

## VARIETY OF THE BENEFICIAL OWNERSHIP CONCEPT

Sonja Cindori<sup>175</sup>

Toni Janković<sup>176</sup>

DOI: <https://doi.org/10.31410/eraz.2018.310>

---

**Abstract:** *Individuals involved in money laundering procedures are trying to take advantage of complex corporate structures in an international context in order to disguise their true identity. Consequently, the EU Member States endeavour to ensure that entities established in their national territory have access to up-to-date information regarding a natural person who is the ultimate owner or controls the company for the purpose of obstructing the misuse of legal persons for criminal activities. Similar structures can also be used by individuals to gain the benefit of taxation which they are not otherwise eligible for, using treaty or directive shopping.*

**Key words:** *beneficial owner, tax, evasion, avoidance, money laundering, register*

---

### 1. FOREWORD

The concept of beneficial owner used by the Double Taxation Conventions (hereinafter: DTC) is not separately defined in the Croatian tax legislation nor was the subject of administrative and judicial interpretation. However, Croatian involvement in the global economy, in particular the intensification of economic ties after joining the European Union, inevitably imposes a need for a discussion of this concept.

Although it is one of the cornerstones of the Directive 2015/849 and anti-money laundering and terrorist financing (hereinafter: AML/TF) legislation, it can also be found in the area of tax law. Regardless of the fact that theory and legislative related to taxation as well as to money laundering and terrorist financing (hereinafter: ML/TF) prevention use the same term „beneficial owner“, its meaning is not identical.

Distinguish among concept of beneficial ownership in the field of ML/TF prevention and DTC as well as Directive 2003/49/EZ [1] and Directive 2003/48/EZ [2], is considerable. In order to explain the crucial points of differentiation between various beneficial owner concepts, the paper briefly explains the purpose of defining the notion of the beneficial owner in DTC and the significance of defining that concept in the field of DTC abuse (as well as in European Union legislation) along with the determination of the beneficial owner's provisions related to Croatian AML/TF law. The complexity and diversity of defining the said concept consequently emphasizes the need of joint action.

### 2. DOUBLE TAXATION CONVENTIONS

The principal purpose of DTC is to promote, by eliminating international double taxation, exchanges of goods and services, as well as the movement of capital and persons. It is also a purpose of DTC to prevent tax avoidance and evasion [3]. Under these treaties, source countries

---

<sup>175</sup> Faculty of law, University of Zagreb, Trg Republike Hrvatske 14, Zagreb, Croatia

<sup>176</sup> Ministry of finance, Tax administration, Trg Franje Tuđmana 4, Split, Croatia

agree not to exercise their right to tax passive income (such as dividends, royalties and interest) paid to non-residents or to do so at reduced rates. This is often critical in tax planning structures [4].

## **2.1 DETERMINATION OF TERMS RELATED TO TAX AVOIDANCE**

Although terms tax evasion and tax fraud, as well as tax avoidance, are used as synonyms it is necessary to highlight certain differences. Tax evasion includes the use of illegal methods of avoiding assessment or payment taxes owed, as well as not reporting income or reporting expenses which are not legally allowed. Vice versa, tax avoidance represents a legitimate way to minimize tax liability opposite to essential elements of tax evasion. Although the structure of a venture may be completely legitimate, it is usually contrary to the legislator's intention. In this respect, it is necessary to distinguish between acceptable and unacceptable tax avoidance. The traditional distinction between illegal tax evasion and legal tax avoidance (or planning, or mitigation) has been complicated by the efforts of the authorities to have some forms of avoidance seen as unacceptable even if they satisfy the letter of the law [6].

Acceptable tax avoidance has been explained by national courts during history in a similar way as it is now by the European Court of Justice. As an example can be mentioned Tomlin comments (UK, 1936) App. Cas. 1, 19 in *Commissioners of Inland Revenue v. Duke of Westminster*: "[e]very man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be". The same state can be find in the case *Gregory v. Helvering*, 69 F.2d 809, 810 (SAD, 1934) which goes beyond that: "[a]ny one is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes". Likewise, this issue has been approached in a verdict of the case *Jaques v. Federal Commissioner of Taxation*, 34 C.L.R. 328, 362 (Australia, 1924) and *Cour de cassation*, 1961 Pas. Bel. I 1082, 1089 (Belgium, 1961) [5].

### **2.1.1 DIFFERENT CATEGORY OF DOUBLE TAXATION CONVENTIONS ABUSE**

DTC abuse represents the type of tax planning that uses artificial legal constructions aimed to secure the benefits of both the tax advantages available under certain domestic laws and the reliefs from tax provided for in DTC [7]. Treaty shopping is undesirable because the principle of reciprocity is breached, international income flowing may be exempted from taxation altogether or be subject to inadequate taxation in a way unintended by the contracting states and defeats an incentive for third-party States to negotiate DTC with the contracting states. However, countries that aspire to attract investment (at any cost) can consider treaty shopping as a useful tool. In this regard, Indian Supreme Court considered that treaty shopping was a necessary evil in developing economy and is generally valid under the Indian tax treaty network [8].

According to van Weeghel, the term "treaty shopping" connotes a situation in which a person who is not entitled to the benefits of a tax treaty makes use – in the widest meaning of the word – of an individual or legal person in order to obtain those treaty benefits that are not available directly [9]. Vogel provides a slightly different definition of treaty shopping by referring to a situation where transactions are entered, or entities are established, in other states, solely for the purpose of enjoying the benefit of particular treaty rules existing between the state involved and a third state which otherwise would not be applicable, e.g., because the person claiming the benefit is not a resident of one of the contracting states [10].

Specifically, limitation of benefits arising from DTC to the beneficial owner of income represents a suitable mean of combating DTC abuse. Beneficial owner concept restrains access to treaty benefits only for other contracting state residents and limits opportunities for taxpayers in third countries to indirectly enjoy benefits to which they are not eligible by setting up intermediate companies in the contracting state.

### 3. DIVERSITY OF BENEFICIAL OWNER CONCEPT

During the history, the concept of the beneficial owner in DTC has been changed. According to DTC, the concept of beneficial owner restricts the possibility of using the privileges from the DTC in such a manner that a state of source is not obliged to give up taxing rights over dividends, interest and royalties [11] if beneficial owner of such income is not resident of another member state. The term beneficial owner is not used in a narrow technical sense, rather, it should be understood in its context and in light of the object and purposes of the DTC, including avoiding double taxation and the prevention of fiscal evasion and avoidance [12].

Where an item of income is paid to a resident of a contracting state acting in the capacity of agent or nominee or where a resident of a contracting state simply acts as a conduit for another person who in fact receives the benefit of the income concerned, it would be inconsistent with the object and purpose of the DTC for the state of source to grant relief or exemption. The direct recipient of an item of income is not the beneficial owner because he is obliged (by a contractual or legal obligation) to pass on the payment received to another person [13].

Furthermore, Directive 2003/49/EZ is designed to eliminate taxes levied at source on payments of interest and royalties between associated companies of different Member States as well as permanent establishments of such companies. The Directive provides an exemption if the beneficial owner of the interest or royalties is a company of another Member State or a permanent establishment situated in another Member State of a company of a Member State. That company (or permanent establishment) shall be treated as the beneficial owner of interest or royalties only if it receives those payments for its own benefit and not as an intermediary, such as an agent, trustee or authorised signatory, for some other person.

The objective of Directive 2011/96/EU [14] is to exempt dividends and other profit distributions paid by subsidiary companies to their parent companies from withholding taxes and to eliminate double taxation of such income at the level of the parent company. The Directive does not explicitly require that a company located in the EU which receives dividends from companies

*Sonja Cindori is currently working at the Faculty of Law, University of Zagreb at the Department of Financial Law and Financial Science, as Associate Professor (2017). Before receiving her PhD at the Faculty of Law, University of*



*Zagreb (2009), she worked at the Ministry of Finance – Tax Administration and Anti-Money Laundering Office. She has attended numerous national and international scientific conferences and has published many research articles, research papers, review articles, books, and textbooks as author and co-author. She is the leader of The Croatian Science Foundation’s project headed “Legal and Economic analysis of Anti-Money Laundering and Terrorist financing system” and associate on the project “New Croatia legal system” instituted by the Faculty of Law, University of Zagreb. Her field of interest includes Financial Law with an emphasis on Anti-money Laundering and Terrorist Financing System.*

established in another Member State is a beneficial owner of that dividends. However, The Danish Eastern High Court referred two cases to the Court of Justice of the European Union (CJEU) [15], asking CJEU, among other things, to interpret the concept of beneficial ownership in the context of the Directive 2011/96/EU and to clarify the applicability of the OECD's Commentaries on the Model Tax Convention in this respect.

The term beneficial owner can also be found in Directive 2003/48/EZ as any individual who receives an interest payment or any individual for whom an interest payment is secured, unless he provides evidence that it was not received or secured for his own benefit.

In a frame of AML/TF system such term has been defined differently due to the specificity of the observed issues. Simplified its definition, money laundering is the process of turning „dirty“ money into the „clean“ one [16], involving the use of criminal or illicit funds and assigns criminal liability to otherwise legitimate business practise [17]. Dirty money is considered as any money acquired through criminal offense and any assets derived from it [18].

***Toni Janković***

*He works in the Ministry of finance, Croatian tax administration, Department for large tax payers, as the Head of regional office in Split. He attends the postgraduate specialist study at the Faculty of Law in Zagreb "Fiscal system and fiscal policy". His main interest is taxation of e-commerce. He is a member of the Croatian team in OECD Task Force for Digital Economy*



Art 3 Par 6 of Directive 2015/849 more closely determines beneficial owner as any natural person(s) who ultimately owns or controls the customer and/or the natural person(s) on whose behalf a transaction or activity is being conducted. According to mentioned, as opposed to determining the actual beneficiary in the DTC, Directive 2015/849 is not satisfied with the determination of the beneficial owner within the meaning of the legal entity that controls the transaction, but also includes a natural person - beneficial owner of controlled transactions. Consequently, in Art 13 of Directive 2015/849 preamble emphasizes the need for identification and verification of beneficial owners which should extend to legal entities that own other legal entities, and obliged entities should look for the natural person(s) who ultimately exercises control through ownership or other means of the legal entity that is the customer. Whereas, Member States may stipulate a broader definition of the term beneficial owner in relation to Directive 2015/849.

Financial Action Task Force (FATF) describes beneficial owner as a natural person(s) who ultimately owns or controls a customer and/or the natural person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate effective control over a legal person or arrangement. The terms "ultimately owns or controls" and "ultimate effective control" refer to situations in which ownership/control is exercised through a chain of ownership or by means of control other than direct control [19].

### **3.1 BENEFICIAL OWNERSHIP REGISTER**

As one of the key points of improving AML/TF system, Directive 2015/849 sets out to enhance cooperation (and transparency) between various Member States by laying down obligation to form a central database which collects beneficial ownership information, a business register or another central register. Information from such a registry should be available to competent

authorities and financial-intelligence units, to obliged entities when taking customer due diligence measures as well as to other persons who are able to demonstrate a legitimate interest with respect to ML/TF and the associated predicate offences (corruption, tax crimes and fraud) are granted access to beneficial ownership information, in accordance with data protection rules.

According to Croatian AML/TF law, the register of real users are consisted of beneficial owners data of legal entities established in Croatia, as well as trusts that are obliged to register in Croatia and obtained PIN (OIB). However, it should be borne in mind that public access to information about beneficial ownership of particular legal entity may have consequences on the type, ways and forms of asset investment and impact on investor confidence towards the State institutions. Regardless of the possible negative connotations, the establishment of beneficial owners register will facilitate treatment in tax matters in terms of establishing the existence of links between companies in cross-border transactions, as a precondition for a transfer pricing audits.

#### 4. CONCLUSION

The concept of the beneficial owner in the DTC, as well as in the EU Directives will remain subject to review economic reality of transactions to which it relates, as taxation within the EU (also between the signatory countries of Conventions), should not be an obstacle to free trade. Accordingly, review of the beneficial owner is limited to reviewing the legal person of the observed transaction user (not a beneficial owner as a natural person). Personal data about natural person - the owner of a company that is behind a offshore company or trust, for tax administration can pose significant information to improve the quality of risk analysis and to facilitate finding the conduit companies in analysing the use of tax benefits in cross-border transactions. The connection may indicate the establishment of several companies' complex arrangements aim to reduce the tax liability in a scope of tax evasion or tax avoidance. In order to achieve the goal, it is not enough for tax administrations simply to have insight into a beneficial ownership register. It is for the tax administration to use the register for establishing operational organizational structures that will facilitate the identification of high-risk transactions and improving the level of tax administration efficiency.

#### REFERENCES

- [1] Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States (*OJ L 157, 26.6.2003, p. 49–54*).
- [2] Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments (*OJ L 157, 26.6.2003, p. 38–48*).
- [3] OECD (2015), Model Tax Convention on Income and on Capital 2014 (*Full Version*), *Commentary on Article 1: Concerning the Person covered by the Convention*, OECD Publishing, p. C(1)-19.
- [4] Vella, J. (2015), *Corporate tax practices and aggressive tax planning in the EU*, Directorate General for Internal Policies, Policy Department, A: Economic And Scientific Policy, European Parliament, pp. 6. Retrieved on [http://www.europarl.europa.eu/RegData/etudes/IDAN/2015/563446/IPOL\\_IDA\(2015\)563446\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/IDAN/2015/563446/IPOL_IDA(2015)563446_EN.pdf) (02/03/2018)
- [5] Thuronyi, V. ed., (1996), *Law Design and Drafting*, Vol. 1, Vanistendael, F. *Tax Legal Framework for Taxation* International Monetary Fund, pp. 44. Retrieved on <http://www.imf.org/external/pubs/nft/1998/tlaw/eng/> (08/3/2018)



- [6] Alldridge, P. (2017), *Criminal Justice and Taxation*, Oxford University Press, Oxford, pp. 29.
- [7] OECD (2015), *Model Tax Convention on Income and on Capital 2014 (Full Version)*, Commentary on Article 1: Concerning the Person covered by the Convention, OECD Publishing, p. C(1)-19.
- [8] Jinyan, L. (2012), *Beneficial Ownership in Tax Treaties: Judicial Interpretation and the Case for Clarity*, Comparative Research in Law & Political Economy, Research Paper No. 4, pp. 191. Retrieved at <http://digitalcommons.osgoode.yorku.ca/cgi/viewcontent.cgi?article=1004&context=clpe> (12/3/2018)
- [9] Weeghel, S. (1998), *The Improper Use of Tax Treaties*, Kluwer Law International, London, pp. 117.
- [10] Reimer, E., Alexander Rust, A., (1991), *Klaus Vogel On Double Tax Conventions*, Wolters Kluwer, Boston, pp. 50.
- [11] OECD (2017), *Model Tax Convention on Income and on Capital: Condensed Version 2017*, OECD Publishing, pp. 35, 36, 37.
- [12] Ibidem, Commentary on Article 10, 11 and 12, pp. 233, 259, 271.
- [13] Ibidem, Commentary on Article 10, 11 and 12, pp. 234, 260, 271, 272.
- [14] Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (OJ L 345, 29.12.2011, p. 8–16)
- [15] Court of Justice of the European Union, Case C-116/16, *Skatteministeriet v T Danmark* (2016/C 270/29), Case C-117/16 *Skatteministeriet v Y Denmark Aps*, (2016/C 270/30);
- [16] Madinger, J. (2012), *Money Laundering: A Guide for Criminal Investigators*, CRC Press, Taylor & Francis Group, Boca Raton, pp. 5.
- [17] Turner, J. E. (2011), *Money Laundering prevention: Detering, Detecting, and Resolving Financial Fraud*, John Wiley and Sons, New Jersey, pp. 3.
- [18] Cindori, S. (2007), *Sustav sprječavanja pranja novca*, *Financijska teorija i praksa* 31 (1), pp. 56.
- [19] FATF, *FATF Guidance: Transparency and Beneficial Ownership*, Financial Action Task Force, France. Retrieved at: <http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-transparency-beneficial-ownership.pdf> (9/4/2018)