted in good faith" in light of object and purpose.
- **Andhra Pradesh High Court** in **Sanofi Pasteur Holding SA (354 ITR 316)** – Observation in Para 22 – "……*Where the operative treaty's provisions are unambiguous and their legal meaning clearly discernible and lend to an uncontestable comprehension on good faith interpretation, no further interpretive exertion is authorized"*
- The intention of introducing BO is to clarify the meaning of the words "paid ..to resident' – Refer to Para 12 of Art 10 of OECD MC echoed in Articles 11 and 12.
- UN Committee noted that BO is not included in Article 13 and further work is required - **4STM_EC18_2008_CRP2_Add1**
- Observations of **Mumbai ITAT** in the case of **Blackstone FP Capital Partners Mauritius V Ltd vs. DCIT – [TS-381-ITAT-2022]**
- **Delhi High Court** in **Blackstone Capital Partners (Singapore) VI FDI Three Pte. Ltd – W.P.(C) 2562/2022 – Para 61**
- Circular 789 – in the context of Mauritius – Requirement of TRC

Beneficial Ownership – Capital Gains

- Prof Philip Baker, in his report titled "Possible extension of the Beneficial Ownership Concept," – Para 54 - the inclusion of a beneficial ownership limitation in the capital gains article of specific, bilateral conventions is not part of the current treaty practice of any state"
- **Her Majesty vs Alta Energy Luxembourg SARL – 2021 SCC 49 – Supreme Court of Canada** – Para 148 – *BO is utterly foreign to Art 13. Para 149 - For all these reasons, beneficial ownership would not be an appropriate anti-avoidance tool to curb tax treaty exploitation involving art. 13 dealing with the realization of capital gains.*
- **Spanish Supreme Court** in **Colgate Palmolive Case (ECLI:ES: TS:2020:3062)** – Spain – Switzerland DTAA does not include BO in Royalty – BO Concept cannot be construed by resorting to OECD because soft law documentation cannot supersede DTAA.
- Refer to **Singapore – Israel DTAA – Specific requirement of BO in Capital Gains Clause – Bilaterally negotiated**

Beneficial Ownership – Capital Gains

View 2 – Beneficial Ownership is applicable

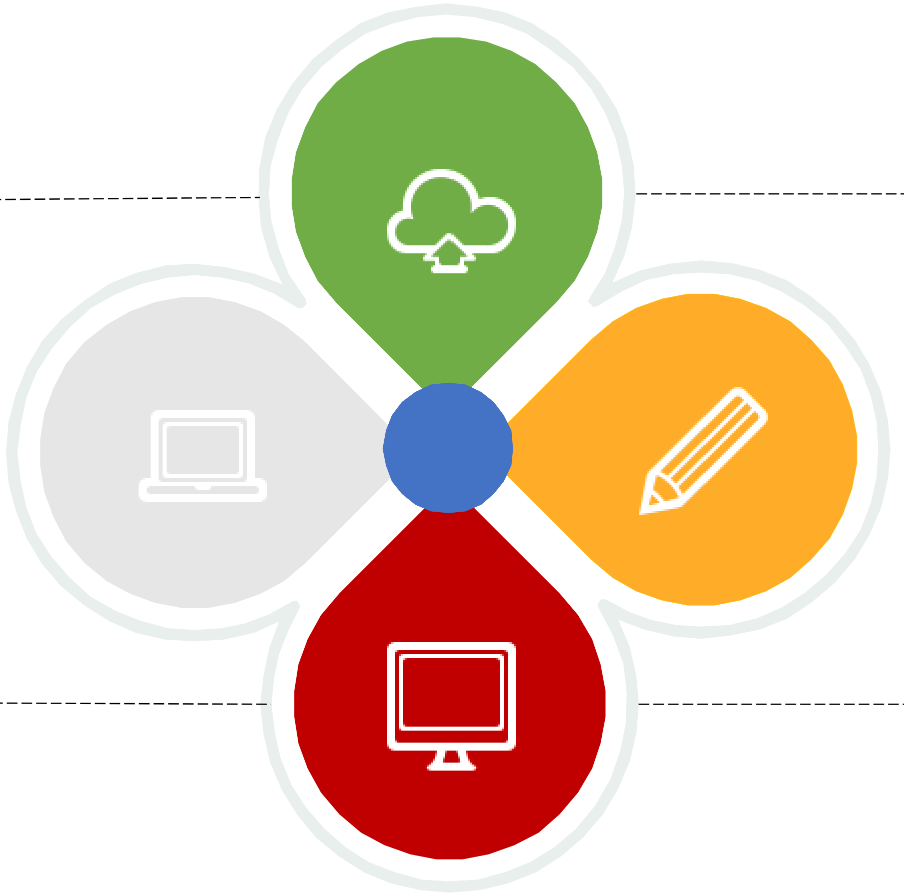
- The use of terms like “derived’, or ‘alienation’, is indicative of the fact that only the real owner will be entitled to the gains. Accordingly, the aspect of BO is inherently present in the Capital Gain article.
- The Korean Supreme Court in KT Co Ltd [TS-894-FC-2013(KOR)] – denied Art 13 benefits to Malaysia Co under Korea-Malaysia DTAA, treating the Malaysian entities as a conduit entity.
- The Russian Arbitral Court (Case No. A11-6602/2016) - applied the concept of beneficial ownership introduced in their domestic law in 2015 to deny treaty benefits on the sale of Russian Co shares by a Cypriot entity. (Russia-Cyprus DTAA) - BO of domestic laws was applied retrospectively
- Bombay High Court ruling in **Aditya Birla Nuvo Ltd. vs. DDIT - [TS-5445-HC-2011(BOMBAY)-O]** – Rejected Treaty benefits to Mauritius Co applying BO – Distinguished by Mumbai ITAT (infra)
- Observations of **Mumbai ITAT** in the case of **Blackstone FP Capital Partners Mauritius V Ltd vs. DCIT – [TS-381-ITAT-2022] –** Application of BO on Capital Gains is inconclusive and is pending before the ITAT for evaluation

Factors to be considered

Key Considerations

Tax Residency Certificate
- HSBC Bank (Mauritius) Ltd

Agreement to transfer and burden of proof

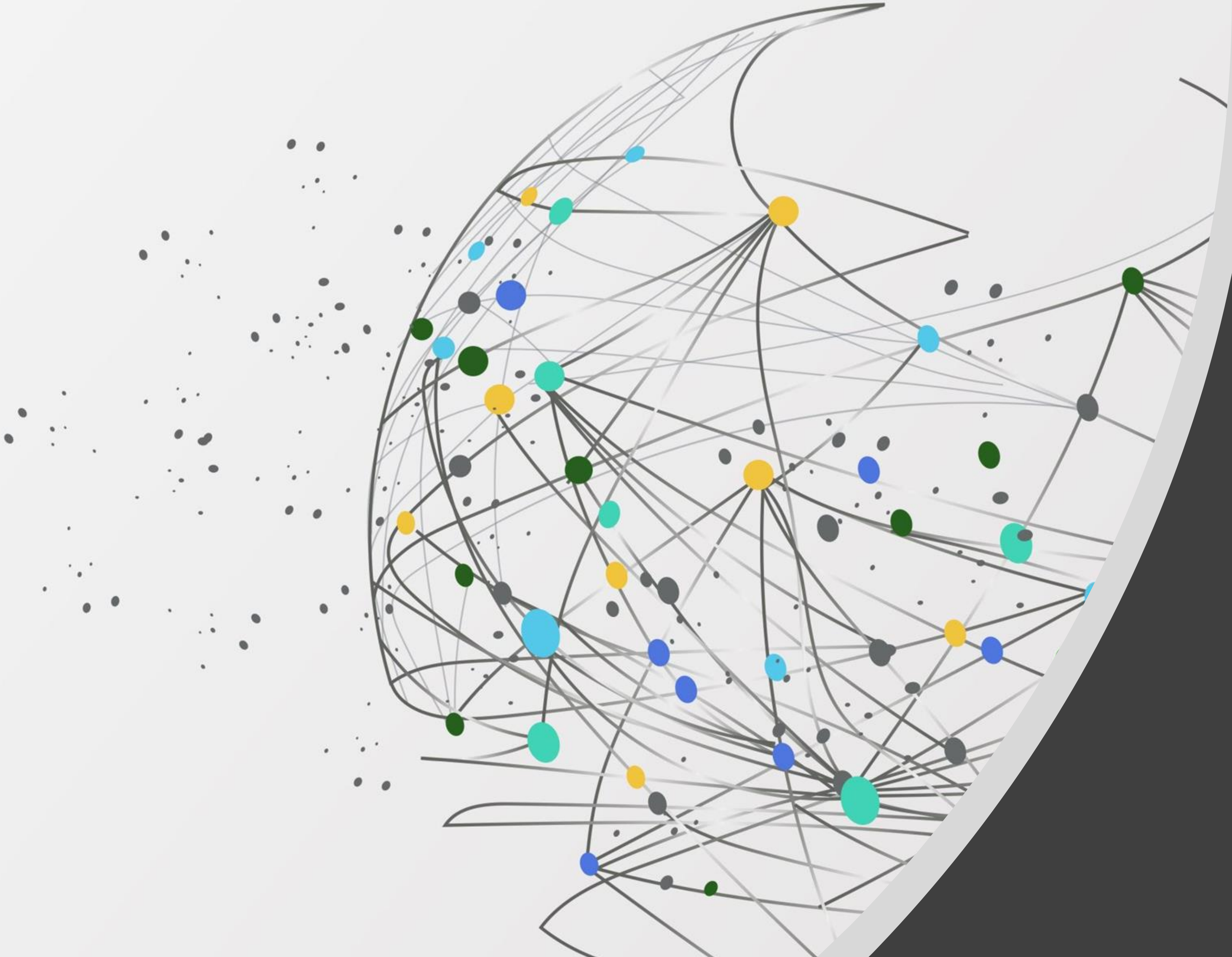


Group Structure and Common Management

Substantive business activities
Corning Inc - Korea

Distribution to investors
– Prevost Car Inc, Danish Rulings

Shareholders loan or capital raises
- Danish Rulings



Thank You

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