

**A South African perspective on the meaning of “beneficial ownership” in
Article 10 of the OECD Model Tax Convention on Income and Capital in
the context of conduit company treaty shopping**

by

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SUMMARY

The use of conduit company treaty shopping structures is often regarded as an impermissible erosion of a country's tax base. For a developing country, such as South Africa, the protection of its tax base is an important policy consideration.

Arguably, one way of combatting conduit company treaty shopping structures is by including in a country's double taxation agreements the beneficial ownership requirement set out in Article 10(2) of the OECD MTC. The study examines how a South African court would interpret this requirement in provisions in South African double taxation agreements in the context of conduit company treaty shopping involving conduit companies receiving dividends.

The study firstly considers whether the beneficial ownership requirement can be regarded as an anti-avoidance rule aimed at combatting conduit company treaty shopping falling outside agents and nominee scenarios.

It further considers whether the term "beneficial owner" should have a legal or economic meaning. It explores the meanings given to this term by scholars and foreign courts and the OECD in its Commentaries to the OECD MTC. The study also considers the application of the rules of interpretation contained in the Vienna Convention on the Law of Treaties when giving meaning to this term.

Lastly, the study considers whether the term should have the meaning assigned to it under the domestic law of a treaty country, or under international tax law. As part of this enquiry, the meanings of the expression "beneficial owner" in South African case law and legislation are explored.

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ABBREVIATIONS AND ACRONYMS

AD	Appellate Division, before being restructured as the Supreme Court of Appeal (South Africa)
AN	<i>Audiencia Nacional</i> (Spain)
BEPS	Base erosion and profit shifting
Canadian ITA	Income Tax Act, R.S.C., 1985, c1 (5th Supp.) (Canada)
CA	Court of Appeal (United Kingdom)
CFA	Committee on Fiscal Affairs of the Organisation for Economic Cooperation and Development
CGT	Capital gains tax
CIV	Collective investment vehicle
DTA	Double taxation agreement
FATF	Financial Action Task Force
FCA	Federal Court of Appeal (Canada)
GAAR	General anti-avoidance rule
HMRC	Her Majesty's Revenue & Customs (United Kingdom)
IFA	International Fiscal Association
ITA	Income Tax Act 58 of 1962 (South Africa)
LOB	Limitation of benefit
MLC	Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting
NRST	Non-resident shareholders' tax (as imposed by earlier South African legislation)
OECD	Organisation for Economic Cooperation and Development
OECD MTC	OECD Model Tax Convention on Income and Capital
PE	Permanent establishment

POEM	Place of effective management
PPT	Principal purpose test
SAAR	Specific anti-avoidance rule
SADC	Southern African Development Community
SARS	South African Revenue Service
SCA	Supreme Court of Appeal (South Africa)
SCC	Supreme Court of Canada (Canada)
STC	Secondary Tax on Companies (South Africa)
TCC	Tax Court of Canada (Canada)
UK	United Kingdom
UN	United Nations
US	United States
VCLT	Vienna Convention on the Law of Treaties
1941 ITA	Income Tax Act 31 of 1941 (South Africa)

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CHAPTER 1

INTRODUCTION

Chapter overview

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1.1 Background and motivation for the study

An important policy challenge for South Africa as a developing country is the maintenance of its sustainable sources of revenue. In order to achieve this goal, South Africa needs to protect its tax base adequately. Questions that are increasingly being asked in public policy debates around the world on how multinational enterprises seemingly manage to pay low effective tax rates are thus also important in the South African context.¹ The then South African Minister of Finance recognised this in his 2017 budget speech.² It was also an impetus of the joint project on base erosion and profit shifting (the “BEPS” project) of the Organisation for Economic Co-operation and Development (“OECD”) and G20,³ which started in 2012.⁴

An important aim of the BEPS project for developing countries is to address treaty abuse and in particular treaty shopping.⁵ Treaty shopping, which is explained more comprehensively in

¹ HJ Ault & BJ Arnold “Protecting the Tax Base of Developing Countries: An Overview” in A Trepelkov, H Tonino & D Halka (eds) *United Nations Handbook on Selected Issues in Protecting the Tax Base of Developing Countries* (2015) 1 1.

² P Gordhan *2017 Budget Speech* available at <http://www.gov.za/speeches/minister-pravin-gordhan-2017-budget-speech-22-feb-2017-0000> (accessed on 28-02-2017).

³ The Group of Twenty (“G20”) is a “forum for its members’ international economic cooperation and decision-making” (<http://g20.org.tr/about-g20/> (accessed on 22-07-2017)). Its current members are Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Republic of Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, the United Kingdom, the United States and the European Union.

⁴ Ault & Arnold “Protecting the Tax Base of Developing Countries” in *UN Handbook on Selected Issues in Protecting the Tax Base of Developing Countries* (2015) 1.

⁵ AW Oguttu “OECD’s Action Plan on Tax Base Erosion and Profit Shifting: Part 1 - What Should be Africa’s Response?” (2015) 69 *BFIT* 653 665 notes that this is the view of the G20. GS Cooper “Preventing Tax Treaty Abuse” in A Trepelkov, H Tonino & D Halka (eds) *United Nations Handbook on Selected Issues in Protecting*

part 1.3, allows multinational enterprises to reduce their effective tax rates by using the networks of double taxation agreements⁶ (“DTAs”) around the world to reduce their exposure to withholding taxes on passive income streams, such as dividends. Although the BEPS project makes provision for measures to address the misuse of the treaty network by way of treaty shopping, this is not the first time that the OECD has introduced anti-treaty shopping measures. One measure that has been in existence for many decades is the inclusion of the term “beneficial owner” in DTAs.⁷ Until now, this beneficial ownership requirement has been regarded as the main tool for combatting treaty shopping internationally.⁸

Considering the importance of protecting South Africa’s tax base against treaty shopping and the role that the inclusion of the term “beneficial owner” in its DTAs may play in this regard, South Africa’s stance on the meaning of the term should be clear. This study will attempt to bring more insight into this issue. Furthermore, this study will add to the body of knowledge on the more general question as to how South African courts interpret undefined terms in DTAs.

1.2 The term “beneficial owner”

The term “beneficial owner” has been included in the OECD’s Model Tax Convention on Income and Capital (“OECD MTC”) since 1977. The OECD MTC is widely used as the basis for the negotiation of treaties⁹ by member states, such as Canada, the Netherlands and the United Kingdom (“UK”), as well as non-member states such as South Africa.¹⁰

the Tax Base of Developing Countries (2015) 275 275 n 1 indicates that, in responses to a 2014 BEPS initiative focusing on developing countries circulated by the United Nations (“UN”), a number of countries have stressed the importance of this action point. More generally, the OECD identified in another report (*OECD Addressing Base Erosion and Profit Shifting* (2013) 47) the lack of effective anti-avoidance measures to address treaty abuse as one of the “key pressure points” of the BEPS project.

⁶ As pointed out in *ITC 1878* (2015) 77 SATC 349 n 9, the terms “treaty”, “convention” and “agreement” are often used interchangeably in literature. P Baker *Double Taxation Conventions* (2014) para C.03 adds “arrangement” to this list.

⁷ It should be added that it is the view of the OECD that the beneficial ownership requirement is a measure aimed at combatting treaty shopping, but that this view is not universally accepted.

⁸ RS Avi-Yonah & CHJI Panayi “Rethinking Treaty Shopping: Lessons for the European Union” in M Lang, P Pistone, J Schuch, C Staringer, A Storck & M Zagler (eds) *Tax Treaties: Building Bridges between Law and Economics* (2010) 21.

⁹ *ITC 1878* (2015) 77 SATC 349 para [14]. The current model has its origin in work done by the League of Nations and the Organisation for European Economic Cooperation, the predecessor to the OECD, as explained by DA Ward, JF Avery Jones, L de Broe, MJ Ellis, SH Goldberg, J Killius, J le Gall, G Maisto, T Miyatake, H Torrione, K van Raad & B Wilman *The Interpretation of Income Tax Treaties with Particular Reference to the Commentaries on the OECD Model* (2005) 3 and 6. Ward et al *Interpretation of Income Tax Treaties* 3-4 and 7-8 mention three models on income and capital that have been prepared by the OECD: a draft model in 1963, a

The term “beneficial owner” is not defined in the OECD MTC and is seldom defined in DTAs.¹¹ It is used in Article 10 of the OECD MTC where the relevant part currently states as follows:

- “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 and 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:
 - a) 5 per cent of the gross amount of the dividends if the *beneficial owner* is a company (other than a partnership) which holds directly at least 25 per cent of the capital of the company paying the dividends;
 - b) 15 per cent of the gross amount of the dividends in all other cases ...”¹²

Article 10(2) thus provides for a reduced rate at which dividends are taxed in the country in which the company paying the dividend is resident. This serves to limit corporate tax especially in groups of companies when dividends move across borders. The benefit of the reduced dividend rate is, however, only available if a resident of the other contracting state is the “beneficial owner” of the dividend.¹³

The OECD MTC is accompanied by commentaries (the “Commentaries”) that are periodically updated by the OECD’s Committee on Fiscal Affairs (“CFA”).¹⁴ The OECD

model in 1977 and the current version, which appears in loose-leaf since 1992 and which is amended from time to time.

¹⁰ Ward et al *Interpretation of Income Tax Treaties* 12-13; U Linderfalk & M Hilling “The Use of OECD Commentaries as Interpretative Aids - the Static/Ambulatory - Approaches Debate Considered from the Perspective of International Law” (2015) *Nordic Tax Journal* 34 41. In respect of the influence of the OECD MTC on South African DTAs, see *Secretary for the Inland Revenue v Downing* 1975 (4) SA 518 (A) 523.

¹¹ CHJI Panayi *Double Taxation, Tax Treaties, Treaty-Shopping and the European Community* (2007) 44; C du Toit & J Hattingh “Beneficial Ownership and Double Tax Conventions” in A P de Koker & E Brincker (eds) *Silke on International Tax* (2010) para 9.1.

¹² Emphasis added. OECD *Draft 2017 Update to the OECD Model Tax Convention* (2017) Part 1B para 14 proposes amendments to the wording of Article 10(2)(a), but these amendments are not relevant to this study.

¹³ There is support in foreign case law for the argument that, even if the term “beneficial owner” does not appear in a DTA, it should be implied. See the examples mentioned by L de Broe, N Goyette, P Martin, R Rohatgi, S van Weeghel & P West “Tax Treaties and Tax Avoidance: Application of Anti-Avoidance Provisions” (2011) 65 *BFIT* 375 388. However, see the question raised by E Kemmeren “Preface to Articles 10 to 12” in E Reimer & A Rust (eds) *Klaus Vogel on Double Taxation Conventions Volume I* 4 ed (2015) 705 716 m.nrs. 21-23 and 729 m.nr. 54 on whether the amendments made in 2014 to the Commentary on Article 10 will have an impact on this view.

¹⁴ PJ Wattel & O Marres “The Legal Status of the OECD Commentary and Static or Ambulatory Interpretation of Tax Treaties” (2003) 43 *Euro Tax* 222 224; Ward et al *Interpretation of Income Tax Treaties* 7-8.

maintains in the Commentaries that the term “beneficial owner” serves, amongst other possible purposes, an anti-abuse or anti-avoidance purpose.

South Africa has formulated its own model tax convention. This model is primarily based on the OECD MTC and mainly differs from it with regard to those provisions in respect of which South Africa has reserved its position in terms of the Commentaries.¹⁵ This is not done with regard to the term “beneficial owner” in Article 10. The term is thus commonly used in South African DTAs in the article dealing with dividends.¹⁶ It is, however, not defined in any of these DTAs.¹⁷

1.3 Treaty shopping

Oguttu explains that the inclusion of the term “beneficial owner” is primarily aimed at a form of treaty shopping.¹⁸ She describes treaty shopping as “the use of double taxation treaties by the residents of a non-treaty country in order to obtain treaty benefits that are not supposed to

¹⁵ E Brincker “The Nature of Double Taxation Agreements Concluded by South Africa” in A P de Koker & E Brincker (eds) *Silke on International Tax* (2010) para 13.2. As K Burt “The OECD Commentaries: On What Legal Basis and to what Extent are They Relevant to Tax Treaty Interpretation” (2017) 8 *BTCLQ* 5 15 explains, although South Africa is not an OECD member, it is allowed to note its disagreement with an interpretation set out in the Commentaries by way of stating its “position”. For a list of non-OECD members whose positions are noted in this manner, see para 4 of the Introduction to the *Non-OECD Economies’ Positions on the OECD Model Tax Convention*, published as part of the 2014 version of the OECD MTC. The views of non-OECD members who do not form part of this list are usually not reflected by the OECD.

¹⁶ The exception is some of the DTAs that were concluded before or just after 1977, when the term was first included in the OECD MTC. Examples include the DTAs with Germany, Grenada, Israel, Malawi, Sierra Leone, Zimbabwe and Zambia. See L Olivier & M Honiball *International Tax: A South African Perspective* 5 ed (2011) 541-542 for a summary of the use of the term in South African DTAs in Arts 10-12 as at the date of publication of that contribution (2011). Some South African DTAs contain a comparative requirement, but use different terminology, e.g. the DTA with Australia uses in Art 10(1) the phrase “beneficially owned”.

¹⁷ Art 3(2) of the 2002 South Africa/New Zealand DTA notes as follows:

“For the purposes of Arts 10, 11 and 12, a trustee subject to tax in a Contracting State in respect of dividends, interest or royalties shall be deemed to be the beneficial owner of those dividends, interest or royalties.”

Art 3(2) of the 2015 South Africa/Singapore is almost identically worded. The provision in the South Africa/New Zealand DTA is common in New Zealand DTAs and is in line with an observation that New Zealand had in the Commentaries until 2000 (para 14 of the Commentary to Art 3 as it read from 23 July 1992 to 29 April 2000). R Vann “Beneficial Ownership: What Does History (and Maybe Policy) Tell Us” in M Lang, P Pistone, J Schuch, C Staringer & A Storck (eds) *Beneficial Ownership: Recent Trends* (2013) 267 276-277 notes that the provision is the result of the 1966 UK/New Zealand DTA where the UK sought to introduce the term “beneficial owner” in the DTA. The New Zealand negotiators were concerned that trustees would in some instances, due to the usual meaning of the term “beneficial owner” in the context of New Zealand trust law, not be regarded as “beneficial owners”, despite being subject to tax on the income.

¹⁸ AW Oguttu “Curbing ‘Treaty Shopping’: the ‘Beneficial Ownership’ Provision Analysed from a South African Perspective” (2007) 40 *CILSA* 237 238. Avi-Yonah & Panayi “Rethinking Treaty Shopping” in *Tax Treaties: Building Bridges* (2010) 21 explain that the expression “treaty shopping” seemingly originates from the US and the use of the term “forum shopping”. The latter refers to the practice whereby a litigant in US civil cases tries to “shop” between jurisdictions based on the expectation of which jurisdiction will provide a more beneficial outcome. According to De Broe et al (2011) *BFIT* 382 treaty shopping is the most “prevalent perceived abuse” of DTAs.

be available to them”.¹⁹ De Broe in turn regards it as “a premeditated effort to take advantage of the international tax treaty network and a careful selection of the most favourable tax treaty for a specific purpose”.²⁰

One form of treaty shopping, called “conduit company treaty shopping”,²¹ involves a person inserting a company in order to qualify for a reduced tax rate under a treaty that would otherwise not have been available to such person. It entails a “single-step” (or direct) investment being broken down into two or more steps, thereby becoming an indirect investment.²² The tax benefits pursued under conduit structures may be aimed at the benefits given by the country of source (where the company paying the dividend is resident), the country of residence of the person who ultimately benefits from the dividend, or the country of residence of the recipient of the dividend.²³

The following example illustrates a “direct conduit” method of treaty shopping:²⁴ Company R, a tax resident of Country R, is contemplating the incorporation of Company S in Country S and expects to receive dividends from Company S. However, there is no DTA between Countries S and R and the rate at which the tax on dividends is withheld in Country S will thus not be reduced.²⁵ There is, however, a DTA between Country S and Country C, which includes a provision based on Article 10 of the OECD MTC. Company R thus incorporates a company, Company C, in Country C to hold the shares in Company S. When Company S pays dividends to Company C, the reduced rate provided for in Article 10(2) will apply

¹⁹ Oguttu (2007) *CILSA* 238.

²⁰ L de Broe *International Tax Planning and Prevention of Abuse A Study under Domestic Tax Law, Tax Treaties and EC Law in Relation to Conduit and Base Companies* (2007) 5.

²¹ Oguttu (2007) *CILSA* 240.

²² De Broe *International Tax Planning* 9; J Wheeler “Persons Qualifying for Treaty Benefits” in A Trepelkov, H Tonino & D Halka (eds) *United Nations Handbook on Selected Issues in Administration of Double Tax Treaties for Developing Countries* (2013) 51 83.

²³ De Broe *International Tax Planning* 8 and 9; DG Duff “Responses to Treaty Shopping: A Comparative Evaluation” in M Lang, P Pistone, J Schuch, C Staringer, A Storck & M Zagler (eds) *Tax Treaties: Building Bridges between Law and Economics* (2010) 75 78.

²⁴ The example is based on the one given by De Broe *International Tax Planning* 5-7. Apart from a direct conduit structure, other structures that involve more than three countries are also used. These are called “stepping stone conduits”, and are especially useful if the income flows through a high-tax jurisdiction. In these structures Company R, resident in Country R, incorporates Company C in Country C, to receive dividends from Company S, resident in Country S. Company C may be subject to tax at a high rate on these dividends. It will pay a tax-deductible expense to Company B, a company resident in Country B, which has the same shareholders as Company C. The income received by Company B is either not taxable, or taxed at a lower rate. This example is based on the example provided by De Broe *International Tax Planning* 7.

²⁵ Alternatively, there is a DTA, but the reduced tax rate under the Country S/Country R DTA is higher than the reduced rate under the Country S/Country C DTA. Para 10 of the OECD *Double Taxation and the Use of Conduit Companies Report* (1986) (the “Conduit Report”) also notes other possible reasons for inserting Company C, such as the avoidance of disclosure of information in Country R.

(assuming that Company C is the “beneficial owner” of the dividends). In literature, Company C is often referred to as the “direct recipient” or “intermediate company” and Company R as the “ultimate recipient”. These terms are also used in this study.

The next step entails the dividend flowing through to Company R.²⁶ Several possibilities exist to ensure that this takes place. Company C may on-distribute the dividends to Company R as dividends. Such passing-on of the income in the same form is colloquially referred to as “on-payments”.²⁷ There may also be an obligation on Company C to pass on the dividends to Company R in a different form (colloquially referred to as “payment equivalents”).²⁸

In conduit structures the direct and ultimate recipients are frequently related.²⁹ The former is often a holding company forming part of a group of companies. It is important to note that holding companies, even those not incorporated to obtain treaty benefits,³⁰ often have no substantial business activities and mainly hold investments in subsidiaries, which carry out the business activities.³¹

The direct recipient is, however, not always related to the ultimate recipient. This is often the case in structured finance arrangements that have been entered into to access lower withholding rates. It may, for example, be that the ultimate recipient is the owner of shares, in respect of which he or she is expecting payment of dividends. Before payment of the anticipated dividends, the ultimate recipient transfers his or her right to these dividends to the direct recipient. This may be achieved by selling and transferring the shares to the direct recipient, with a right to repurchase them after the dividends have been paid. Alternatively, the ultimate recipient may grant a usufruct to the direct recipient. Another possibility is a

²⁶ J Wheeler “The Attribution of Income to a Person for Tax Treaty Purposes” (2005) 59 *BFIT* 477 482 points out that the Conduit Report includes an example (Example 3 in para 5(c)) where the income is not passed on, but is reinvested in a subsidiary. She questions whether this can be seen as an example of a “conduit”.

²⁷ R Collier *Letter dated 15 July 2011 to Jeffrey Owens, Director CTPA* (2011) available at <http://www.oecd.org/tax/treaties/48413377.pdf> (accessed on 24-06-2017).

²⁸ Collier *Letter dated 15 July 2011 to Jeffrey Owens, Director CTPA*. See also R Collier “Clarity, Opacity and Beneficial Ownership” (2011) *BTR* 684 694-695.

²⁹ Wheeler (2005) *BFIT* 482; Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.1.

³⁰ There may be very good commercial reasons (other than obtaining treaty benefits) for establishing holding companies, as acknowledged in paras 3 and 9 of the Conduit Report. See also the reasons provided by A Perdelwitz “International Tax Structuring for Holding Activities” in M Cotrut, A Bal, R Betten, R Hamzaoui, B Obuoforibo & O Ostaszewska (eds) *International Tax Structures in the BEPS Era: An Analysis of Anti-Abuse Measures* (2015) 281 282 and R Karadka “Action 6 of the OECD/G20 BEPS Initiative: The Effect on Holding Companies” (2017) 71 *BFIT* 1 heading 3.1.

³¹ Wheeler “Persons Qualifying for Treaty Benefits” in *UN Handbook on Selected Issues in Administration of Double Tax Treaties for Developing Countries* (2013) 83-84; Perdelwitz “International Tax Structuring” in *International Tax Structures in the BEPS Era* (2015) 282; Karadka (2017) *BFIT* heading 3.1.

swap arrangement in terms of which the dividends are paid to the direct recipient, who then makes swap payments (in a different form) to the ultimate recipient.³² Usually, in these circumstances, the direct recipient will make a return from the arrangement, which is often part of the withholding taxes saved by the arrangement.

A number of reasons have been advanced as to why treaty shopping may be regarded as undesirable.³³ It should also be noted that, as explained in part 1.1, governments of developing countries have identified the combatting of treaty shopping as a particular important outcome of the BEPS project. It thus seems fair to conclude that conduit company treaty shopping will for the most part not be regarded as a permissible form of tax planning in the eyes of these governments.

One of the main reasons for regarding treaty shopping as undesirable is that the principle of reciprocity³⁴ is impeded when persons who are resident in a third country (Country R in the example above) enjoy the treaty benefits that were meant for residents of the contracting countries (Countries S and C in the example above), without Country R having to provide reciprocal treaty benefits to residents of the contracting countries (Countries S and C).³⁵

Another reason often voiced, is that conduit company treaty shopping limits the incentive for countries to conclude new treaties. According to Avi-Yonah and Panayi this put countries that comply with their duties under treaties to provide co-operation in fiscal matters, such as

³² These examples are provided by P Baker “The Meaning of ‘Beneficial Ownership’ as Applied to Dividends under the OECD Model Tax Convention” in G Maisto (ed) *Taxation of Intercompany Dividends under Tax Treaties and EU Law* (2012) 87 101-102.

³³ See in this regard Conduit Report para 6; Oguttu (2007) *CILSA* 241-242; Avi-Yonah & Panayi “Rethinking Treaty Shopping” in *Tax Treaties: Building Bridges* (2010) 25-26; Duff “Responses to Treaty Shopping” in *Tax Treaties: Building Bridges* (2010) 79; Olivier & Honiball *International Tax* 551; J Li *Beneficial Ownership in Tax Treaties: Judicial Interpretation and the Case for Clarity Comparative Research in Law & Political Economy Research Report No. 4/2012* (2012) available at <http://digitalcommons.osgoode.yorku.ca/cgi/viewcontent.cgi?article=1004&context=clpe> (accessed on 16-01-2017) 191. The reasons commonly advanced against allowing treaty shopping summarised in the main text are not universally accepted. These counter-arguments are summarised by Avi-Yonah & Panayi “Rethinking Treaty Shopping” in *Tax Treaties: Building Bridges* (2010) 27-30; Li *Beneficial Ownership in Tax Treaties* 191-192 and Karadka (2017) *BFIT* Table 1.

³⁴ BJ Arnold “The Interpretation of Tax Treaties: Myth and Reality” (2010) 64 *BFIT* 1 10-11 describes the principle of reciprocity in the context of DTAs as follows:

“The provisions of tax treaties are usually expressed in terms of reciprocal obligations. One country yields its right to tax in certain circumstances in consideration for the treaty partner yielding its right to tax in similar circumstances.”

³⁵ But see the counter-arguments raised by Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.14 and Avi-Yonah & Panayi “Rethinking Treaty Shopping” in *Tax Treaties: Building Bridges* (2010) 27.

exchange of information, at a competitive disadvantage from an international perspective. This lack of co-operation opens up the possibility for international tax evasion.³⁶

Finally, it is also argued that treaty shopping results in double non-taxation, or at least in “inadequate” taxation. Duff explains that it “can undermine basic tax principles of economic efficiency and horizontal equity, as investment decisions are distorted by tax considerations and tax burdens are shifted to less internationally mobile activities”.³⁷

1.4 Research question

The question that this study aims to address is how a South African court would interpret the term “beneficial owner” in provisions in South African DTAs based on Article 10(2) of the OECD MTC, in the context of conduit company treaty shopping.

The meaning given to the term “beneficial owner” is dependent on one’s view on a number of interdependent issues and the study will consider these issues in order to address the research question posed above. The issues are as follows:

- a) Whether the beneficial ownership requirement can be regarded as an anti-avoidance rule aimed at combatting conduit company treaty shopping.
- b) Whether the term “beneficial owner” should have a legal or economic meaning.
- c) Whether the term “beneficial owner” should have the meaning assigned to it under the domestic law of a treaty country,³⁸ or under “international tax law”.

1.5 Methodology

The research in this study is conducted by analysing applicable domestic legislation, DTAs, case law, academic literature, the Commentaries and other OECD reports and materials.

The study also involves comparative research. Although the focus is on the South African perspective, leading cases dealing with beneficial ownership in the context of DTAs from three foreign jurisdictions are analysed in detail. The 1994 decision by the Dutch *Hoge Raad*

³⁶ Avi-Yonah & Panayi “Rethinking Treaty Shopping” in *Tax Treaties: Building Bridges* (2010) 26.

³⁷ Duff “Responses to Treaty Shopping” in *Tax Treaties: Building Bridges* (2010) 79.

³⁸ There has been some debate on whether the domestic meaning of the source or resident country should be given. Many scholars, including De Broe *International Tax Planning* 667, support the argument that it is the meaning in the source country. However, there is also a contrary view, as explained by AJM Jiménez “Beneficial Ownership: Current Trends” (2010) 2 *World Tax J* 35 55-56. For further sources, see Kemmeren “Preface to Articles 10 to 12” in *Klaus Vogel* (2015) 718 m.nr. 25. See also n 763 below.

in the *Market Maker* case,³⁹ as well as the UK High Court⁴⁰ and Court of Appeal (“CA”)⁴¹ decisions in the matter of *Indofood* are considered. From Canada, judgments by the Tax Court of Canada (“TCC”)⁴² and the Federal Court of Appeal (“FCA”) in the matter of *Prévost Car Inc.*, as well as the decision of the TCC in the *Velcro* case,⁴³ are analysed.⁴⁴ The reasons for selecting these cases are also explained in some detail in chapter 6. Suffice it to say at this stage that they have been selected, firstly, based on the fact that they provide views on all the issues identified in part 1.4. Secondly, they represent judgments by courts of both the civil and common-law traditions, the Netherlands belonging to the former and the UK to the latter. Although the Canadian provinces mostly follow common law, Quebec follows civil law. This consideration is particularly important for this study since the concept of beneficial ownership is not widely known in civil-law jurisdictions, but *is* widely known in common-law jurisdictions. Thirdly, the cases are representative of the two “schools of thought” on beneficial ownership, that is, the legal and economic approaches to the interpretation of the term. Lastly, and rather importantly, they feature prominently in scholarly discussions on beneficial ownership.

Linking with the analysis of the case law from these jurisdictions, the judicial anti-avoidance measures and interpretational approaches followed by the domestic courts in Canada, the Netherlands and the UK are compared to such measures and approaches followed by South African courts.

Lastly, the study also contrasts “ownership” as understood in common- and civil-law jurisdictions.

1.6 Demarcation of the research field

South African DTAs commonly use the term “beneficial owner” not only in Article 10 (dealing with the payment of dividends), but also in Articles 11 (dealing with the payment of

³⁹ *Decision by the Hoge Raad* (6 April 1994) 28638 BNB 1994/217.

⁴⁰ *Indofood International Finance Ltd v JP Morgan Chase Bank NA, London Branch (Formerly JP Morgan Chase Bank, London Bank)* [2005] EWHC 2103 (Ch).

⁴¹ *Indofood International Finance Ltd v JP Morgan Chase Bank NA, London Branch (Formerly JP Morgan Chase Bank, London Bank)* [2006] STC 1195.

⁴² *Prévost Car Inc. v The Queen* 2008 TCC 231.

⁴³ *Velcro Canada Inc. v the Queen* 2012 TCC 57 (CanLII).

⁴⁴ The decision by the Spanish *Audiencia Nacional* (“AN”) in *Real Madrid F.C. v Oficina Nacional de Inspeccion* Judgments of the AN of 18 July 2006 (JUR\2006\204307, JUR\2007\8915 and JUR\2007\16549), 10 November 2006 (JUR\2006\284679), 20 July 2006 (JUR\2007\16526), 13 November 2006 (JUR\2006\284618), 26 March 2007 (JUR\2007\101877) is also briefly referred to.

interest) and 12 (dealing with the payment of royalties).⁴⁵ This is in line with the usage of the term in the OECD MTC. It has been proposed that the term has the same meaning in all these articles,⁴⁶ although the fact that the declaration of dividends is usually subject to the discretion of the board of directors and is thus less predictable, may differentiate Article 10 from the other two articles.⁴⁷ Nevertheless, the research in this study will be limited to the meaning of “beneficial owner” in Article 10, in order to keep the scope of the study within limits. Other issues that arise within Article 10, such as the meaning of the terms “dividends” and “resident”, will not be addressed.

The focus of this study is the meaning of the term “beneficial owner” as a measure to combat conduit company treaty shopping.⁴⁸ For this purpose it is accepted that the direct recipient (Company C in the earlier example) is a “company” as defined in Article 3(1) of the OECD MTC and thus fiscally non-transparent.⁴⁹ It is also accepted that the direct recipient is regarded as a “resident” of the country in which it was incorporated (Country C in the earlier

⁴⁵ The term also appears in other articles in South African DTAs. Examples include South African DTAs where the term is used with regard to technical fees, such as the DTAs with the Islamic Republic of Pakistan (Art 12), Tunisia (Art 12A), Uganda (Art 13), Malaysia (Art 13) and Botswana (Art 20). Another use of the term is found in a protocol with Switzerland, regarding the granting of tax credits for secondary tax on companies (“STC”) (Art 22). A 1947 inheritance tax treaty between South Africa and the United States (“US”) also contains the phrase in Art III(2), which reads:

“[T]he situs of any of the following rights and interests, legal or equitable ... shall, for the purposes of the imposition of tax, be determined exclusively in accordance with the following rules...: (d) share or stock in a corporation (including *shares or stock held by a nominee where the beneficial ownership* is evidenced by script certificates or otherwise) shall be deemed to be situated at the place in or under the laws of which such corporation was created or organised” (emphasis added).

This corresponds to the use of the term “beneficial owner” in the 1945 US/UK treaty, referred to by JDB Oliver “Beneficial ownership and the OECD Model” (2001) *BTR* 27 28.

⁴⁶ Baker “‘Beneficial Ownership’ as Applied to Dividends” in *Taxation of Intercompany Dividends* (2012) 87 and 100; OECD *OECD Model Tax Convention: Revised Proposals Concerning the Meaning of “Beneficial Owner” in Article 10, 11 and 12* (2012) (the “2012 Revised Discussion Draft”) para 32.

⁴⁷ Baker “‘Beneficial Ownership’ as Applied to Dividends” in *Taxation of Intercompany Dividends* (2012) 87 and C du Toit “The Evolution of the Term ‘Beneficial Ownership’ in Relation to International Taxation over the Past 45 Years” (2010) 64 *BFIT* 500 508. See also Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.6.3 and Olivier & Honiball *International Tax* 549 Example 19.3.

⁴⁸ Treaty shopping can also occur in scenarios that are not aimed at obtaining the treaty benefits relating to dividends, interest or royalties. See the examples provided by De Broe *International Tax Planning* 9-10. These are not addressed in this study.

⁴⁹ This refers to the situation where the income of the entity is subject to taxation at the level of the direct recipient (because such recipient is regarded as a person) and not at the level of the person who has an interest in that entity. See, for example, the proposed para 7 of the Commentary to Art 1, as set out in *Draft 2017 Update Part 1C* para 24. De Broe *International Tax Planning* 14 and Wheeler “Persons Qualifying for Treaty Benefits” in *UN Handbook on Selected Issues in Administration of Double Tax Treaties for Developing Countries* (2013) 82 explain that the direct recipient will usually qualify as a “person” for treaty purposes. For this reason companies are a popular choice, as confirmed in the Conduit Report para 2. Some writers also argue that treaty shopping can occur through individuals, as explained by Duff “Responses to Treaty Shopping” in *Tax Treaties: Building Bridges* (2010) 77 n 11. Duff’s examples, however, do not involve scenarios where access to the benefit under Art 10(2) is planned for and are thus not relevant to this study.

example) for purposes of all the countries involved.⁵⁰ Furthermore, it is accepted that the direct recipient receives “dividends”, as contemplated in Article 10(3) of the OECD MTC.

Lastly, many changes are proposed to the OECD MTC, the Commentaries and domestic legislation following the BEPS project. This study only considers the amendments made and proposals submitted up to 31 July 2017.

1.7 Structure of the study

The study commences in chapter 2 with a discussion of the manner in which the OECD and foreign scholars view the issues listed in part 1.4.

Chapter 3 considers the meaning of the concept of beneficial ownership in a non-tax context in common and civil-law countries. Although the focus of this chapter is the manner in which the concept is understood by South African courts, the concept of “ownership” in common and civil-law countries is also compared.

In the subsequent chapter, chapter 4, the focus is on how courts generally interpret DTAs. It considers the impact of the public international law rules in respect of the interpretation of treaties set out in the Vienna Convention on the Law of Treaties (“VCLT”),⁵¹ as well as the role of the Commentaries in the interpretation of DTAs. It also introduces the topic of general *renvoi* clauses, which are usually based on Article 3(2) of the OECD MTC. These clauses allow for the use of domestic meanings when interpreting undefined terms in DTAs.

Chapter 5 examines the anti-avoidance purpose of the beneficial ownership requirement. It explores the interaction between the beneficial ownership requirement and (other) anti-avoidance measures aimed at combatting tax avoidance and considers the interpretative approaches followed by domestic courts in the Netherlands, the UK and Canada. The reason for the selection of these jurisdictions is that it aids in our understanding of the case law on the term “beneficial owner”, which is considered in the following chapter.

Chapter 6 analyses the leading cases from the Netherlands, the UK and Canada dealing with beneficial ownership in the context of DTAs.

Chapter 7 gives a South African perspective on some of the topics explored in chapters 4 and 5, by considering how South African courts interpret DTAs and how they deal with tax

⁵⁰ See De Broe *International Tax Planning* 11-14 for this aspect of treaty shopping.

⁵¹ UN Doc. A/Conf. 39/27, fourth annex, UNTS 1155/331.

avoidance through the interpretation of tax rules. At the end of chapter 7 an international meaning for the treaty term “beneficial owner” is proposed.

In the next part of the study the focus shifts to the domestic meaning of beneficial ownership. Chapter 8 considers the interpretation of general *renvoi* clauses based on Article 3(2) of the OECD MTC and gives a South African view on this topic. Chapter 9 then considers the meanings of the term “beneficial owner” in South African statutory law. This chapter concludes with a finding on whether any of these meanings will be applicable to the treaty term “beneficial owner” under the general *renvoi* clauses.

The study concludes in chapter 10 by collating all the findings in the preceding chapters in order to answer the research question posed in part 1.4.

CHAPTER 2
VIEWS OF THE OECD AND SCHOLARS ON THE MEANING OF THE TERM
“BENEFICIAL OWNER”

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2.1 Introduction

This chapter has three goals. The first is to identify the purpose for which the term “beneficial owner” was inserted in the OECD MTC in 1977. The second goal is to determine the OECD’s view on the meaning of the term, as expressed in the Commentaries and OECD reports. Here it is important to note that the OECD’s view has influenced scholars and courts alike⁵² and may therefore also influence South African courts. The third goal is to introduce

⁵² This appears especially from the frequent reference to the Commentaries in the writings of scholars, as discussed in part 2.4, and the views of foreign courts, as summarised in part 6.7.

the views of scholars on the various issues that arise when interpreting the beneficial ownership requirement.

In order to achieve these goals, the chapter commences with a brief introduction to the various measures currently employed to combat treaty shopping. This will serve as background to the rest of the chapter. The chapter then discusses the reasons for inserting the term “beneficial owner” in the 1977 OECD MTC, as well as the OECD’s view, as it developed over time, on the meaning of the term. Thereafter the chapter considers the views of foreign scholars on the meaning of the term. The chapter concludes by asking whether the most recent amendments to the Commentaries are likely to unify the diverse views on beneficial ownership.

2.2 The beneficial ownership requirement as a possible anti-avoidance tool

Conduit company treaty shopping is traditionally viewed as a form of tax avoidance that is made possible by the very existence of the DTA itself: the country of source of the dividend usually levies a tax in its domestic legislation on non-residents in respect of the dividend, but the DTA creates the reduction in the rate that makes the treaty shopping structure advantageous.⁵³ It follows that treaty shopping is often countered by way of measures in the DTA. However, it may also be addressed by way of measures found under domestic law.

The measures employed may be broadly divided into two categories, namely anti-avoidance rules and the interpretation of the DTA. Starting with anti-avoidance rules, these may be contained either in the DTA itself, or in domestic law.⁵⁴ The rule may be general (known as a “general anti-avoidance rule” or “GAAR”) or specific (known as a “specific anti-avoidance rule” or “SAAR”). Domestic rules may in turn be developed judicially,⁵⁵ or contained in legislation.

Anti-avoidance rules usually attack conduit company treaty shopping on either of two bases.⁵⁶ The first applies to so-called “income conduits”, where the focus is on the relationship between the payment received by the direct recipient and on-payment thereof to

⁵³ Para 6 of the Conduit Report.

⁵⁴ Duff “Responses to Treaty Shopping” in *Tax Treaties: Building Bridges* (2010) 95-102; De Broe et al (2011) *BFIT* 384.

⁵⁵ See the examples given by De Broe et al (2011) *BFIT* 384-385.

⁵⁶ Collier (2011) *BTR* 694-695.

the ultimate recipient.⁵⁷ The question that arises in these cases is whether a direct recipient who receives dividends and uses it to pay an existing debt or to on-declare dividends can be regarded as the beneficial owner of the dividend. Certain anti-avoidance rules thus focus on the relationship between the incoming and outgoing payments. These rules may for example employ a “but for” test: the direct recipient “would not have granted finance on the same terms in one part of the structure, *but for* the finance provided to it in the other part”; the period between the payments; and whether the direct recipient would have sufficient funds to “carry out ‘its’ part of the structure on its own”.⁵⁸ The consideration of whether the direct recipient carries the risk of its debtor not performing may also be taken into account under these anti-avoidance rules.⁵⁹ Wheeler also explains that some anti-avoidance rules that deal with income conduits take into account the existence of a tax avoidance purpose, which may manifest in the direct recipient having no economic substance.⁶⁰

The second basis applies to “entity conduits”, which focuses on the direct recipient itself, rather than on the income received. Wheeler explains that in this case the ultimate recipient uses the direct recipient as its “*alter ego*”, thereby creating residence in the direct recipient’s state of residence and ensuring that the income can be attributed to the direct recipient.⁶¹ The question that is often asked with regard to entity conduits is whether the fact that a direct recipient may be under the control of the ultimate recipient and therefore practically likely to pay the dividends received to the ultimate recipient means that the direct recipient cannot be regarded as the beneficial owner of the dividends.⁶² Anti-avoidance rules aimed at combatting entity conduits focus on the direct or indirect ownership of the entity⁶³ and factors indicating that a sufficient nexus between the direct recipient and its country of residence does not exist. The anti-avoidance rules may, for example, question whether the direct recipient carries on an active business.⁶⁴

⁵⁷ Wheeler (2005) *BFIT* 482 explains that “income conduits” involve multiple payments that constitute one income stream. These conduits create the appearance that the income belongs to the direct recipient and thus allows it to claim a treaty benefit which the ultimate recipient cannot claim.

⁵⁸ 483.

⁵⁹ 482-483.

⁶⁰ 483.

⁶¹ Wheeler (2005) *BFIT* 482.

⁶² Baker *Double Taxation Conventions* para 10B-15.

⁶³ Wheeler (2005) *BFIT* 484; N Bammens & L de Broe “Treaty Shopping and Avoidance of Abuse” in M Lang, P Pistone, J Schuch, C Staringer, A Storck & M Zagler (eds) *Tax Treaties: Building Bridges between Law and Economics* (2010) 51 60.

⁶⁴ Wheeler (2005) *BFIT* 484.

No anti-avoidance rules are currently included in the OECD MTC itself although the Commentary to Article 1 mentions a number of examples of anti-avoidance rules that may be considered for inclusion. The Multilateral Instrument to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (“MLC”), an outcome of the BEPS project, obliges signatories to include at least one anti-avoidance rule and the 2017 draft update to the OECD MTC also makes provision for such rules.⁶⁵

Apart from anti-avoidance rules, treaty shopping may be addressed by the manner in which the DTA is interpreted. It is argued that this may be achieved, firstly, by the manner in which the DTA as a whole is interpreted. In terms of this argument there is an inherent anti-abuse principle in DTAs which can be applied to combat treaty shopping.⁶⁶ Secondly, it may be achieved by the manner in which certain provisions in the DTA are interpreted. Examples of these provisions include the residency requirement as it relates to the direct recipient,⁶⁷ as well as the beneficial ownership requirement.

Concerning the interpretation of the beneficial ownership requirement, the issue is often reduced to the following question: should the term have a “legal” or “economic” meaning? The following explanation by Wheeler aptly describes the friction between an economic and legal view of a conduit company treaty shopping structure:

“The claim to treaty benefits of a company that is part of a conduit structure relies on the legal view.... [The conduit company] is legally entitled to the income for which treaty protection is claimed and the income is usually paid to it... The economic view is rather different, however.

In the extreme case, the conduit carries on very little activity in its residence State, or none at all, other than owning assets, collecting the income produced by the assets and making payments. It has minimal management which could, furthermore, be carried on outside the conduit State, often by employees of other companies in the corporate group which uses the structure or by employees of the group’s advisers. Virtually all of the income collected by the company is used to make payments which are deductible in the conduit State, and those payments are made to other members of the group who are resident outside that State.”⁶⁸

⁶⁵ See the discussion in part 2.3.6.

⁶⁶ Duff “Responses to Treaty Shopping” in *Tax Treaties: Building Bridges* (2010) 91-94. See also De Broe et al (2011) *BFIT* 386 and n 822 below.

⁶⁷ See the discussion by Duff “Responses to Treaty Shopping” in *Tax Treaties: Building Bridges* (2010) 80-86.

⁶⁸ Wheeler “Persons Qualifying for Treaty Benefits” in *UN Handbook on Selected Issues in Administration of Double Tax Treaties for Developing Countries* (2013) 83-84.

There is support for both a legal and economic meaning among scholars and courts, although tax authorities seem increasingly to adopt economic meanings.⁶⁹ From a policy perspective, both approaches have their advantages and disadvantages. This is especially true if what is understood under the economic approach is that beneficial ownership should be regarded as a broad anti-avoidance measure. A legal approach ensures greater certainty. However, it has limited scope to combat the wide variety of forms that treaty shopping may take.⁷⁰ An economic approach serves the latter purpose better, but the resultant uncertainty is undesirable not only from a legal perspective, but may also have negative economic implications. It may, for example, impact the pricing of financial instruments if investors are unclear on whether reduced withholding tax rates will apply to these instruments.⁷¹ The facilitation of international trade, one of the purposes of DTAs, may be negatively influenced by such uncertainty.⁷² It may even negatively affect the rights of taxpayers under their domestic laws since the safeguards normally put in place under such laws to prevent an overly broad application of domestic anti-avoidance measures do not apply in this instance.⁷³

2.3 The use of the term “beneficial owner” in the OECD MTC, the Commentaries and OECD reports

2.3.1 Inclusion of the term “beneficial owner” in the 1977 OECD MTC

This study has the benefit of being able to refer to comprehensive research conducted during the past few years regarding the reasons for the inclusion of the term “beneficial owner” in the 1977 OECD MTC.⁷⁴ The research carried out by Ng⁷⁵ and Vann⁷⁶ forms the basis of the discussion under this heading.

⁶⁹ Collier (2011) *BTR* 694-698, whose research was concluded before the Commentaries were amended in 2014.

⁷⁰ A Wardzynski “The 2014 Update to the OECD Commentary: A Targeted Hybrid Approach to Beneficial Ownership” (2015) 43 *Intertax* 179 183 and 186.

⁷¹ Collier (2011) *BTR* 699.

⁷² Wardzynski (2015) *Intertax* 186.

⁷³ AJM Jiménez “Beneficial Ownership: Current Trends” (2010) 2 *World Tax J* 35 53.

⁷⁴ According to L Friedlander & S Wilkie “Policy Forum: The History of Tax Treaty Provisions - And Why It Is Important To Know About It” (2006) 54 *Can Tax J* 907 courts generally do not consider the historical development of tax treaties. The relevance of such an analysis within the rules of interpretation contained in the VCLT is also not clear, as briefly mentioned in part 4.3.4.

⁷⁵ R Ng “The Concept of Beneficial Ownership” in T Ecker & G Ressler (eds) *History of Tax Treaties The Relevance of the OECD Documents for the Interpretation of Tax Treaties* (2011) 509.

⁷⁶ Vann “What Does History Tell Us” in *Beneficial Ownership* (2013).

The term “beneficial owner” was used in DTAs dating as far back as 1942.⁷⁷ Before the term was included in the OECD MTC, its usage was especially prevalent in DTAs entered into by the UK,⁷⁸ such as the 1968 UK/South Africa DTA.⁷⁹ In these UK DTAs the term was mainly used as an alternative to “subject-to-tax clauses”.⁸⁰ These clauses are usually aimed at ensuring that only the person who is subject to a tax may claim the treaty benefit pertaining to that tax. They were, however, perceived to cause inequitable results for tax-exempt entities such as UK charities and pension funds.⁸¹ In this regard, Vann explains that the term “beneficial owner” was instead adopted and that it was intended, when used in this manner, to deal with nominees and agents (and to an extent trustees) receiving income for the benefit of others. He also points out that, although these situations could be the result of tax planning (to get treaty benefits), it could also be the result of the manner in which a particular industry, where the use of nominees and agents is prevalent, operates.⁸²

The draft 1963 OECD MTC did not contain the term “beneficial owner”.⁸³ The decision to insert the “beneficial owner” terminology in the 1977 OECD MTC originated from UK delegates. This was in response to a request to identify problems that have been experienced with the draft 1963 OECD MTC.⁸⁴ In a document dated May 1967,⁸⁵ these delegates observed as follows:

⁷⁷ According to Vann “What Does History Tell Us” in *Beneficial Ownership* (2013) 271 the first DTA in which the term was used, was the 1942 Canada/US DTA.

⁷⁸ Baker “‘Beneficial Ownership’ as Applied to Dividends” in *Taxation of Intercompany Dividends* (2012) 88; Vann “What Does History Tell Us” in *Beneficial Ownership* (2013) 271.

⁷⁹ The dividends article of the DTA (Art 9) used both the phrases “beneficially owned” and “beneficial owner”. As pointed out by Jiménez (2010) *World Tax J* n 73, the interest and royalty articles in the same DTA did not contain this wording and instead included a “subject to tax” requirement.

⁸⁰ Baker “‘Beneficial Ownership’ as Applied to Dividends” in *Taxation of Intercompany Dividends* (2012) 88. This applies to those DTAs that were entered into from the 1960s, starting with a 1966 UK/US protocol. In DTAs entered into before this time the term served a different purpose. See Vann “What Does History Tell Us” in *Beneficial Ownership* (2013) 271-279.

⁸¹ JF Avery Jones, L de Broe, MJ Ellis, K van Raad, J le Gall, SH Goldberg, J Killius, G Maisto, T Miyatake, H Torriero, RJ Vann, DA Ward & B Wiman “The Origins of Concepts and Expressions Used in the OECD Model and Their Adoption by States” (2006) *BTR* 695; Jiménez (2010) *World Tax J* 52 n 73.

⁸² Vann “What Does History Tell Us” in *Beneficial Ownership* (2013) 280-281.

⁸³ Art 10 of the 1963 OECD MTC read as follows:

“However, such dividends may be taxed in the Contracting State of which the company paying the dividends is a resident, and according to the law of that State, but the tax so charged shall not exceed: (a) 5 per cent of the gross amount of the dividends *if the recipient* is a company (excluding partnership) which holds directly at least 25 per cent of the capital of the company paying the dividends; (b) in all other cases, 15 per cent of the gross amount of the dividends. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation. This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid” (emphasis added).

⁸⁴ Ng “The Concept of Beneficial Ownership” in *History of Tax Treaties* (2011) 522; Vann “What Does History Tell Us” in *Beneficial Ownership* (2013) 282.

“In our view the relief provided for under these Articles [10 – 12] ought to apply only if the beneficial owner of the income in question is resident in the other contracting state, *for otherwise the Articles are open to abuse by taxpayers who are resident in third countries and who could, for instance, put their income into the hands of bare nominees who are resident in the other contracting state.*”⁸⁶

Despite the reference to abuse in the above observation, subsequent reports prepared by the working party responsible for redrafting the interest and royalty articles, paid little attention to abuse of these articles.⁸⁷ Furthermore, at a subsequent occasion the UK delegate in attendance no longer referred to abuse, indicating instead that the dividends, interest and royalty articles “were defective in that they would apply to dividends, interest and royalties paid to an agent or a nominee with a legal right to the income”.⁸⁸ The UK delegate proposed two solutions to this perceived problem: the introduction of a “subject to tax” clause or the insertion of the phrase “beneficial owner”. The latter was given preference.⁸⁹ In subsequent comments on why the term should be included, the focus was, again, on problems relating to agents and nominees and not, Vann concludes, on issues of abuse.⁹⁰

The solution of inserting the beneficial owner requirement was later also adopted by the working party responsible for the redrafting of Article 10.⁹¹ The Commentary to Article 10 was likewise amended to provide:

⁸⁵ *Observations of Member Countries on Difficulties Raised by the OECD Draft Convention on Income and Capital (TFD/FC/216) Comments received from Delegates on the OECD Draft Conventions (Art. 2 to 29) as at 2nd May 1967, and which supersedes TFD/FC/209 (1967)* available at <http://www.taxtreatieshistory.org/> (accessed on 30-06-2017).

⁸⁶ *Observations of Member Countries on Difficulties Raised by the OECD Draft Convention on Income and Capital* heading “Article 10: Dividends United Kingdom”, also quoted by Ng “The Concept of Beneficial Ownership” in *History of Tax Treaties* (2011) 522; Vann “What Does History Tell Us” in *Beneficial Ownership* (2013) 282. Emphasis added.

⁸⁷ Vann “What Does History Tell Us” in *Beneficial Ownership* (2013) 283.

⁸⁸ Quoted by Vann “What Does History Tell Us” in *Beneficial Ownership* (2013) 283.

⁸⁹ Ng “The Concept of Beneficial Ownership” in *History of Tax Treaties* (2011) 522; Vann “What Does History Tell Us” in *Beneficial Ownership* (2013) 283-284. Lüthi, when giving expert evidence in *Prévost Car Inc. v The Queen* 2008 TCC 231 para 56 (discussed in part 6.5.2), noted that there is no clear answer regarding why the term “beneficial owner” instead of other terms considered at the time (such as “final recipient”) was chosen. See also CP du Toit *Beneficial Ownership of Royalties in Bilateral Tax Treaties* (1999) 148 and 196.

⁹⁰ Vann “What Does History Tell Us” in *Beneficial Ownership* (2013) 287.

⁹¹ In the 1977 OECD MTC the relevant part of Art 10(2) read as follows:

“However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the recipient *is the beneficial owner of the dividends* the tax so charged shall not exceed: a) 5 per cent of the gross amount of the dividends *if the beneficial owner is a company ...*” (emphasis added). In 1995, the wording of Art 10(2) was amended by replacing the words “if the recipient is the beneficial owner of the dividends” with “if the beneficial owner of the dividends is a resident of the other Contracting State”.

See the brief discussion of the reason for this amendment by Vann “What Does History Tell Us” in *Beneficial Ownership* (2013) 287 n 44 and 307 n 82.

“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. States which wish to make this more explicit are free to do so during bilateral negotiations.”⁹²

In addition, the Commentary to Article 1 was also amended due to the work carried out by another working party, which was tasked with considering treaty abuse. The term “beneficial owner” was mentioned in its reports, but Vann’s analysis of the work of this working party illustrates that little attention was paid to the problem of conduit company treaty shopping. Instead, the focus of this group was abuse by way of base companies (and personal holding companies), which were used to defer taxation in the resident country of the ultimate shareholder.⁹³

The working party succeeded in ensuring the insertion of new paragraphs under the heading “Improper use of the Convention”, in the Commentary to Article 1. These read as follows:⁹⁴

“7. The purpose of double taxation conventions is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement 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 differences in tax levels between States and the tax advantages provided by various countries’ taxation laws, but it is for the States concerned to adopt provisions in their domestic laws to counter such manoeuvres. Such States will then wish, in their bilateral double taxation conventions, to preserve the application of provisions of this kind contained in their domestic laws.

8. Moreover, the extension of the network of double taxation conventions still reinforces the impact of such manoeuvres by making it possible, using artificial legal constructions, to benefit both from the tax advantages available under domestic laws and the tax relief provided for in double taxation conventions.

9. This would be the case, for example, if a person (whether or not a resident of a Contracting State), acts through a legal entity created in a State essentially to obtain treaty benefits that would not be available directly....

⁹² Para 12 of the Commentary to Art 10 (1977) (emphasis added). Other amendments were also made to the Commentary to Art 10, notably to para 22, quoted at n 97 below.

⁹³ Vann “What Does History Tell Us” in *Beneficial Ownership* (2013). See the description of base companies by De Broe *International Tax Planning* ch 2.

⁹⁴ Paras 7-10 of the Commentary to Art 1. The paragraphs quoted in the main text have been updated to reflect minor amendments that were effected in September 1995 (referred to at n 114 below).

10. *Some of these situations are dealt with in the Convention, e.g. by the introduction of the concept of “beneficial owner” (in Articles 10, 11 and 12) ... Such problems are also mentioned in the Commentaries on Article 10 (paragraphs 17 and 22) ... It may be appropriate for Contracting States to agree in bilateral negotiations that any relief from tax should not apply in certain cases, or to agree that the application of the provisions of domestic laws against tax avoidance should not be affected by the Convention.*”⁹⁵

It has been argued that these paragraphs, especially paragraph 10, confirm from the outset that the term “beneficial owner” served as an anti-avoidance measure against conduit company treaty shopping.⁹⁶ Vann, however, points out that paragraph 10 refers to the beneficial owner requirement in the context of abuse as foreseen under paragraph 22 of the Commentary to Article 10. That paragraph refers to base companies and not conduit companies.⁹⁷ He thus argues that other forms of abuse were the main concern which the working party responsible for the redrafting of the Commentary to Article 1 sought to address with the paragraphs quoted above. He concludes that “there is no clear historical justification [in the work carried out by this working party] for the view that the beneficial ownership concept deals with conduit companies”.⁹⁸

In summary, it can be said that no clear picture emerges that the term “beneficial owner” was included in Article 10 of the 1977 OECD MTC to deal with conduit company treaty shopping as such. If combatting abuse was, indeed, (one of) the purposes for the insertion, only abuse in the form of the direct recipient acting as an “agent” or “nominee” in legal terms was clearly envisioned.⁹⁹ Unfortunately, Vann’s research might have come too late.¹⁰⁰ Foreign

⁹⁵ Emphasis added.

⁹⁶ Kemmeren “Preface to Articles 10 to 12” in *Klaus Vogel* (2015) 716 m.nrs. 20-21.

⁹⁷ Para 22 of the Commentary to Art 10 read after its amendment in 1977:

“Attention is drawn generally to the following case: the beneficial owner of the dividends arising in a Contracting State is a company resident of the other Contracting State; all or part of its capital is held by shareholders resident outside that other State; *its practice is not to distribute its profits in the form of dividends; and it enjoys preferential taxation treatment* (private investment company, *base company*)” (emphasis added).

Vann “What Does History Tell Us” in *Beneficial Ownership* (2013) 295-296 explains that this paragraph did not focus on conduit company treaty shopping. See also Vann’s comments on para 17 of the Commentary to Art 10.

⁹⁸ Vann “What Does History Tell Us” in *Beneficial Ownership* (2013) 296. Jiménez (2010) *World Tax J* 53 n 77 also points out that the UK (in addition to the beneficial ownership requirement) usually also included specific anti-avoidance clauses in their dividends articles and that the UK thus thought that the beneficial ownership requirement could not counter all forms of treaty abuse.

⁹⁹ The following authors share this view: Jiménez (2010) *World Tax J* 53 and the sources mentioned at n 78 of that contribution; Collier (2011) *BTR* 687; G Watson “Treaty Shopping and Base Erosion and Profit Shifting Action 6” (2014) 62 *Can Curr Tax* 1085 1089. See also Lüthi’s expert evidence, referred to in *Prévost Car Inc. v The Queen* 2008 TCC 231 para [55] (discussed in part 6.5.2).

¹⁰⁰ D Gutmann “The 2011 Discussion Draft on Beneficial Ownership: What Next for the OECD?” in M Lang, P Pistone, J Schuch, C Staringer & A Storck (eds) *Beneficial Ownership: Recent Trends* (2013) 341 341-342 notes

scholars and courts (as shown in chapter 6) have claimed many times that combatting treaty shopping was, indeed, at least one of the purposes for which the beneficial ownership requirement was included. Often when these statements are made, they are not limited to treaty shopping involving agents or nominees. This is compounded by the impression given by the historical research that, when the term was included, there was no clear idea as to its meaning.¹⁰¹ Courts may thus in future not be prepared to depart from the idea that at least one of the purposes of inserting the term was to combat conduit company treaty shopping beyond the agent/nominee scenario. The words “intermediary, *such as* an agent or nominee” in the Commentary to Article 10 also left open the possibility for later arguments that agents and nominees were not the only intended targets.¹⁰² These arguments were expressed in later work done by the OECD MTC.

2.3.2 The 1986 OECD Conduit Report and 1992 amendments to the OECD MTC

In 1986, the OECD prepared the Conduit Report in which the role of conduit companies in treaty shopping was discussed.¹⁰³ Case law on beneficial ownership often refers to this report,¹⁰⁴ which noted with regard to the use of the term “beneficial owner” as follows:

“The OECD has incorporated in its revised 1977 Model provisions precluding in certain cases persons not entitled to a treaty from obtaining its benefits through a ‘conduit company’...

- (b) Articles 10 to 12 of the OECD Model deny the limitation of tax in the State of source on dividends, interest and royalties *if the conduit company is not its ‘beneficial owner’*. Thus the limitation is not available when, economically, it would benefit a person not entitled to it who interposed the conduit company as an intermediary between himself and the payer of the income (paragraphs 12, 8 and 4 of the Commentary to Articles 10, 11 and 12 respectively). 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*

with regard to Vann’s research (and another contribution): “[I]t is now too late for tax academics and judges to become historians. Certainly, one may have regrets... However, regrets do not build the future of tax treaties.”

¹⁰¹ Baker “‘Beneficial Ownership’ as Applied to Dividends” in *Taxation of Intercompany Dividends* (2012) 94.

¹⁰² See the discussion in part 2.4.

¹⁰³ See also the OECD *Double Taxation and the Use of Base Companies Report* (1986) para 38, as discussed by Vann “What Does History Tell Us” in *Beneficial Ownership* (2013) 297.

¹⁰⁴ As concluded in part 6.7. Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.14 n 133 question the validity of the report as a source to interpret a DTA. Similarly, see H Pijl “The Definition of ‘Beneficial Owner’ under Dutch Law” (2000) 54 *BFIT* 256 260. For a contrary view, see De Broe *International Tax Planning* 683.

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). In practice, however, it will usually be difficult for the country of source to show that the conduit company is not the beneficial owner. The fact that its main function is to hold assets or rights is not itself sufficient to categorise it as a mere intermediary, although this may indicate that further examination is necessary. ... It is apparently in view of these difficulties that the Commentaries on the 1977 OECD Model mentioned the possibility of defining more specifically during bilateral negotiations the treatment that should be applicable to such companies (cf. paragraph 22 of the Commentary on Article 10)¹⁰⁵.¹⁰⁶

According to Vann, this is the first instance where the OECD expressly extended the meaning of the term “beneficial owner” to deal with conduit companies.¹⁰⁷ The above statement was included in the Commentary to Article 10 with some amendments and is discussed further in part 2.3.4.

The Conduit Report also suggested several different approaches that may be useful when seeking to include a SAAR in a DTA to counter conduit company treaty shopping.¹⁰⁸ In 1992, amendments were made to the Commentaries to refer to these approaches¹⁰⁹ (but not to the comments in the Conduit Report in respect of beneficial ownership).

The approaches that were included in the Commentary to Article 1 in 1992 were as follows:

- a) the “look-through” approach: denying treaty benefits if the direct recipient is not owned by residents of the contracting states;¹¹⁰
- b) the “exclusion approach”: denying treaty benefits in respect of income received or paid by a company with special tax privileges;¹¹¹

¹⁰⁵ However, see the main text corresponding to n 97 above and Vann’s argument that para 22 of the Commentary to Art 1 did not deal with conduit company treaty shopping.

¹⁰⁶ Para 14 of the Conduit Report (emphasis added).

¹⁰⁷ Vann “What Does History Tell Us” in *Beneficial Ownership* (2013) 298. Du Toit *Beneficial Ownership of Royalties* 217-218, however, argues that the report does not add anything to what was already implied in the 1977 Commentaries.

¹⁰⁸ Para 42 of the Conduit Report also recommended that specific provisions be included to ensure that treaty benefits be granted where there is no abuse. See also S van Weeghel *The Improper Use of Tax Treaties With Particular Reference to the Netherlands and the United States* (1998) 216.

¹⁰⁹ These amendments are listed in the OECD *The Revision of the Model Convention* (1992). Another change made in 1992 was to remove the reference in the title to the OECD MTC to the purposes of the Convention. (At that time, the title stated that the purposes were to eliminate double taxation and prevent fiscal evasion.)

¹¹⁰ Paras 23-25 of the Conduit Report.

¹¹¹ Paras 26-28.

- c) the subject-to-tax approach: where the direct recipient only qualifies for a reduced rate if it is subject to tax in its state of residence;¹¹² and
- d) the channel (or base erosion) approach: where treaty benefits are denied if persons not resident in the same country as the direct recipient have a substantial interest in and are in control of the direct recipient and more than 50 per cent of income received by the direct recipient is used to satisfy claims, such as interest or royalties, by these persons.¹¹³

2.3.3 The 1998 OECD report on harmful tax competition

The next¹¹⁴ noteworthy mention of beneficial ownership in reports of the OECD was in a 1998 report on harmful tax competition (the “Harmful Tax Competition Report”).¹¹⁵ There it was mentioned:

“118. Countries that have introduced regimes constituting harmful tax competition often view the development of their network of tax conventions as an asset that facilitates and encourages the use of these regimes by residents of third countries. A wide treaty network may therefore have the unintended consequence of opening up the benefits of harmful preferential tax regimes offered by treaty partners.

119. Various approaches have been used by countries to reduce that risk... Another example involves denying companies *with no real economic function* treaty benefits because these companies *are not considered as beneficial owner* of certain income formally attributed to them. The Committee intends to continue to examine these and other approaches to the application of the existing provisions of the Model Tax Convention, with a view to recommending appropriate clarification to the Model Tax Convention.”¹¹⁶

Vann notes in this regard that this approach appears “to retrofit the new policy change to existing tax treaties by interpretation which would seem to go beyond the legitimate sphere of interpretation.”¹¹⁷

¹¹² Paras 29-36.

¹¹³ Paras 37-41.

¹¹⁴ In 1995 amendments were made to the wording of Art 10(2) of the OECD MTC, as mentioned at n 91 above. In addition, some minor amendments were also made to paras 7-9 of the Commentary to Art 1 and para 12 of the Commentary to Art 10.

¹¹⁵ OECD *Harmful Tax Competition: An Emerging Global Issue Report* (1998).

¹¹⁶ *Harmful Tax Competition Report* recommendation 9 (emphasis added).

¹¹⁷ Vann “What Does History Tell Us” in *Beneficial Ownership* (2013) 299.

2.3.4 The 2002 OECD report on restrictions to the entitlement to treaty benefits and the 2003 amendments to the Commentaries

Following the further work recommended in the above-mentioned 1998 report, the OECD prepared a 2002 report on restricting the entitlement to treaty benefits.¹¹⁸ The 2002 report did not deal with the interaction between domestic anti-avoidance measures and DTAs (despite the 1998 report mentioning this as an area in respect of which further work was required).¹¹⁹ However, in the 2003 update to the Commentaries this issue was dealt with by amending the Commentary to Article 1 in a number of ways. Firstly, the Commentary now explicitly stated that it was also a purpose of DTAs to prevent tax avoidance and evasion.¹²⁰ Secondly, changes pertaining to the Commentary on the granting of treaty benefits in cases of abuse and the interaction between domestic anti-avoidance rules and DTAs were made.¹²¹ Thirdly, the Commentary now included a principal purpose test (not to be confused with the test discussed in part 2.3.6) that countries could include in their DTAs, should they wish to do so.¹²² This test was based on a provision that has been used in a number of UK DTAs¹²³ and has been included in a few South African DTAs.¹²⁴

During the 2003 amendment of the Commentaries, a number of changes were also made that were directly relevant to the beneficial ownership requirement. These changes were the result of the further work foreseen in the Harmful Tax Competition Report and were set out in the 2002 OECD report.¹²⁵

Vann makes the following connection between these amendments and the amendments pertaining to the Commentary to Article 1 on the granting of treaty benefits in cases of abuse and the interaction between domestic anti-avoidance rules and DTAs referred to above:

“Presumably beneficial ownership was raised [in the 2002 report] because agreement had not been reached in 2002 on the interaction of domestic anti-avoidance rules with tax treaties.

¹¹⁸ OECD *Restricting the Entitlement to Treaty Benefits Report* (2002).

¹¹⁹ *Harmful Tax Competition Report* recommendation 10.

¹²⁰ Para 7 of the Commentary to Art 1 (2003). See also para 9.5 of the Commentary to Art 1(2003) and the discussion in part 4.3.4.

¹²¹ Primarily paras 9.1-9.5 and 22-22.2 of the Commentary to Art 1 (2003). These are discussed in part 5.2.

¹²² Para 21.4 of the Commentary to Art 1 (2003).

¹²³ BJ Arnold “Tax Treaties and Tax Avoidance: The 2003 Revisions to the Commentary to the OECD Model” (2004) 58 *BFIT* 244 257.

¹²⁴ See the list in National Treasury of South Africa *The Republic of South Africa Status of List of Reservations and Notifications at the Time of Signature* (2017) available at <http://www.oecd.org/tax/treaties/beps-mli-position-south-africa.pdf> (accessed on 8-06-2017) 27.

¹²⁵ *Restricting the Entitlement to Treaty Benefits Report* Heading 6.

When that issue was resolved by the OECD in 2003 in favour of domestic anti-avoidance rules not being subject to tax treaties, there was little need for the comments on beneficial ownership. Perhaps the OECD realized it was on doubtful ground on both issues and was trying to shore up every possibility.”¹²⁶

The amendments pertaining more directly to the beneficial ownership requirement included changes, firstly, to the Commentary to Article 1.¹²⁷ Most notable in this regard was the inclusion of an example of a detailed limitation of benefits (“LOB”) provision.¹²⁸ In brief, LOB clauses restrict treaty benefits where the person who claims the benefit does not have substantial connections with that country.¹²⁹ Article 22 of the 1997 DTA between South Africa and the United States (“US”) is an example of such a clause.

Secondly, the explanation of the beneficial ownership requirement in the Commentary to Article 10 was extended considerably. The amended paragraph 12 of the Commentary to Article 10 is quoted in full in an annexure.¹³⁰ It is repeated here for the sake of convenience:

“12 The term “beneficial owner” is not used in a narrow technical sense, rather, it should be understood in its context and in the light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.¹³¹

12.1 Where an item of income is received by a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption merely on account of the status of the immediate recipient of the income as a resident of the other Contracting State ... 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

¹²⁶ Vann “What Does History Tell Us” in *Beneficial Ownership* (2013) 301 (footnote omitted).

¹²⁷ In addition to the amendment discussed in the main text, the Commentary to Art 1 was also amended to add para 9.6 and amend para 10. These amendments confirmed that there is a need for specific provisions in DTAs aimed at preventing particular forms of tax avoidance. It also retained the reference to the beneficial ownership requirement as an example of such a SAAR. Changes were also made to the approaches mentioned in part 2.3.2.

¹²⁸ Para 20 of the Commentary (2003) to Art 1.

¹²⁹ Ault & Arnold “Protecting the Tax Base of Developing Countries” in *UN Handbook on Selected Issues in Protecting the Tax Base of Developing Countries* (2015) 30. Wheeler “Persons Qualifying for Treaty Benefits” in *UN Handbook on Selected Issues in Administration of Double Tax Treaties for Developing Countries* (2013) 75 explains, however, that LOB clauses may go beyond this “role of backing up the residence definition”, for example if they consider whether the particular income received is a “genuine receipt of an active business” carried on by the company in its country of residence.

¹³⁰ See Annexure A to this study.

¹³¹ See also the amendment to para 7 of the Commentary (2003) to Art 1, discussed in part 4.3.4.

Convention 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.”¹³²

These amendments adopted the wording of the Conduit Report, quoted in part 2.3.2, to a large extent. A number of noteworthy changes were, however, made. These changes include the omission of the following statements found in the Conduit Report: the statement that a person will not be a beneficial owner if such person “takes over obligations under which he has *a similar function to those of a nominee or an agent*”; the reference to whether a person is the “formal owner of certain assets” and the reference to the shareholders of the direct recipient likely being the parties on whose account the direct recipient is acting. The word “economically” was also omitted. Apart from these omissions, the 2003 Commentary introduced wording that was not included in the Conduit Report. It introduced the phrase “as a practical matter” and stated that the term “beneficial owner” should not be used “in a narrow technical sense”.

The amended wording in the 2003 Commentary has often been referred to in international case law on the meaning of beneficial ownership.¹³³ Due to the importance of this wording, Vann’s comments on the amendments are worth repeating in full:

“The object and purpose of tax treaties are used here to try to yoke agents/nominees and conduit companies together. The policy asserted in relation to agents and nominees is that the state of residence does not attribute the income to the agent or nominee so that there is no double taxation to prevent. This is fully consistent with the history and policy of beneficial ownership outlined earlier.

The policy asserted in relation to conduit companies, however, is quite different – acting as a conduit for another person who in fact receives the benefit of the income concerned. This policy would on a strict view mean that any legal entity will not be the beneficial owner as ultimately all legal entities act as a conduit for another real flesh and blood person who receives the benefit of the income. This view would require beneficial ownership to be interpreted as meaning the ultimate economic owner of the income which has never been the intended meaning for the term.

¹³² Emphasis added. Para 12.2 also related to Art 10(2) and is repeated in Annexure A to this study.

¹³³ Discussed in ch 6.

The remedy which immediately follows taken out of the Conduit Companies Report does not match the policy asserted as it is much narrower in effect, similarly as for the different policy asserted in the conduit company report. The problem of linking broad policies with tests that are much narrower in operation is that readers may come away with different messages, which clearly is what has happened. In particular, tax administrations seem to have focused on the asserted policy, not the much narrower test applicable to conduits.”¹³⁴

From at least this date it has been argued that the term also serves an anti-abuse or anti-avoidance purpose.¹³⁵ However, as Vann pointed out, what exactly this meant in practical terms was unclear.¹³⁶

2.3.5 The 2014 amendments to the Commentary

Contradicting views in case law prompted the OECD to seek a more “precise” commentary on the term “beneficial owner”.¹³⁷ Consequently, in 2011 the OECD released a public discussion draft on the meaning of the term (“the 2011 Discussion Draft”).¹³⁸ Following comments received on that draft, a revised discussion draft was prepared in 2012.¹³⁹ In 2014, the OECD responded to some of the comments received to the 2012 draft¹⁴⁰ and indicated how the Commentary to Article 10 would be amended.¹⁴¹ The amended paragraph 12 of the Commentary to Article 10 is quoted in full in an annexure.¹⁴²

Following these 2014 amendments, the Commentary to Article 10 pertaining to the meaning of “beneficial owner” can be summarised as follows:

- a) The 2014 Commentary expressly states that the term does not refer to “any technical meaning that it could have had under the domestic law of a specific country” and is

¹³⁴ Vann “What Does History Tell Us” in *Beneficial Ownership* (2013) 300 (footnote omitted).

¹³⁵ DG Duff “Beneficial Ownership: Recent Trends” in M Lang, P Pistone, J Schuch, C Staringer & A Storck (eds) *Beneficial Ownership: Recent Trends* (2013) 11.

¹³⁶ See also Li *Beneficial Ownership in Tax Treaties* 199.

¹³⁷ P Baker “United Kingdom: Indofood International Finance Ltd v JP Morgan Chase Bank NA” in M Lang, P Pistone, J Schuch, C Staringer & A Storck (eds) *Beneficial Ownership: Recent Trends* (2013) 27 27, who singles out the decision *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] STC 1195 as the catalyst for reconsidering the meaning of the term.

¹³⁸ OECD *Clarification of the Meaning of “Beneficial Owner” in the OECD Model Tax Convention* (2011).

¹³⁹ OECD *OECD Model Tax Convention: Revised Proposals Concerning the Meaning of “Beneficial Owner” in Article 10, 11 and 12* (2012).

¹⁴⁰ The comments are available at <http://www.oecd.org/tax/treaties/publiccommentsreceivedonthediscussiondraftonthemeaningofbeneficialownerintheoecdmodeltaxconvention.htm> (accessed on 8-06-2017).

¹⁴¹ OECD *2014 Update to the OECD Model Tax Convention* (2014). In addition, Art 10 itself was also amended, for the reasons discussed by Vann “What Does History Tell Us” in *Beneficial Ownership* (2013) 287 n 44 and 307 n 82.

¹⁴² See Annexure A to this study.

“therefore not used in a narrow technical sense (such as the meaning that it has under the trust law of many common law countries)”. The 2014 Commentary furthermore states that the term should be understood “in its context, in particular in relation to the words ‘paid ... to a resident’, and in light of the object and purposes of the Convention”.¹⁴³ It also includes a footnote addressing the position of trusts (or trustees). In comparison, under the 2003 Commentary it was stated that the term 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 Convention”.¹⁴⁴

- b) The 2014 Commentary rejects the meaning given in other instruments, such as the meaning given by the Financial Action Task Force (“FATF”).¹⁴⁵ This meaning concerns the person (usually an individual) who exercises “ultimate control over entities or assets”.¹⁴⁶
- c) The 2014 Commentary explicitly states that Article 10 refers to the beneficial owner of a dividend, rather than a share.¹⁴⁷
- d) The 2014 Commentary also expressly notes that, even if a direct recipient is regarded as a “beneficial owner”, other anti-avoidance measures may come into play to prevent treaty benefits being granted to such a company.¹⁴⁸
- e) All versions of the Commentary make it clear that a direct recipient receiving a dividend in the capacity of an agent or nominee is not the beneficial owner of the dividend.¹⁴⁹ The 2003 and 2014 Commentaries respectively state that in these circumstances it would be inconsistent with the object and purpose of the DTA to grant the treaty benefit since no potential double taxation arises. The reason provided is that the direct recipient is not the owner of the income for tax purposes in its country of residence.
- f) The 2003 and 2014 Commentaries further state that it would be inconsistent with the object and purpose of DTAs if the direct recipient is regarded as the “beneficial owner”, but a person other than the direct recipient “in fact receives the benefit” of the dividend. This is the case if a “conduit company” has “as a practical matter, very narrow powers

¹⁴³ Para 12.1 of the Commentary (2014).

¹⁴⁴ Para 12 of the Commentary (2003).

¹⁴⁵ See also part 9.3.3.

¹⁴⁶ Para 12.6 of the Commentary (2014).

¹⁴⁷ This is made especially clear in para 12.6 of the Commentary (2014).

¹⁴⁸ Para 12.5 of the Commentary (2014).

¹⁴⁹ Paras 12 of the Commentary (1977), 12.1 of the Commentary (2003) and 12.2 of the Commentary (2014).

which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties”.¹⁵⁰

- g) Added to the above, and perhaps the most controversial amendment, is a new paragraph in the 2014 Commentary. It states that in the examples of an “agent, nominee, a conduit company acting as a fiduciary or administrator” the direct recipient is not the beneficial owner since its right to use and enjoy the dividend is constrained by a contractual or legal obligation to pass on the payment received to another person.¹⁵¹ This paragraph is discussed in part 2.6.

2.3.6 The BEPS project and the MLC

In the final report in respect of BEPS Action Point 6 it was recommended that the Commentary to Article 1 be amended. These amendments deal with the interaction between domestic anti-avoidance rules and DTAs and are discussed in part 5.2.¹⁵²

In this report it was also recommended that countries should include a statement in their DTAs. This statement, which is considered in part 4.3.4, declares that, by entering into the DTA, the contracting countries intend to avoid creating opportunities for non-taxation, or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements.¹⁵³ The statement is included in the 2017 draft update to the OECD MTC,¹⁵⁴ as well as the MLC.¹⁵⁵ (The MLC is an output of the BEPS project,¹⁵⁶ aimed at modifying existing DTAs in order to implement the BEPS measures.¹⁵⁷)

Lastly, it was recommended that countries adopt one of the following as a minimum standard to counter treaty shopping: both a principal purpose test (“PPT”) and a LOB (either simplified or detailed); a detailed LOB provision, supplemented by specific mechanisms that

¹⁵⁰ Paras 12.1 of the Commentary (2003) and 12.3 of the Commentary (2014).

¹⁵¹ Para 12.4 of the Commentary (2014). The most comments were received in respect of this paragraph, according to the *2012 Revised Discussion Draft* para 11 and the *2014 Update to the OECD Model Tax Convention 2*.

¹⁵² OECD *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances - Action 6, 2015 Final Report* (2015) para 59. The proposed amendments have also resulted in proposed changes to paras 12.4, 12.5 and 12.7 of the Commentaries to Article 10. These changes are indicated in Annexure A to this study.

¹⁵³ *2015 BEPS Report on Action Point 6* para 22.

¹⁵⁴ *Draft 2017 Update Part 1B* para 4.

¹⁵⁵ Art 6.1 of the MLC.

¹⁵⁶ This was proposed in the OECD *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties, Action 15 – 2015 Final Report* (2015).

¹⁵⁷ Para 13 of the Explanatory Statement to the MLC notes that the MLC “operates to modify tax treaties between two or more Parties to the Convention. It will not function in the same way as an amending protocol to a single existing treaty, which would directly amend the text of the Covered Tax Agreement; instead, it will be applied alongside existing tax treaties, modifying their application in order to implement the BEPS measures.”

deal with conduit arrangements not already dealt with in DTAs; or a PPT only.¹⁵⁸ The MLC includes a simplified LOB and a PPT. The 2017 draft update to the OECD MTC includes all three options.¹⁵⁹

South Africa, who has signed the MLC on 7 June 2017, opted for a PPT.¹⁶⁰ It is important to note that the beneficial ownership requirement still remains as a requirement¹⁶¹ and that it is likely to be regarded by the Commissioner of the South African Revenue Service (“Commissioner”) as a valuable anti-treaty shopping tool, especially since PPTs have internationally in the past seldom been applied by countries that have included them in their DTAs.¹⁶²

2.3.7 Other OECD reports

Apart from the OECD material mentioned above, two further OECD reports are worth a brief mention. The first is a 1999 report on partnerships wherein the OECD stated that, when deciding whether a partnership is the “beneficial owner” of dividends under the dividends article, it is the qualification of the entity under the country of residence that is relevant.¹⁶³ A domestic meaning (under the law of the country of residence), rather than an international meaning, was thus seemingly proposed.

¹⁵⁸ It has been argued in the *2015 BEPS Report on Action Point 6* para 19 that the PPT is nothing more than the guiding principle in para 9.5 (and the principles currently contained in sub-paras 22, 22.1 and 22.2) of the Commentary to Art 1. See also the *Draft 2017 Update* Part 1C para 24, which renumbers this para 9.5 as para 61 of the Commentary to Art 1 and adds the following sentence: “That principle applies independently from the provisions of paragraph 9 of Article 29 [the PPT], which merely confirm it.” L de Broe & J Luts “BEPS Action 6: Tax Treaty Abuse” (2015) 43 *Intertax* 122 131-131, however, argue that the threshold is lowered in the PPT.

¹⁵⁹ *Draft 2017 Update* Part 1C para 23, providing for a new Art 29. See also *Draft 2017 Update* Part 1C para 24 for a proposed amendment to para 1 of the Commentary to Art 1 and which cross-refers to this new Art 29. In addition, the methods described in part 2.3.2 included in 1992 in the Commentary to Art 1 are deleted in the update, as per *Draft 2017 Update* Part C para 24.

¹⁶⁰ National Treasury of South Africa *SA Status of List of Reservations and Notifications 27*. The test in Art 7.1 of the MLC reads as follows:

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

¹⁶¹ Para 16 of the proposed amendments to the Commentary to Art 1, quoted at *2015 BEPS Report on Action Point 6* para 59, repeats what is currently contained in para 10 of the Commentary to Art 1.

¹⁶² D Gutmann “Limitations on Benefits Articles in Income Treaties: The Current State of Play” (2012) 66 *BFIT* 1 1. For criticism against the use of such a test, see J Hattingh “The Multilateral Instrument from a Legal Perspective: What May Be the Challenges?” (2017) 71 *BFIT* 1 2-3.

¹⁶³ Para 54 of the OECD *The Application of the Model Tax Convention to Partnerships Report* (1999).

The second is a 2010 report on collective investment vehicles (“CIVs”).¹⁶⁴ The report notes that “[b]ecause the term ‘beneficial owner’ is not defined in the [OECD] Model, it ordinarily would be given the meaning that it has under the law of the State applying the Convention, unless the context otherwise requires.”¹⁶⁵ As discussed in part 2.4, this goes against the view often put forward that a domestic meaning should not be given to the term (unless the implication is that this may be one of those instances “where the context otherwise requires”). Although the report made statements on whether CIVs should be regarded as beneficial owners,¹⁶⁶ Collier concludes that not much can be deduced from this report and the amendments that were subsequently made to the Commentaries with regard to the meaning of beneficial ownership in scenarios that do not concern CIVs.¹⁶⁷

2.4 The views of foreign scholars

Most scholars agree that the term beneficial ownership in a treaty context should have an international rather than domestic meaning.¹⁶⁸ They also mostly agree that such international meaning may be derived from the Commentaries.¹⁶⁹ On what that meaning may be there is, however, less agreement. Their views can be divided into two camps: those that (mainly) regard it as having a legal meaning and those that regard it as having an economic meaning. Under the former the question of whether a person is a “beneficial owner” turns on the legal

¹⁶⁴ OECD *The Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles Report* (2010). The report resulted in changes to the Commentaries, especially to paras 6.8-6.34 of the Commentary to Art 1 and para 59 of the Commentary to Art 10.

¹⁶⁵ Para 31 of *The Granting of Treaty Benefits with respect to the Income of CIVs Report*. See also OECD *Report of the Informal Consultative Group on the Taxation of Collective Investment Vehicles and Procedures for Tax Relief for Cross-Border Investors on Possible Improvements to Procedures for Tax Relief for Cross-Border Investors* (2009) para 34 (pointed out by Jiménez (2010) *World Tax J* 56 n 97), where it is accepted that the parties to a DTA can have different views on beneficial ownership.

¹⁶⁶ See the criticism by JF Avery Jones, R Vann & J Wheeler *Response to: OECD Discussion Draft ‘Clarification of the Meaning of “Beneficial Owner” in the OECD Model Tax Convention’* (2011) available at <http://dare.uva.nl/search?identifier=5afcc70d-c1ad-4960-81b1-1e66805d9d84> (accessed on 25-05-2017).

¹⁶⁷ Collier (2011) *BTR* 692.

¹⁶⁸ RJ Danon *Switzerland’s Direct and International Taxation of Private Express Trusts with Particular References to US, Canadian and New Zealand Trust Taxation* (2004) 329-330. Wheeler (2005) *BFIT* 481 points out that the view that an international meaning be given, was also held by the panels at two meetings (1998 and 1999) of the International Fiscal Association (“IFA”). Examples of scholars that agree with this view include Danon *Switzerland’s Taxation of Trusts* 330; PL Jezzi “The Concept of Beneficial Ownership in the *Indofood* and *Prévost Car* Decisions” (2010) 64 *BFIT* 253 254; Kemmeren “Preface to Articles 10 to 12” in Klaus Vogel (2015) 720-721 m.nrs. 29-31; F Vallada “Beneficial Ownership under Articles 10, 11 and 12 of the 2014 OECD Model Convention” in M Lang, P Pistone, A Rust, J Schuch, C Staringer & A Storek (eds) *The OECD-Model-Convention and its Update 2014* (2015) 25 39; JF Avery Jones “Treaty Interpretation” in R Vann (ed) *Global Tax Treaty Commentaries* (2015) para 8.2.4.2.2; Baker *Double Taxation Conventions* paras 10B-13 – 10B-14. Part 9.6 considers the reasons that have been advanced in favour of an international meaning.

¹⁶⁹ See, e.g. Baker “‘Beneficial Ownership’ as Applied to Dividends” in *Taxation of Intercompany Dividends* (2012) 101.

rights that such person holds, which is determined based on areas of private law such as contract and company law.¹⁷⁰ The economic view is not limited to such a consideration of legal rights and takes into account various facts, depending on the particular view.

2.4.1 Beneficial owner: a legal meaning

Jiménez argues that both the 1977 and the 2003 Commentaries do not support a (broad) economic approach to beneficial ownership and provides the following reasons for his view:¹⁷¹ Firstly, the 2003 Commentary to Article 10 only excludes direct recipients with “very narrow powers which render it... a mere fiduciary or administrator acting on account of” others. Only some (and not all) conduit companies are thus excluded. Secondly, this Commentary did not retain the word “economically” from the Conduit Report.¹⁷² Thirdly, the Partnership Report links the beneficial ownership requirement with the attribution of income, rather than focusing on an anti-abuse purpose.¹⁷³ Fourthly, until 2003 the OECD was reluctant to apply (or was not clearly in favour of applying) domestic anti-avoidance measures in a treaty context.¹⁷⁴ Therefore, to the extent that the beneficial ownership requirement can serve as a “back door” to introduce such measures, the OECD would not have been in favour thereof.¹⁷⁵ Lastly, if the beneficial ownership requirement could be used to combat all conduit structures, the other anti-abuse methods set out in the Commentary to Article 1 would have been unnecessary.¹⁷⁶

Collier advances the following additional arguments in favour of a legal meaning:¹⁷⁷ In the first place, the word “powers” in the phrase “very narrow powers” in the 2003 Commentary to Article 10 points towards a legal meaning.¹⁷⁸ In the second place, had this Commentary intended to allow for an economic meaning, much more explanation would have been provided in the Commentary given the potentially wide scope of such an economic approach. In the third place, the need to retain the references to “nominees” and “agents” in the 2003 Commentary would have fallen away. Lastly, the 2003 Commentary clearly refers to the

¹⁷⁰ F Zimmer “Form and Substance in Tax Law - General Report” in *IFA Cahiers de Droit Fiscal International Vol. 87a* (2002) 19 23; Li *Beneficial Ownership in Tax Treaties* 199-200 and see also part 5.3.

¹⁷¹ Jiménez (2010) *World Tax J* 53-54.

¹⁷² See also part 2.3.4.

¹⁷³ See also part 2.3.7.

¹⁷⁴ See the main text corresponding to n 774 below.

¹⁷⁵ See also De Broe *International Tax Planning* 671.

¹⁷⁶ See also 689-690 and Collier (2011) *BTR* 691.

¹⁷⁷ Collier (2011) *BTR* 690-691.

¹⁷⁸ See also Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.14.

Conduit Report. Yet that report indicated that the beneficial ownership requirement could not “adequately” address the problems created by conduit structures.¹⁷⁹ The intention could thus not have been that the 2003 Commentary should be interpreted in a broad, economic manner that would cover all conduit structures.

Scholars who support a legal meaning agree on a number of points with regard to determining beneficial ownership. They agree that the intention of the parties to obtain a tax benefit is irrelevant,¹⁸⁰ as is the substance of the direct recipient. There is, however, no uniform view on what the “test” for beneficial ownership should be.

One view is that the beneficial owner should be the person who is liable to tax,¹⁸¹ according to the law of the country in which it is resident.¹⁸² Jiménez explains this view as follows:

“It seems that its original function was closer to that of an internal attribution-of-income rule, which determines who the person is that should be taxed (or benefit from a DTC in cases of no taxation, such as the situation of charities and pension funds in the United Kingdom, which motivated the inclusion of beneficial ownership to replace “subject-to-tax clauses”) because income can be attributed to them. *Therefore, originally not any form of treaty shopping could be attacked with the term “beneficial owner” and it had more to do with an analysis of legal substance of ownership*”.¹⁸³

Libin, however, points out that there may be instances where a person is subject to tax on the dividend received, but is an agent or nominee.¹⁸⁴ For this reason, it is often argued that this “test” cannot function independently and needs to be supplemented by other criteria.¹⁸⁵

¹⁷⁹ See, e.g. paras 16 and 21 of the Conduit Report.

¹⁸⁰ Du Toit *Beneficial Ownership of Royalties* 247-248; De Broe *International Tax Planning* 690; Jiménez (2010) *World Tax J* 54.

¹⁸¹ As to whether the person should actually be subject to tax, see De Broe *International Tax Planning* 691-693 and Kemmeren “Preface to Articles 10 to 12” in *Klaus Vogel* (2015) 722 m.nr. 33.

¹⁸² De Broe *International Tax Planning* 691 and 722; BJ Arnold “The Concept of Beneficial Ownership under Canadian Tax Treaties” in M Lang, P Pistone, J Schuch, C Staringer & A Storck (eds) *Beneficial Ownership: Recent Trends* (2013) 39 48; Vann “What Does History Tell Us” in *Beneficial Ownership* (2013) 306; Kemmeren “Preface to Articles 10 to 12” in *Klaus Vogel* (2015) 721 m.nr. 32 (who also refers to para 12.2 of the Commentary (2014) to Article 10).

¹⁸³ Jiménez (2010) *World Tax J* 53 (emphasis added, footnote omitted).

¹⁸⁴ Duff “Beneficial Ownership: Recent Trends” in *Beneficial Ownership* (2013) 16 also argues that this view requires that a domestic meaning according to the country of residence of the conduit is given and that that would contradict Article 3(2), which arguably requires the domestic meaning of the country of source to be given. See also n 38 above.

¹⁸⁵ JDB Oliver, JB Libin, S van Weeghel & C du Toit “Beneficial ownership” (2000) 54 *BFIT* 310 322 and see also the problems identified by Jiménez (2010) *World Tax J* 56-58. See also the main text corresponding to n 212 below.

Another view is that only agents and nominees are disqualified from beneficial ownership. Although most scholars agree that agents and nominees are excluded from beneficial ownership,¹⁸⁶ some argue that *only* these categories are excluded. One such scholar is Van Weeghel,¹⁸⁷ who finds support for his view in the *Market Maker* case,¹⁸⁸ discussed in part 6.2. There are, however, others that disagree with his view of this case,¹⁸⁹ either because they read that judgment differently, or because they argue that the wording of the Commentaries does not support such a view. With regard to the Commentaries, the 1977 version refers to intermediaries “*such as*” agents and nominees, which may suggest that agents and nominees are only examples of disqualified intermediaries.¹⁹⁰ The 2003 amendments make it clearer that “conduits” other than agents and nominees can be excluded. Finally, scholars often accept that at least one of the purposes of inserting the term is to combat some forms of treaty shopping. They argue that this purpose supports the argument that at least certain intermediate companies other than agents and nominees should be excluded from beneficial ownership.¹⁹¹

That brings one to the next point of divergence, which is how “conduit companies” that do not belong to either of these categories should be identified. Du Toit argues in his 1999 study that the term should have the meaning that it has under common law.¹⁹² Du Toit’s analysis of the history of the inclusion of the term in the 1977 OECD MTC leads to his conclusion that the OECD borrowed the meaning from common-law countries. Upon an application of the rules of interpretation under the VCLT,¹⁹³ he concludes that this meaning (that is, the meaning in common-law countries) should be the international meaning, which should apply in the context of DTAs.¹⁹⁴

¹⁸⁶ Oliver et al (2000) *BFIT* 320 (opinion of Van Weeghel).

¹⁸⁷ Van Weeghel *The Improper Use of Tax Treaties* 91 argues that “beneficial owner” refers to “the creditor of the income, or, if the creditor is acting as agent or nominee, the principal for the account of whom the agent or nominee is acting.” For other supporters of this view, see the sources mentioned by J Prebble “Trusts and Double Taxation Agreements” (2004) 2 *eJITaxR* 192.

¹⁸⁸ *Decision by the Hoge Raad* (6 April 1994) 28638 BNB 1994/217.

¹⁸⁹ Part 6.2.3.2.

¹⁹⁰ The following scholars (not all supporting a legal meaning) have raised this argument: Du Toit *Beneficial Ownership of Royalties* 216; Danon *Switzerland’s Taxation of Trusts* 333; De Broe *International Tax Planning* 664; Wardzynski (2015) *Intertax* 181-182; C Poiret “Beneficial Ownership: Concept, History and Perspective” (2016) 56 *Euro Tax* 275.

¹⁹¹ De Broe *International Tax Planning* 664.

¹⁹² The views of Du Toit, who is South African, are included in this chapter since the focus of his PhD study, which he undertook at the University of Amsterdam, was not the meaning of the term in South Africa.

¹⁹³ Discussed in part 4.3.

¹⁹⁴ Du Toit *Beneficial Ownership of Royalties* 196.

According to Du Toit's interpretation of the common-law meaning of the term, the beneficial owner is "the person whose ownership attributes outweigh those of any other person".¹⁹⁵ If a person only has the legal title, without "the right to deal with the thing to some extent as [his] own", such person cannot be the beneficial owner. Furthermore, the rights of the beneficial owner must be legally recognised and enforceable by courts. Lastly, where income is acquired subject to the obligation to transfer it to others, the direct recipient is not the beneficial owner.¹⁹⁶

In the case of "outweigh", it is "not so much a case of holding the biggest number of attributes but more a case of holding the biggest weight", which will depend on the particular circumstances.¹⁹⁷ Furthermore in a civil-law context, the "ownership attributes" will include personal rights (such as contractual rights) and not only rights *in rem*.¹⁹⁸

De Broe summarises various points of criticism against Du Toit's view.¹⁹⁹ Firstly, he questions whether it is likely that two civil-law countries negotiating a DTA would intend for its terms to have the (unfamiliar) meaning that they have under common law.²⁰⁰ He also points out that, even in common-law countries, there is little clarity on what the term means outside limited circumstances in trust law.²⁰¹ Secondly, De Broe argues that, although the OECD was aware of Du Toit's point of view, his view was not confirmed when the 2003 amendments were made to the Commentary to Article 10.²⁰² Thirdly, Du Toit's view is problematic when it comes to trustees, who cannot qualify as beneficial owners under the common-law meaning of the term.²⁰³ Fourthly, the official French translation of the term²⁰⁴ does not refer to "ownership" and may be an indication that the common-law meaning was unintentional.

Despite the criticism against Du Toit's views, scholars have struggled to suggest an alternative legal meaning, especially when attempting to make sense of paragraph 12.1 of the

¹⁹⁵ 21 and 201. See also Du Toit (2010) *BFIT* 501.

¹⁹⁶ Du Toit *Beneficial Ownership of Royalties* 200 and 222.

¹⁹⁷ 201.

¹⁹⁸ 203-205.

¹⁹⁹ De Broe *International Tax Planning* 679-680 and 718. See also Collier (2011) *BTR* 700 n 57.

²⁰⁰ For similar criticism, see Oliver et al (2000) *BFIT* 320 (opinion of Van Weeghel). Collier (2011) *BTR* 700 n 57 also points out that in 1977, when the beneficial owner term was included in Art 10 of the OECD MTC, 18 of the 24 member countries of the OECD were civil-law jurisdictions. A similar argument was put forward in *Prévost Car Inc. v The Queen* 2008 TCC 231 para [59].

²⁰¹ See the discussion in part 3.2.3.4.

²⁰² De Broe *International Tax Planning* 679-680.

²⁰³ 679 and see also Danon *Switzerland's Taxation of Trusts* 333-334. See Du Toit *Beneficial Ownership of Royalties* 149 and 216 for his reasoning in this regard.

²⁰⁴ The French translation is "*bénéficiaire effectif*".

2003 Commentary to Article 10. The problem is that it may not be enough only to consider whether the direct recipient is a “fiduciary” or “administrator” in the legal sense.²⁰⁵ If one does, it would disqualify all fiduciaries. However, at least one category of fiduciaries, namely trustees,²⁰⁶ is likely to qualify for beneficial ownership in certain circumstances.²⁰⁷ If one accepts this view regarding trustees, one has to interpret the phrase in the 2003 Commentaries to mean that not *all* fiduciaries are disqualified, but only “mere” fiduciaries that are “conduits” with “very narrow powers” with regard to the income.

Moreover, it is here that one finds it difficult to adhere to a legal analysis because it is doubtful whether there are established legal meanings for concepts such as “benefit”²⁰⁸ and “conduit”.²⁰⁹ There is also no legal yardstick for what may constitute “very narrow” powers. The Conduit Report did add a yardstick of sorts by stating that the conduit will not be the beneficial owner if it “has a similar function to those” of an agent or nominee. How helpful that is in finding a legal meaning is debatable, but the phrase was in any event left out in the 2003 Commentary.²¹⁰

This difficulty is illustrated when one considers the meaning put forward by De Broe. Having considered the Conduit Report and the 2003 Commentary, he argues for an “intermediate reading” of the latter. This means that a beneficial owner excludes (in addition to agents and nominees) a direct recipient that “acts in reality as an administrator or fiduciary on account of its shareholder or creditor”. He explains further:

“[T]he determination whether the conduit acts in reality as an administrator or fiduciary on account of its shareholder or creditor must be determined in law on the basis of an appreciation of the facts, but not purely in fact. Thus, a wide economic interpretation of the term by having regard to the economics of the structure and to all sorts of practical assumptions and considerations (such as the fact that in practice the conduit does pay on the income received and

²⁰⁵ But see De Broe *International Tax Planning* 686.

²⁰⁶ The Commentary refers here to a “conduit company” with narrow powers. One argument would thus be that it only refers to companies. Even if this argument is correct (but see the contrary view expressed by I du Plessis *A South African Perspective on Some Critical Issues Regarding the OECD Model Tax Convention on Income and on Capital, with Special Emphasis on its Application to Trusts* LLD thesis University of Stellenbosch (2014) 281), it does not solve the problem relating to corporate trustees (that are companies).

²⁰⁷ It is unlikely that trustees are disqualified from beneficial ownership in all circumstances. See ns 548 and 549 below and Baker *Double Taxation Conventions* 10B-14. For a South African perspective on this issue, see Du Plessis *Critical Issues Regarding the OECD Model Tax Convention* ch 8.

²⁰⁸ See the discussion in part 9.4.2.1.

²⁰⁹ See also Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) paras 9.5 and 9.14.

²¹⁰ But see the argument of Collier (2011) *BTR* 690 that the 2003 Commentary “should be interpreted so as to give the result that, functionally and legally, the circumstances contemplated by the amended 2003 wording should be close to those which would relate to agents and nominees as originally referred to.”

that in all likelihood it will continue to do so, etc.) is inappropriate. The question is whether the conduit owns the income for its own benefit and not for that of a third party. *Such is the case where it collects the income in its own name; has no obligation to pay the specific income received to its shareholder or creditor; where its payment obligation is independent from the receipt of income down the chain and where as a result it carries the risk of solvency (and currency, if any) of its debtor...* If one or more of those features lack, the conduit may be said to be a fiduciary owner of property acting on account of its shareholders or creditors... Under such ‘intermediate reading’ of the Commentary beneficial ownership is only capable of countering the most blatant cases of treaty shopping and in certain jurisdictions in essence transactions that are a sham.”²¹¹

De Broe thus does not attempt to determine the ordinary meaning of a “fiduciary” or “administrator”. His analysis instead aims to give meaning to the other expressions used in the 2003 Commentary in this context, in particular in identifying the “very narrow powers” that would mean that the direct recipient is a “mere” fiduciary and thus not the beneficial owner.

Lastly, Jiménez argues that

“if the income is attributed to a taxpayer in the state of residence in only very limited cases should that person be refused the condition of beneficial owner. Only if from a legal standpoint, the function of the recipient can be assimilated to that of a custodian/intermediary, should the characterization as beneficial owner be refused.”²¹²

2.4.2 Beneficial owner: an economic meaning

Supporters of an economic approach base their view on a number of arguments. They, firstly, point to the purported purpose of the insertion of the term as anti-avoidance measure to combat treaty shopping.²¹³ Secondly, they find support for their views in OECD reports and the Commentaries. They point out that the Conduit Report uses the word “economically”; and that the Harmful Tax Competition Report mentions the possibility that beneficial ownership

²¹¹ De Broe *International Tax Planning* 687 (emphasis added).

²¹² AJM Jiménez “Beneficial Ownership as an Attribution-of-Income Rule in Spain: Source and Residence Country Perspective” in M Lang, P Pistone, J Schuch, C Staringer & A Storck (eds) *Beneficial Ownership: Recent Trends* (2013) 199 139 (footnote omitted).

²¹³ Danon *Switzerland’s Taxation of Trusts* 336-337 argues that “trying to give to the term a meaning that is consistent with its anti-DTC shopping purpose therefore amounts to identifying and isolating the ownership attributes which allow this goal to be ... achieved” (emphasis added). See also Kemmeren “Preface to Articles 10 to 12” in *Klaus Vogel* (2015) 716 m.nrs. 21-23. But see Wardzynski (2015) *Intertax* 185, who argues that proponents of the economic view do not attach importance to “the vague original intentions of the drafters”, but rather the later happenings, such as the Conduit Report and the 2003 Commentaries.

can be denied in the case of companies “with no real economic function”.²¹⁴ With regard to the Commentary to Article 10, they highlight the fact that intermediaries “such as” agents and nominees were excluded under the 1977 Commentary, confirming that persons not belonging to these two categories can also be disqualified from beneficial ownership. They furthermore emphasise the fact that the 2003 Commentary states that beneficial ownership should not be used in a “narrow technical sense”; and that the analysis should be whether someone else “in fact” receives the “benefit” of the income and whether the beneficial owner “as a practical matter” has very narrow powers.²¹⁵

Different factors that may determine who, economically speaking, is the beneficial owner of income have been put forward. One view looks to the person who ultimately benefits from the income. Bammens and De Broe, for example, interpret (but do not support) certain court judgments²¹⁶ to give to the term the meaning of the “ultimate beneficiary” who “reaps the economic benefits” of the income.²¹⁷ Put differently, it is the person “who in economic and/or practical terms is the ultimate recipient of income in a chain of related transactions.”²¹⁸

Other commentators focus on the subjective intention of the role players, specifically whether the direct recipient serves a function other than the channelling of the income it receives.²¹⁹

Some prominent scholars emphasise the question of control. According to an earlier edition of *Klaus Vogel on Double Taxation Conventions*, a beneficial owner is the person²²⁰

“who has the right to decide whether or not a yield should be realized – i.e., whether the capital or other assets should be used or made available for use [and who has] the right to dispose of the yield. Ownership is merely formal, if the owner is fettered in regard to both aspects either in law or in facts. On the other hand, recourse to the treaty is ... not improper ... if he who is entitled under private law is free to wield at least one of the powers referred to.”²²¹

²¹⁴ Para 119 of the *Harmful Tax Competition Report*, discussed in part 2.3.3.

²¹⁵ These arguments are listed (but not necessarily supported) by Collier (2011) *BTR* 690 and Wardzynski (2015) *Intertax* 185-186.

²¹⁶ They include here *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] *STC* 1195 (discussed in part 6.3.3).

²¹⁷ Bammens & De Broe “Treaty Shopping” in *Tax Treaties: Building Bridges* (2010) 63.

²¹⁸ De Broe *International Tax Planning* 711.

²¹⁹ Jezi (2010) *BFIT* 255-256 argues that some foreign judgments can be explained in this manner, as discussed in part 6.3.4.4.

²²⁰ This person does not have to be the owner of the right or property giving rise to the income. Therefore, a usufructuary will be a beneficial owner under this view. K Vogel “Preface to Arts. 10-12” in K Vogel (ed) *Klaus Vogel on Double Taxation Conventions* 3 ed (1997) 562 m.nr. 9.

²²¹ Vogel “Preface to Arts. 10-12” in (1997) 562 m.nr. 9. The author thus concludes:

“[T]he beneficial owner is he who is free to decide (1) whether or not the capital or other assets should be used or made available for use by others or (2) on how the yields therefrom should be used or (3) both”.

Where the economic or “factual” determination of beneficial ownership is concerned, this contribution stated:

“Even if ... a company were obliged to distribute all of its profits to its shareholders ..., this would not affect its beneficial ownership, as would a commitment to pass on such profits to third parties... If a company is bound by its controlling shareholder’s decisions on what should be done with certain assets and the yields they generate (as in the case of *BFH BstB1. II 721 (1971)* in which BFH assumed the existence of a trustee relationship...), its ownership may be formal, but this depends on the factual situation. On the other hand, even a one hundred percent interest in a subsidiary does not necessarily preclude the latter’s ‘beneficial ownership’ in assets held by it. There would have to be other indications of the fact that the subsidiary’s management is not in a position to make decisions differing from the will of the controlling shareholder. If it were so, the subsidiary’s power would be no more than formal and the subsidiary would, therefore, not qualify as a ‘beneficial owner’ within the meaning of Arts 10 to 12 MC.”²²²

Despite the statements that “facts” and “substance”²²³ should be considered, it is noteworthy that the position under “private law” is referenced. The examples given also raise the question as to what extent an economic view was taken in this contribution.²²⁴ The reference to case law where the court has assumed the existence of a trustee relationship highlights this. And if a subsidiary’s management cannot take a position that differs from the “will of the controlling shareholder”, one might ask whether this is not rather an enquiry into whether piercing the corporate veil should take place (although this might be problematic in a treaty context).²²⁵

²²² 563 m.nr. 10.

²²³ At 562 m.nr. 9 it is argued that “substance” should trump “form”.

²²⁴ Jiménez (2010) *World Tax J* seems equally unsure where to place the view held in that contribution. He notes at 51 n 67 that this view is “closer to economic interpretation”. But at 54 n 86 he states that “the position of that author regarding whether beneficial ownership is a legal or economic requirement” is “somehow ambiguous”.

²²⁵ As discussed in part 5.2.

Danon,²²⁶ although generally agreeing with the above meaning that the focus should be on control (“legally, economically or factually”), criticises the fact that control over the “capital or other assets” is taken into account. According to him, only the power to control the attribution of the income is relevant.²²⁷ He explains:

“[A] teleological interpretation dictates, in the author’s view, that beneficial ownership focus primarily on the level of *economic control* exercised by the recipient over the income received. Indeed, the crucial element of a treaty shopping structure is the legal, economic or factual ability of a person of a third country to compel an entity interposed in the residence state to transfer to the former the income received from the source state. Accordingly, it must be recognized that, where the entity of the residence state genuinely holds the power to control the attribution of the income it derives from the source state, it would be difficult to allege that it was interposed by a treaty shopper, as this person is then no longer in a position to secure the transfer of the income in its favour.”²²⁸

Kemmeren, in the later edition of *Klaus Vogel on Double Taxation Conventions*, argues:

“[T]he beneficial owner is the person who is **economic owner** of the income (i.e., the recipient whose property has benefited from the income, taking into account all economically directly connected receivables and liabilities and related income streams). In this context, a conduit will only be beneficial owner as far as it concerns the reported spread because that spread benefits the property. The person to whom the conduit makes the connected payment will be the beneficial owner of the remainder of the income because his property is benefited with the remainder of the income... With this definition, not only the two elements of the term ‘beneficial owner’ are taken into account, but also its nature as anti-avoidance measure countering some forms of tax avoidance (i.e., some forms of abusive tax treaty shopping by interposing intermediary persons close to the source of income who try to benefit from a tax reduction in the State of source, but whose property only benefit marginally or partly from the income with which the claimed reduction of source State taxation is connected).²²⁹

He does not expand on what he regards as “all economically directly connected receivables and liabilities and related income streams”.

²²⁶ Danon *Switzerland’s Taxation of Trusts* 332 bases his views on the argument that the Commentaries can be a source of the ordinary meaning of treaty terms.

²²⁷ Danon *Switzerland’s Taxation of Trusts* 336-338 and 340.

²²⁸ R Danon “Clarification of the Meaning of ‘Beneficial Owner’ in the OECD Model Tax Convention - Comment on the April 2011 Discussion Draft” (2011) 65 *BFIT* 437 439.

²²⁹ Kemmeren “Preface to Articles 10 to 12” in *Klaus Vogel* (2015) 726 m.nr. 47 (emphasis in the original).

For Panayi, the beneficial owner is the person who has actually conducted the activity that generated the income; in other words, the person who is legally and economically entitled to the income, having earned or generated it “in some real way”. For her, risk is the important factor, in the sense of whether the ultimate recipient runs the risk of not receiving the income.²³⁰

A general criticism against a (broad) economic approach is that it may obviate the need for additional anti-avoidance measures to combat treaty shopping.²³¹ Yet the Commentary to Article 1 specifically makes provision for such additional anti-avoidance measures to be incorporated into DTAs.²³² To this should be added that the MLC and the draft 2017 update to the OECD MTC now also prescribe the adoption of at least one additional measure, as discussed in part 2.3.6.

2.5 The 2014 Commentaries: a domestic or international meaning

After 2003, the Commentary to Article 10 stated that the term “is not used in a narrow technical sense”.²³³ It also stated that the term had to be understood in light of the object of the Convention, including the prevention of fiscal avoidance.²³⁴ Based on this wording many scholars argue that the 2003 Commentary prescribed the use of an international meaning.²³⁵

This reading of the 2003 Commentaries should be contrasted with the statement of the OECD in its 2010 report on CIVs, mentioned in part 2.3.7. There the OECD indicated that, since the term is undefined in the OECD MTC, it would ordinarily have the meaning under the domestic law of the state that applies the DTA, unless the context otherwise requires.²³⁶

Turning to the 2014 Commentary to Article 10, this version provides as follows:

“Since the term ‘beneficial owner’ was added to address potential difficulties arising from the use of the words “paid to...a resident” in paragraph 1 [of Article 10], it was intended to be interpreted in this context and the term was not intended to refer to *any technical meaning* that

²³⁰ Panayi *Double Taxation, Tax Treaties, Treaty-Shopping and the European Community* 49.

²³¹ De Broe *International Tax Planning* 689-690; Jiménez (2010) *World Tax J* 42; Baker “‘Beneficial Ownership’ as Applied to Dividends” in *Taxation of Intercompany Dividends* (2012)101. For this reason Wardzynski (2015) *Intertax* 186 supports a much narrower economic approach.

²³² As mentioned in part 2.2 and see also para 12.5 of the Commentary (2014) to Art 10.

²³³ Para 12 of the Commentary (2003) to Art 10.

²³⁴ Para 12(1) of the Commentary (2003) to Art 10.

²³⁵ Baker *Double Taxation Conventions* para 10B-14. De Broe *International Tax Planning* 671; Danon (2011) *BFIT* 438; Kemmeren “Preface to Articles 10 to 12” in *Klaus Vogel* (2015) 720-721 m.nrs. 29-31 and Poirer (2016) *Euro Tax* 276 agree with this reading of the Commentary (2003).

²³⁶ *The Granting of Treaty Benefits with respect to the Income of CIVs Report* para 31.

it could have had under the domestic law of a specific country (in fact, when it was added to the paragraph, the term did not have a precise meaning in the law of many countries). The term ‘beneficial owner’ *is therefore not used in a narrow technical sense (such as the meaning that it has under the trust law of many common law countries)*, rather, it should be understood in its context, in particular in relation to the words ‘paid ... to a resident’, and *in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance*’.²³⁷

The reference to the fact that the term should be understood in light of the object of the Convention, including the prevention of fiscal avoidance, is also retained from 2003.

The 2014 Commentary thus now specifically states that the term does not refer to “any technical meaning” under domestic law. It notes that “when it was added to the paragraph, the term did not have a precise meaning in the law of many countries”. This seems to echo the view of scholars that, since the term came to be used in DTAs from “international tax practice” rather than from the countries’ domestic tax systems, an international meaning should be given to it.²³⁸ However, this reading of the 2014 Commentary is not without problems.

In the subsequent paragraph, the 2014 Commentary states that “therefore” the term is not used in a “narrow technical sense”. This is the wording of the 2003 Commentary. Prebble argues that when this phrase appeared in the 2003 Commentary, it could only have referred to the meaning of the term in common-law jurisdictions relating to trusts.²³⁹ The 2014 Commentary now specially uses as an example of such a “narrow technical sense” the trust law of common-law countries. By referring specifically to the meaning under trust law,²⁴⁰ the 2014 Commentary makes it clearer that the meaning of the term in common-law countries when it comes to trusts in the strict sense²⁴¹ is excluded.²⁴²

But what is meant by the word “technical” here? Why are only “technical” meanings in domestic law excluded, but not other meanings (if they exist)? As discussed in part 4.3.2, it is

²³⁷ Para 12.1 of the Commentary to Art 10 (2014) (emphasis added).

²³⁸ Du Toit *Beneficial Ownership of Royalties* 177-178; Baker “‘Beneficial Ownership’ as Applied to Dividends” in *Taxation of Intercompany Dividends* (2012).

²³⁹ Prebble (2004) *eJITaxR* heading “The amendments of 2003”. De Broe *International Tax Planning* 686, however, reads this to mean “in a strict legal sense”.

²⁴⁰ Also in the example in the footnote to para 12.1.

²⁴¹ See n 396 below.

²⁴² Incidentally, the footnote added to paragraph 12.1 of the Commentaries (2014) to Article 10 states that trustees of a discretionary trust, or the trust, can be recognised as beneficial owners. It is, however, unclear how this statement can be reconciled with the statement at paragraph 12.4 that a direct recipient who “does not have the right to use and enjoy the dividend received” is not the beneficial owner.”

not unusual for terms that have a legal or technical meaning in a particular discipline or area of the law to be referred to as the “ordinary” meaning of the term if used in that area. Does this leave open the possibility that the meaning in common-law countries outside the law of trusts in the strict sense can be considered?²⁴³ If so, what about the meanings found in definitions in domestic legislation? If *all* domestic meanings are excluded, why is it necessary to still refer to the meaning under the trust law? Or, is this entire paragraph only meant to deal with the problematic area of beneficial ownership as an attribution rule with regard to trusts?²⁴⁴

All these questions illustrate that the 2014 Commentary to Article 10 is still not particularly clear about rejecting *all* domestic meanings. Nevertheless, the popular view amongst scholars is that the Commentary prescribes (more clearly than the 2003 version) an autonomous meaning.²⁴⁵

Lastly, a proposed new provision in the Commentary to Article 1 (discussed in part 5.2.3) should be noted. This provision recognises that SAARs found in domestic law may through Article 3(2) have an impact on the manner in which treaty provisions are applied.²⁴⁶ If accepted, this provision leaves a back door open for Article 3(2) to apply in the context of the beneficial ownership requirement.

²⁴³ See part 3.2.3.4.

²⁴⁴ The views of the working party responsible for the amendments are not particularly clear. At *2012 Revised Discussion Draft* paras 3-4 the working party remarks:

“[T]he majority of comments supported the conclusion that an autonomous meaning should be given to the term.... Based on the guidance in existing paragraph 12 and the majority of the comments received on this issue, the Working Party concluded that the interpretation reflected in the proposed paragraph was the correct one”

At *2014 Update to the OECD Model Tax Convention 2* the working party remarks:

“Whilst commentators generally supported the deletion of the sentence referring to domestic law which was included in paragraph 12.1 of the first discussion draft, some suggested that the draft should more clearly address the issue of the applicability of the domestic law meaning of the term ‘beneficial owner’.

The Working Party, however, did not consider that further explanations were necessary given that the changes were simply intended to clarify the phrase ‘[t]he term “beneficial owner” is not used in a narrow technical sense’ currently found in the Commentary.” See also WR Munting & R Huisman “‘Beneficial Ownership: Handle with Care’. Update naar Aanleiding van het Gewijzigde OESO-Voorstel” (2013) 142 *WFR* 219 220-221.

²⁴⁵ Baker “‘Beneficial Ownership’ as Applied to Dividends” in *Taxation of Intercompany Dividends* (2012) 94; J Gooijer “Beneficial Owner: Judicial Variety in Interpretation Counteracted by the 2012 OECD Proposals?” (2014) 42 *Intertax* 204 214; Watson (2014) *Can Curr Tax* 1092; KD Weber “Tax Treaty Treatment of Dividend Related Payments under Share Loan Agreements” (2014) 6 *World Tax J* 111 119; Kemmeren “Preface to Articles 10 to 12” in *Klaus Vogel* (2015) 720-721 m.nrs. 29-31; Vallada “Beneficial Ownership” in *Update 2014* (2015) 39; Poiret (2016) *Euro Tax* 277.

²⁴⁶ *Draft 2017 Update* Part 1C para 24, setting out the proposed Article 73 of the Commentary to Art 1.

2.6 The 2014 Commentaries: a legal or economic view

The following newly inserted paragraph 12.4 of the Commentary to Article 10 is arguably the most controversial of the changes made in 2014:

“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.”²⁴⁷

Paragraph 12.4 further explains in an additional paragraph that a direct recipient will be the beneficial owner if the obligation to pass on the income is *independent* from the direct recipient receiving the income. An example would be if the obligation to pass on the income is not dependent on receipt of the payment and the direct recipient has this obligation by virtue of being a debtor. It also states that “where the 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”.²⁴⁸

At first glance, the reference to a “*contractual or legal obligation*” supports a legal approach.²⁴⁹ It has also been argued that the statement in paragraph 12.5 (that other provisions may, in addition to the beneficial ownership requirement, also address conduit company treaty shopping) indicates that the beneficial ownership requirement should be interpreted narrowly and not serve as a general anti-abuse provision.²⁵⁰

²⁴⁷ Emphasis added.

²⁴⁸ Para 12.4 also explains that the “typical distribution obligations” of pension schemes and CIVs are not included here. This second paragraph was added after the working party had received comments on the *2011 Discussion Draft*. It clearly tried to put to rest some of the concerns raised that the amendments would unintentionally impact CIVs and financial institutions such as banks (as mentioned at *2012 Revised Discussion Draft* paras 12 and 13). Leaving those examples aside, and focusing on the statement that a direct recipient will be the beneficial owner if his obligation to “pass on” the income is *independent from him receiving the income*, the phrase “pass on” is an odd one. It usually indicates that one is transferring to someone something that one has received. It is thus unclear how a direct recipient can be obliged to “pass on” income irrespective of whether he has received it. Presumably, though, it was chosen to link up with the first paragraph of para 12.4.

²⁴⁹ Emphasis added.

²⁵⁰ Collier (2011) *BTR* 702-703; Baker “‘Beneficial Ownership’ as Applied to Dividends” in *Taxation of Intercompany Dividends* (2012) 92. Although they only considered the *2011 Discussion Draft*, no substantial

However, it is unlikely that tax authorities, scholars and courts will no longer find support for an economic approach to beneficial ownership in the 2014 Commentary. Firstly, this paragraph cannot be read in isolation and it should be noted that some of the wording from the 2003 Commentary, which has been argued to support an economic meaning,²⁵¹ is repeated in the 2014 Commentary. The Commentary thus still provides that where a person “simply acts as a conduit for another person who *in fact* receives the *benefit* of the income”, such person will not be the beneficial owner. The reference to the Conduit Report is also retained, as is the statement that a person will normally not be the beneficial owner if “though the formal owner, it has, *as a practical matter*, very *narrow powers* which render it ... a mere fiduciary or administrator”.²⁵²

It is not clear what the relationship between this old wording (now contained in paragraph 12.3) and the new wording (in paragraph 12.4) is. Are these alternative “definitions”? Or does the new paragraph serve to limit the old “definition”? This is the argument preferred by Collier.²⁵³ It is also supported by the opening phrase of paragraph 12.4 (“[i]n these various examples the direct recipient is not the ‘beneficial owner’”); and the confirmation near the end of paragraph 12.4 that the direct recipient will be the beneficial owner if he or she has “the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment”. Paragraph 12.4 thus provides further explanation for what is meant by paragraph 12.3. (One may pause to reflect here that, by retaining paragraph 12.3, the drafters had perhaps aimed to strengthen the argument that the 2014 amendments are merely clarifying in nature.)²⁵⁴

Secondly, the references to “facts and circumstances” and “substance” (all emphasised in the paragraph quoted above) elicited much comment during the drafting process. In particular, it was questioned whether this refers to economic rather than legal substance.²⁵⁵ Bernstein, for example, asks whether a holding company receiving dividends without a legal obligation

changes were subsequently made to para 12.5. In response to this argument it may be noted that the Commentary has since 2003 implicitly recognised this in paras 9.6 and 11 of the Commentary to Art 1. Yet some have adopted a broad anti-avoidance approach under the Commentary (2003) to Art 10.

²⁵¹ As noted in part 2.4.2.

²⁵² Para 12.3 of the Commentary (2014) to Art 10 (emphasis added).

²⁵³ Collier (2011) *BTR* 701. See also Gooijer (2014) *Intertax* 215-216.

²⁵⁴ See the discussion in parts 4.4.2 and 7.5.7.

²⁵⁵ See the concerns mentioned in the *2012 Revised Discussion Draft* para 16 and Collier (2011) *BTR* 701-702.

(such as under a shareholders' agreement) to pass on dividends, but who regularly does, can be said on a "facts and circumstances" approach to fail this part of the "test".²⁵⁶

The working party responsible for the drafting of the amendments responded to the comments mentioned above by stating that "contracts and formal legal obligations may not always reflect reality and this was therefore an area where it was appropriate to look at facts and circumstances."²⁵⁷ This explanation does not assist much. What "reality" is the working party referring to: the legal or economic reality? If the former, it simply means that the Commentary is referring here to situations where the legal form does not reflect the legal substance, in other words to a simulation (or a scenario where the label principle may apply), as discussed in part 5.4. There are accordingly scholars who support the view that the facts and circumstances may be used only to show the existence of a *contractual or legal obligation*.²⁵⁸

The contrary argument is that this principle (that legal reality takes precedence over legal form) is so entrenched in the law of most, if not all,²⁵⁹ jurisdictions that it is unnecessary to have added such a reservation. Wardzynski is one of the scholars who argues that economic factors may be taken into account under the 2014 Commentary to establish the existence of an "obligation".²⁶⁰ He argues that, in contrast to the position under the pre-2014 Commentaries, these economic factors would be limited to those directed at determining whether the direct recipient has an "obligation" to pass on the income. Other possible considerations, such as whether the direct recipient has economic substance, would not be relevant.²⁶¹ Other authors add that entity conduits are thus generally not denied beneficial ownership²⁶² and factors such as the direct recipient having no offices, employees or (other)

²⁵⁶ J Bernstein "Thoughts on the OECD Discussion Paper on Beneficial Ownership" (2011) *Tax Notes International* 49 53.

²⁵⁷ The 2014 Update to the OECD Model Tax Convention 2.

²⁵⁸ Du Plessis *Critical Issues Regarding the OECD Model Tax Convention* 281; Kemmeren "Preface to Articles 10 to 12" in Klaus Vogel (2015) 723 m.nr. 37. Gutmann "The 2011 Discussion Draft" in *Beneficial Ownership* (2013) 343 n 3 asks:

"Does paragraph 12.4 say that the obligation may stem from facts ('in fact', 'en fait') or do 'facts and circumstances' referred to in paragraph 12.4 serve as tools to prove the existence of a legal obligation? The second option seems highly preferable, considering that a 'factual obligation' is close to nonsense."

²⁵⁹ See n 880 below.

²⁶⁰ DS Smit "The Concept of Beneficial Ownership and Possible Alternative Remedies in Netherlands Case law" in M Lang, P Pistone, J Schuch, C Staringer & A Storek (eds) *Beneficial Ownership: Recent Trends* (2013) 59 68 also notes that the 2011 Discussion Draft leaves open this possibility.

²⁶¹ Wardzynski (2015) *Intertax* 189. He argues, however, that the "economic analysis is of subsidiary importance to the legal aspects of the arrangement".

²⁶² Gooijer (2014) *Intertax* 215-216. For a discussion of "entity conduits", see part 2.2.

assets are not taken into account.²⁶³ Similarly, the reason for interposing the direct recipient should be irrelevant.²⁶⁴

Thirdly, the use of the expression “pass on” is not a term with a well-known (if at all) legal meaning. Vallada thus questions whether the phrase “pass on” is clear enough.²⁶⁵ He argues that it gives rise to questions such as for how long an item of income must remain with the direct recipient,²⁶⁶ how the amount will be calculated (“as gross value or a percentage of the revenues”) and what happens if the income mingles with other income.²⁶⁷ It also gives rise to the question whether “passing on” only involves passing on the payment in the same form or in different forms (for example, dividends being “passed on” as something other than dividends).²⁶⁸ There is support for the views that it only includes the former,²⁶⁹ or both.²⁷⁰

In summary it can be said that the indications are there that the 2014 Commentary will not end the debate on whether an economic or legal meaning is to be given to the term “beneficial owner”.²⁷¹ Jiménez sums this up by stating:

“Therefore the [first paragraph of sub-paragraph 4] seems to reflect a compromise between defendants of the narrow and broad view of beneficial ownership. And, as a result, it is so abstract it can accommodate both positions, with the consequence that it is of little use: it will not put an end to current uncertainty regarding the interpretation of the meaning of beneficial ownership.”²⁷²

²⁶³ Baker “‘Beneficial Ownership’ as Applied to Dividends” in *Taxation of Intercompany Dividends* (2012) 101.

²⁶⁴ Gooijer (2014) *Intertax* 216. However, see the conclusion by Wardzynski (2015) *Intertax* 190: “[A] company should also be able to become the beneficial owner where it passes on a dependent payment *and there are valid commercial reasons behind the structure*”.

²⁶⁵ Collier (2011) *BTR* 701 raises the same question.

²⁶⁶ Kemmeren “Preface to Articles 10 to 12” in *Klaus Vogel* (2015) 756-757 m.nr. 128 agrees that the Commentaries (2014) do not address this issue.

²⁶⁷ Vallada “Beneficial Ownership” in *Update 2014* (2015) 44. Collier (2011) *BTR* 701 and Gooijer (2014) *Intertax* raise similar questions.

²⁶⁸ Kemmeren “Preface to Articles 10 to 12” in *Klaus Vogel* (2015) 756-757 m.nr. 128 agrees that the Commentaries (2014) do not address this issue.

²⁶⁹ Gooijer (2014) *Intertax* 215, who tentatively proposes this alternative.

²⁷⁰ Bernstein (2011) *Tax Notes International* 53.

²⁷¹ Collier (2011) *BTR* 701-702 (who only considered the *2011 Discussion Draft*); Avery Jones et al *Response to: OECD Discussion Draft* heading “Uncertainty in the application of beneficial owner test will not be reduced by the new draft” (who only considered the *2011 Discussion Draft*); Vallada “Beneficial Ownership” in *Update 2014* (2015) 48.

²⁷² Jiménez “Beneficial Ownership as a Broad Anti-Avoidance Provision” in *Beneficial Ownership: Recent Trends* (2013) 138. He only considered the *2011 Discussion Draft*. One of the main differences between that draft and the final version is that the draft did not include the second paragraph of para 12.4.

2.7 Conclusion

Conduit company treaty shopping is commonly considered as a form of tax avoidance that is enabled by the very existence of the DTA itself. The measures employed to counter this specific mischief may be broadly divided into anti-avoidance rules and the interpretation of the DTA. Anti-avoidance rules may be contained either in the DTA itself, or in domestic law. Domestic rules may in turn be developed judicially, or contained in legislation.

The MLC and the 2017 draft update to the OECD MTC now for the first time include anti-avoidance rules aimed at combatting treaty shopping in DTAs and the OECD MTC respectively. Examples of such rules are LOB clauses and a PPT. South Africa adopted the latter.

Apart from these anti-avoidance rules, treaty shopping may be addressed by the manner in which the DTA is interpreted, either as a whole or with regard to certain provisions such as the beneficial ownership requirement.

The historical analysis discussed in this chapter shows that there is no clear indication that the term “beneficial owner” was inserted in the OECD MTC to combat conduit company treaty shopping except, perhaps, if the structure entailed a direct recipient that was an “agent” or “nominee”. However, as mentioned above, Vann’s research in this regard might have come too late. Foreign scholars and courts (as shown in chapter 6) have claimed many times that combatting treaty shopping was, indeed, at least one of the purposes for which the beneficial ownership requirement was inserted. Often when these statements are made, they are not limited to treaty shopping involving agents or nominees. This is compounded by the impression given by the historical research that, when the term was included, there was no clear idea as to its meaning. Courts may thus in future not be prepared to depart from the idea that at least one of the purposes with inserting the term was to combat conduit company treaty shopping beyond the agent/nominee scenario. Furthermore, the OECD has made it clear in the Commentaries from at least 2003 that it regards the beneficial ownership requirement to serve such a purpose.

One of the central questions when it comes to the meaning of beneficial ownership is whether it should be giving a legal or economic meaning. No clear answer appears from the Commentaries and other OECD material. As noted in part 4.4, the Commentaries represent a compromise of various, often diverse, viewpoints and the Commentaries’ less than precise wording on beneficial ownership thus does not come as a surprise.

The Commentary to Article 10 has from the first (1977) version been interpreted to allow for both meanings. The 1986 Conduit Report added fuel to this debate and the 2003 amendments to the Commentaries did little to quell it. It is thus not surprising that the Commentary has not managed to unify the views of scholars on the meaning of the term. It remains to be seen whether the 2014 Commentary is more successful in this endeavour, but the initial impression is that it will not be.

The OECD has also not been successful in giving clear guidance on the other issues addressed in this study. Notably, it is still unclear whether the term should have its domestic meaning, or an international meaning.

CHAPTER 3
BENEFICIAL OWNERSHIP AS A CONCEPT IN THE LAW OF COMMON AND
CIVIL-LAW COUNTRIES, WITH AN EMPHASIS ON THE CONCEPT IN THE
LAW OF SOUTH AFRICA

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3.1 Introduction

In this chapter the meaning of the expression “beneficial owner” as used in the law of common and civil-law jurisdictions other than in DTAs and tax legislation is explored. In my view, this will assist with the evaluation of the various viewpoints raised throughout the study.

As a “mixed legal system” South African law contains elements of both common and civil law. Although the civil-law elements in the form of Roman-Dutch law are especially prevalent in the law of property,²⁷³ South African law has adopted much of the terminology from English trust law and South African company law has been significantly influenced by English law.²⁷⁴ For these reasons, a study of South African law gives one an overview of the important aspects of both common and civil-law jurisdictions. Such a study shows, firstly, the differences between “ownership” as understood between common and civil-law countries²⁷⁵ and, secondly, the diverse ways in which the expression “beneficial owner” may be used. That the latter is true not only in South African law, but also in the law of other jurisdictions, is highlighted by the Canadian scholar, Brown in the following statement:

“[T]he meaning of each concept [of beneficial ownership] is best understood by reference to the context in which the expression is used.... For example, in modern terminology a person may be described as the ‘beneficial owner’ in property law or in trust law, though for entirely different reasons. In property law, a purchaser under an agreement of purchase and sale is referred to as the beneficial owner because the remedy of specific performance may be available. In trust law, the use of the expression ‘beneficial owner’ results from recognition of the beneficiary’s ability to compel the trustee to duly administer the trust. In both contexts, however, the expression ‘beneficial owner’ is used because the courts recognize the claimant’s equitable right and provide an equitable remedy.”²⁷⁶

A study of the use of the expression “beneficial owner” in South African case law may also give some guidance on how the wide definition of “beneficial owner” in the South African

²⁷³ PJ Badenhorst, JM Pienaar & H Mostert *Silberberg and Schoeman’s The Law of Property* 5 ed (2006) 6.

²⁷⁴ HS Cilliers, ML Benade, JJ Henning, JJ du Plessis, PA Delpont, L de Koker & JT Pretorius *Cilliers and Benade Corporate Law* 3 ed (2000) 19-20.

²⁷⁵ See also Du Toit *Beneficial Ownership of Royalties* ch 4, where “ownership” in the laws of the UK and the Netherlands is discussed. Du Plessis *Critical Issues Regarding the OECD Model Tax Convention* 256-260 discusses the meaning of the expression “beneficial owner” in the UK, Canada and the Netherlands. See also the references to the views of the HMRC in part 6.3.4.4 and the negative definition of “beneficial owner” in Dutch tax legislation mentioned in part 9.7.

²⁷⁶ C Brown “Beneficial Ownership and the Income Tax Act” (2003) 51 *Can Tax J* 401 404.

Income Tax Act (“ITA”),²⁷⁷ discussed in chapter 9, is to be interpreted.²⁷⁸ Admittedly, the guidance provided in this chapter is unlikely to play a pivotal role in giving meaning to that definition. The reason is that, as explained in part 4.3.2, words defined in legislation acquire a technical meaning that often differs from both the ordinary and technical meanings that they may have in other areas of law.²⁷⁹

The chapter first briefly introduces subjective rights and ownership attributes in South African law. This includes an overview of the recognition of fragmented ownership in Roman, Roman-Dutch, English and modern South African law. Thereafter it considers the manner in which the concept of beneficial ownership is understood in South African trust and company law, before giving an overview of the various ways in which the expression is used in South African case law. The chapter concludes with a discussion of the dictionary meanings of “beneficial owner” and some of the other expressions used in the Commentary to Article 10.

3.2 Subjective rights and entitlements in South African law

3.2.1 Subjective rights and entitlements: a brief introduction

If viewed from the theory of subjective rights in modern South African law, a person (as legal subject) may be the holder of claims to legal objects as against other persons. These claims are called “subjective rights”.²⁸⁰ Two kinds of subjective rights are particularly relevant to this study and are discussed under separate headings below, namely “personal” and “real” rights.

The holder of a subjective right has by virtue of that right certain entitlements to deal with the legal object of the right.²⁸¹ As will become apparent below, holders of the real right of ownership have more entitlements than the holders of other (limited) real rights. These

²⁷⁷ Income Tax Act 58 of 1962.

²⁷⁸ See also MN Kandev “Tax Treaty Interpretation: Determining Domestic Meaning under Article 3(2) of the OECD Model” (2007) 55 *Can Tax J* 31 42:

“A court faced with [a definition in the income tax legislation that provides little clarity and itself requires interpretation] is naturally led to case-law interpretations of the term, even if these interpretations have been adopted in relation to non-tax matters, as long as the meaning derived from them is applicable for tax purposes”.

²⁷⁹ The meaning of the expression in South African domestic law may also be relevant for other reasons. For example, if the definition of “beneficial owner” in the ITA cannot serve as a domestic meaning for purposes of the general *renvoi* clause, one has to turn to other domestic meanings, as discussed in parts 9.5 and 9.6.

²⁸⁰ Badenhorst et al *Silberberg* 9; L du Plessis *An Introduction to Law* 3 ed (1999) 145.

²⁸¹ See the succinct summary provided by the SCA in *National Stadium South Africa (Pty) Ltd and others v Firstrand Bank Ltd* 2011 (2) SA 157 (SCA) para [31].

entitlements are known by different terms, including “rights” (not to be confused with the subjective right), “powers”, “incidents”, “competencies”²⁸² and “attributes” and include the entitlement to²⁸³ use the object (*ius utendi*), consume and destroy the object (*ius abutendi*), possess the object (*ius possidendi*), dispose of the object (*ius disponendi*), claim the object from any unlawful possessor (*ius vindicandi*), resist unlawful invasion of the object (*ius negandi*) and have the fruits of the object (*ius fruendi*). The fruits include “civil fruits”, being income produced by the thing, such as interest or dividends.²⁸⁴

Although “owner”, theoretically speaking, refers to the holder of the real right of ownership, it is not unusual for courts to also use the word to refer to the holder of other subjective rights. In the past courts have, for example, referred to a person as the “owner” of the following subjective rights: a limited real right;²⁸⁵ immaterial property, such as copyright;²⁸⁶ and personal rights, such as shares.²⁸⁷ This usage is also adopted in this study.

3.2.2 Personal rights

A “personal right” refers to a right to a performance;²⁸⁸ in other words, the holder of a personal right can require another person to deliver or do (or refrain from doing) something.²⁸⁹ In 2015, the Supreme Court of Appeal (“SCA”) explained the nature of this right as follows:

“The obligation which the law imposes on a debtor does not create a real right (*jus in rem*), but gives rise to a personal right (*jus in personam*). In other words, *an obligation does not consist in causing something to become the creditor’s property*, but in the fact that the debtor may be

²⁸² E.g. *Secretary for Inland Revenue v Kirsch* 1978 (3) SA 93 (T) 94; *National Stadium South Africa (Pty) Ltd v Firstrand Bank Ltd* 2011 (2) SA 157 (SCA) para [31]; Du Plessis *An Introduction to Law* 136-137.

²⁸³ Badenhorst et al *Silberberg* 92-93; AJ van der Walt “Gedagtes oor die Herkoms en Ontwikkeling van die Suid-Afrikaanse Eiendomsbegrip” (1988) 21 *DJ* 16 n 6.

²⁸⁴ Badenhorst et al *Silberberg* 43.

²⁸⁵ E.g. *Kommissaris van Binnelandse Inkomste v Anglo American (OFS) Housing Co Ltd* 1960 (3) SA 642 (A) 657.

²⁸⁶ E.g. *Minister of Home Affairs and another v American Ninja IV Partnership and another* 1993 (1) SA 257 (A) 274.

²⁸⁷ See part 3.4 for examples of this use.

²⁸⁸ The phrase “creditors’ rights” is used as an alternative. There is also a view that the object of a personal right is not the performance by the debtor, but the economic aspect of the debtor. JD van der Vyver “The Doctrine of Private-Law Rights” in S A Strauss (ed) *Huldigingsbundel vir WA Joubert* (1988) 201 230 and 232.

²⁸⁹ Badenhorst et al *Silberberg* 51; SWJ van der Merwe, LF van Huyssteen, MFB Reinecke & GF Lubbe *Kontraktereg Algemene Beginsels* 4 ed (2012) 2-3.

compelled to give the creditor something or to do something for the creditor or to make good something in favour of the creditor.”²⁹⁰

An example of a personal right is a share in a company, which is regarded as a bundle of personal rights.²⁹¹ One of these rights is the right to receive dividends, once declared.

In the context of both dividends tax (discussed in part 9.2.2.1) and Article 10 of the OECD MTC, one is concerned with the beneficial owner of a *dividend*. Du Toit and Hattingh describe this as being in the nature of “payments that arise from personal rights” and, in themselves, a form of personal right.²⁹²

With regard to ownership of money deposited into a bank account (which would often be the case where large amounts of dividends are distributed), the SCA indicated in 2013 that the legal position under South African law is as follows:

“Generally, where money is deposited into a bank account of an account-holder it mixes with other money and, by virtue of commixtio, becomes the property of the bank regardless of the circumstances in which the deposit was made or by whom it was made. The account-holder has no real right of ownership of the money standing to his credit but acquires a personal right to payment of that amount from the bank, arising from their bank-customer relationship. This is also so where, as in this case, no money in its physical form is in issue, and the payment by one bank to another, on a client’s instruction, is no more than an entry in the receiving bank’s account. The bank’s obligation, as owner of the funds credited to the customer’s account, is to honour the customer’s payment instructions.”²⁹³

The court also explained:

“Where, as in this case, A causes the transfer of money from his bank account to the account of B, no personal rights are transferred from A to B; what occurs is that A’s personal claim to the

²⁹⁰ *ABSA Bank Ltd v Keet* 2015 (4) SA 474 (SCA) para [23] (emphasis added).

²⁹¹ In *Standard Bank of South Africa Ltd and another v Ocean Commodities Inc and others* 1983 (1) SA 276 (A) 288 the Appellate Division (as it then was) (“AD”) explained that a share “consists of a bundle, or conglomerate, of personal rights entitling the holder thereof to a certain interest in the company, its assets and dividends”. In *Cooper v Boyes NO and another* 1994 (4) SA 521 (C) 535 the court held:

“From all this it is clear that there is no simple definition of a share. The various definitions emphasise a complex of characteristics which are peculiar to it. The gist thereof is that a share represents an interest in a company, which interest consists of a complex of personal rights which may, as an incorporeal movable entity, be negotiated or otherwise disposed of.”

See also *De Leef Family Trust and others v Commissioner for Inland Revenue* 1993 (3) SA 345 (A) 356; *Tigon Ltd v Bestyet Investment (Pty) Ltd* 2001 (4) SA 634 (N) 642-643 and the other sources referred to by P Delpont, Q Vorster, D Burdette, I Esser & S Lombard *Henochsberg on the Companies Act 71 of 2008* (2014) [Issue 10] 157.

²⁹² Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.9.

²⁹³ *Trustees, Estate Whitehead v Dumas and another* 2013 (3) SA 331 (SCA) para 13 (footnotes omitted).

funds that he held against his bank is extinguished upon the transfer and a new personal right is created between B and his bank. Ownership of the money — insofar as money in specie is involved — is transferred from the transferring bank to the collecting bank, which must account to B in accordance with their bank-customer contractual relationship.”²⁹⁴

One type of personal right is a *ius in personam ad rem acquirendam*. This usually refers to a personal right “by virtue of which a thing is claimed from someone”.²⁹⁵ For example, if a person purchased a *merx*, but it has not been delivered yet, the purchaser has a *ius in personam ad rem acquirendam*.²⁹⁶ A holder of such a *ius* enjoys considerable protection in law. For example, if the seller in this example sells the *merx* to another person who was aware of the first sale, the first purchaser can prevent the transfer of the *merx* to the second purchaser. The SCA has stated that this afforded the first purchaser with “what is in effect a limited real right” against the second purchaser.²⁹⁷ Furthermore, in some contexts the courts have attached similar legal consequences to the acquisition of a *ius in personam ad rem acquirendam* than to the acquisition of ownership itself.²⁹⁸

Using the expression *ius in personam ad rem acquirendam* where no real right to a thing is to be acquired, is theoretically problematic. It has, however, been done. For example, in *Secretary for Inland Revenue v Rosen* (“*Rosen*”)²⁹⁹ the court entertained an argument relating to a *ius in personam ad rem acquirendam* in respect of dividends received by a trust.³⁰⁰

²⁹⁴ Para 15 (footnotes omitted).

²⁹⁵ Badenhorst et al *Silberberg* 67.

²⁹⁶ *Bowring NO v Vrededorp Properties CC and another* 2007 (5) SA 391 (SCA) para [17], quoted with approval in *Meridian Bay Restaurant (Pty) Ltd and others v Mitchell NO* 2011 (4) SA 1 (SCA) para [30]. See also the example provided in Badenhorst et al *Silberberg* 67. The question as to when a purchaser acquires a *ius in personam ad rem acquirendam*, an important question in the context of the Transfer Duty Act 40 of 1949, was also addressed in cases such *Commissioner for Inland Revenue v Viljoen and others* 1995 (4) SA 476 (E). Another example is provided in *De Leef Family Trust v CIR* 1993 (3) SA 345 (A) 357, where it was held that, when a company is in liquidation, the shareholders obtain a *ius in personam ad rem acquirendam* with regard to the company’s assets on confirmation of the liquidation and distribution account.

²⁹⁷ *Meridian Bay Restaurant (Pty) Ltd v Mitchell NO* 2011 (4) SA 1 (SCA) paras [17] and [27], referring to *Associated South African Bakeries (Pty) Ltd v Oryx & Vereinigte Bäckereien (Pty) Ltd en andere* 1982 (3) SA 893 (A). However, see the criticism against this statement mentioned at *Meridian Bay Restaurant (Pty) Ltd v Mitchell NO* 2011 (4) SA 1 (SCA) n 23.

²⁹⁸ For example, in *Secretary for Inland Revenue v Hartzenberg* 1966 (1) SA 405 (A) 409 the word “acquire” in s 2 of the Transfer Duty Act was interpreted to include not only the acquisition of ownership, but also a *ius in personam ad rem acquirendam*. See also *De Leef Family Trust v CIR* 1993 (3) SA 345 (A) 355-356 and *Commissioner, South African Revenue Service v Bosch and another* 2015 (2) SA 174 (SCA) para [13].

²⁹⁹ *Secretary for Inland Revenue v Rosen* 1971 (1) SA 172 (A). See also *Brodie and another v Secretary for Inland Revenue* 1974 (4) SA 704 (A) 714-715.

³⁰⁰ See the passage from this case quoted in part 3.3. In that case the court, however, disagreed with the argument raised.

3.2.3 Real rights

A “real right” is a right to a “thing”. It is enforceable “against the whole world”,³⁰¹ which differentiates it from a personal right which is only enforceable against the other person to the obligation.³⁰² A real right establishes “a direct legal connection between a person and a thing”, which is lacking in the case of a personal right.³⁰³ “Things”, the objects of real rights, are limited to corporeals, subject to a number of exceptions.³⁰⁴ Shares³⁰⁵ and personal payment rights that constitute dividends, being incorporeal in nature,³⁰⁶ are thus excluded.

One of the reasons for limiting “things” to corporeals, is that, traditionally, a real right is regarded as conferring direct physical powers over a thing.³⁰⁷ For example, one of the entitlements of ownership is possession. Possession requires the person to be in physical control of the thing,³⁰⁸ which is not possible in the case of incorporeals. Having said that, South African law recognises so-called *quasi*-possession in respect of incorporeals.³⁰⁹ Examples of this recognition are found in case law dealing with the *mandament van spolie*. The *mandament* is a remedy aimed at restoring possession in cases where possessors have been deprived of their possession unlawfully.³¹⁰ In some cases the *mandament* has been allowed in respect of personal rights,³¹¹ as explained in the following statement by the SCA:

“Originally, the mandament only protected the physical possession of movable or immovable property. But in the course of centuries of development, the law entered the world of metaphysics. A need was felt to protect certain rights (tautologically called incorporeal rights)

³⁰¹ Badenhorst et al *Silberberg* 51 explain that this refers to “any person who seeks to deal with the thing to which a real right relates in any manner, which is inconsistent with the exercise of the holder’s entitlement to control it”.

³⁰² 51-54, but see also the criticism against this view discussed there. See also E van der Sijde *Reconsidering the Relationship between Property and Regulation: A Systemic Constitutional Approach* LLD thesis Stellenbosch University (2015) 37.

³⁰³ Badenhorst et al *Silberberg* 51.

³⁰⁴ 13-19; AJ van der Walt *Constitutional Property Law* 3 ed (2011) 115 and see the sources referred to by R Cloete *Onstoflike Sake in die Nuwe Suid-Afrikaanse Sakereg* LLD thesis University of South Africa (2001) 78.

³⁰⁵ Cilliers et al *Corporate Law* 243 n 23; AJ van der Walt & PJ Sutherland “Dispossession of Incorporeals or Rights - Is the Mandament van Spolie the Appropriate Remedy?: Case Comments” (2003) 15 *SA Merc LJ* 95 100. As pointed out by the latter authors, the fact that shares are described as “movable property” in company legislation (currently in s 35 of the Companies Act 71 of 2008) does not change this analysis. However, it should be noted that, as explained in the main text corresponding to n 325 below, it has been held in *Cooper v Boyes NO* 1994 (4) SA 521 (C) that a usufruct (a limited real right) can be established over shares. This is in line with the argument raised by Badenhorst et al *Silberberg* 19, 22 and 33 that the object of *limited* real rights could include incorporeal things in the sense of other rights.

³⁰⁶ Badenhorst et al *Silberberg* 19 n 124 and see also 33.

³⁰⁷ 15, but see 17.

³⁰⁸ 273 and 276.

³⁰⁹ 273. It is also sometimes called “juridical possession”.

³¹⁰ 288.

³¹¹ 296-300 and the cases discussed there.

from being violated. The mandament was extended to provide a remedy in some cases. *Because rights cannot be possessed, it was said that the holder of a right has quasi-possession of it, when he has exercised such right.* Many theoretical and methodological objections can be raised against this construct, inter alia, that it confuses contractual remedies and remedies designed for protecting real rights. However, be that as it may, the semantics of quasi-possession has passed into our law. This is all firmly established.”³¹²

In *Tigon Ltd v Bestyet Investment (Pty) Ltd* (“*Tigon*”)³¹³ the name of a nominee has been removed from a company’s register and the court was asked to grant a *mandament*. Although the court allowed the *mandament*, it has been questioned whether this case remains good authority in light of a later decision by the SCA.³¹⁴ In this later decision, the court seemingly held that the *mandament* can only apply if the personal right concerned flows from, or are incidental to, possession of corporeal property,³¹⁵ which is clearly not the case where shares are involved. Whether this is, indeed, a requirement is not important for this study. What is important, though, is the question as to what constitutes “possession” of a personal right. From the statement quoted above it can be inferred that it usually refers to the exercise of the right.³¹⁶ In *Tigon* the court held that possession of shares is exercised by the holder “negotiating, pledging, bequeathing or otherwise dealing in the shares”³¹⁷ and “by being registered in the register of members and thereby being able to vote and receive dividends”.³¹⁸ Van der Walt and Sutherland, however, question whether any of these could amount to possession. Furthermore, they point out that the person who requested the *mandament* was the nominee and, being merely an agent, would not have been able to perform these acts.³¹⁹

³¹² *Telkom SA Ltd v Xsinet (Pty) Ltd* 2003 (5) 309 (SCA) para [9] (emphasis added).

³¹³ *Tigon Ltd v Bestyet Investment (Pty) Ltd* 2001 (4) SA 634 (N).

³¹⁴ *Telkom SA Ltd v Xsinet (Pty) Ltd* 2003 (5) 309 (SCA). E Leos “Quasi-Usufruct and Shares: Some Possible Approaches” (2006) 123 *SALJ* 126 127 seems to argue that *Tigon Ltd v Bestyet Investment (Pty) Ltd* 2001 (4) SA 634 (N) is no longer good authority and MP Larkin & FHI Cassim “Company Law (Including Close Corporations)” (2003) *ASSAL* 549 576-577 question the authority of this case too.

³¹⁵ See also *Singh and another v Mount Edgecombe Country Club Estate Management Association (RF) NPC and others* 2016 (5) SA 134 (KZD) para [121] and ZT Boggenpoel “Applying the Mandament van Spolie in the Case of Incorporeals: Two Recent Examples from Case Law” (2015) *TSAR* 76 86.

³¹⁶ Van der Walt & Sutherland (2003) *SA Merc LJ* 107 explain it somewhat differently in the following statement: “It has been stated repeatedly that quasi possession of an incorporeal right takes place when a person performs the acts that would otherwise be associated with an exercise of the right.”

³¹⁷ Van der Walt & Sutherland (2003) *SA Merc LJ* 107 query the meaning of the expression “negotiating”.

³¹⁸ *Tigon Ltd v Bestyet Investment (Pty) Ltd* 2001 (4) SA 634 (N) 643.

³¹⁹ Van der Walt & Sutherland (2003) *SA Merc LJ* 107.

Another characteristic that is often attributed to “things” as the legal objects of real rights is that things are susceptible to human control.³²⁰ “Control”, it has been suggested, can be widely construed as “the possibility to enforce and protect the right with regard to the thing”. Under this meaning of “control”, incorporeals can also be subject to control.³²¹

3.2.3.1 Limited real rights

South African law distinguishes between ownership, as “the only real right with regard to one’s own property (*ius in re propria*)”, and limited real rights, as “rights with regard to things which belong to another person (*iura in re aliena*)”.³²²

One example of a limited real right is that of usufruct. Usufruct is a form of personal servitude that confers on its holder the right to use and enjoy the thing to which the usufruct relates, including possession of the thing. Although usufructuaries do not have the entitlements to destroy or alienate the thing, they do have the entitlement to its fruit.³²³ Usufructuaries may dispose of their right to use and enjoy the property, but not the real right itself.³²⁴ It has also been held that shares (forming part of an estate) can be subject to usufruct.³²⁵

It is sometimes said in South African case law that a trust beneficiary with a vested right to trust income has a “usufructuary interest” in the trust property (capital), due to the similarities in the positions of these.³²⁶ There are, however, important differences between them. Only two are mentioned here. Firstly, a usufructuary has a real right, whilst the trust beneficiary only has a personal right. Secondly, although a usufructuary enjoys the right to control of the property subject to the usufruct, a trust beneficiary does not.³²⁷

³²⁰ Badenhorst et al *Silberberg* 21.

³²¹ 21.

³²² 47. These authors also argue that, in the case of limited real rights, the object is not limited to (corporeal) things, but include other rights, as pointed out at n 305 above.

³²³ Badenhorst et al *Silberberg* 339-340; F du Toit *South African Trust Law Principles and Practice* 2 ed (2007) 169 n 3.

³²⁴ Badenhorst et al *Silberberg* 341.

³²⁵ *Cooper v Boyes* NO 1994 (4) SA 521 (C). See also Leos (2006) *SALJ* 127 and Van der Walt *Constitutional Property Law* 115 n 97.

³²⁶ Du Toit *South African Trust Law* 124-125.

³²⁷ 125 n 94.

3.2.3.2 Ownership

Van der Sijde regards the following definition of “ownership” as currently authoritative in South Africa:

“Ownership is defined as the most complete and comprehensive right that an owner can have over a thing and that he may, in principle, do as he pleases with his property, within the boundaries set by public and private law”.³²⁸

Being the “most complete and comprehensive right” that a person can have over a thing, it entitles the owner in principle to all the entitlements mentioned in part 3.2.1.³²⁹ These entitlements may, however, be severely curtailed, for example by the existence of limited real or personal rights.³³⁰ An owner whose entitlements relating to the use and enjoyment of the object have been curtailed is often said to have *nuda proprietas* or “bare dominium”.³³¹ This is in contrast with an owner with *dominium plenum* whose entitlements have not been so curtailed.

Ownership is more than the subtotal of all the entitlements listed earlier.³³² Thus, even though an owner may only have *nuda proprietas*, he or she is regarded as “owner” of the object, just as the owner with *dominium plenum*.³³³ As Borrowdale puts it, modern South African law thus “allow[s] a severance of ownership and benefit”.³³⁴

Only one form (or degree) of ownership is recognised under modern South African law.³³⁵ Accordingly, only one person at a time can be the owner of a thing.³³⁶ Dual ownership,³³⁷

³²⁸ Van der Sijde *Reconsidering the Relationship between Property and Regulation* 82 (footnotes omitted). The difficulty in defining “ownership” is illustrated by the statement in *MEC for Local Government and Finance, Kwazulu-Natal v The North Central and South Central Local Councils, Durban* [1999] 3 All SA 5 (N) 14 that “the concept of ownership has thus far defied exhaustive definition”.

³²⁹ Badenhorst et al *Silberberg* 92; Van der Sijde *Reconsidering the Relationship between Property and Regulation* 38.

³³⁰ *MEC for Local Government and Finance, Kwazulu-Natal v The North Central and South Central Local Councils, Durban* [1999] 3 All SA 5 (N) 17.

³³¹ Also sometimes referred to as “*dominium minus plenum*”.

³³² Van der Walt (1988) *DJ* 18-20.

³³³ AJ van der Walt “Bartolus se Omskrywing van Dominium en die Interpretasies daarvan sedert die Vyftiende Eeu” (1986) 49 *THRHR* 305 311 (for a historical perspective); Van der Walt (1988) *DJ* 18-20 and the sources mentioned there.

³³⁴ A Borrowdale “The Transfer of Proprietary Rights in Shares: a South African Distillation out of English Roots” (1985) 18 *CILSA* 36 36.

³³⁵ It is thus sometime said that ownership is “uniform”, “singular”, “exclusive”, “individual” or “absolute”, although terminology in this regard is not consistent. See the discussion by Van der Sijde *Reconsidering the Relationship between Property and Regulation* 37 and 41.

whereby more than one person can be the owner of a thing simultaneously under different forms of ownership, known as “fragmentation of ownership”, is thus not recognised.³³⁸

3.2.3.3 Dual ownership in Roman and Roman-Dutch law

In contrast to the position under modern South African law, more than one form of ownership was recognised in medieval Roman law.³³⁹ This period was dominated by the feudal system, in terms of which landlords gave their vassals the right to use their land. In an attempt at explaining these feudal relations “as instances of the roman *dominium*”³⁴⁰ the Glossators in the Middle Ages recognised more than one form of ownership. With regard to feudal land³⁴¹ both the holder of the title (the landlord) and the holder of the right to use (the vassal) were regarded as owners of the land.³⁴² The landowner was said to have *dominium directum* (translated as “direct ownership”) and the vassal *dominium utile* (translated as “beneficial ownership”).³⁴³

It has been argued that Roman-Dutch law also recognised dual ownership.³⁴⁴ Visser explains that during this time personal servitudes such as usufruct was possibly regarded by some as a

³³⁶ The exception to this is co-ownership, where the co-owners own the thing in undivided shares. This exception does not, however, allow for different forms of ownership, as pointed out by Van der Walt (1988) *DJ* n 14.

³³⁷ Also sometimes called “split”, “divided” or “fragmented” ownership.

³³⁸ Badenhorst et al *Silberberg* 92; *MEC for Local Government and Finance, Kwazulu-Natal v The North Central and South Central Local Councils, Durban* [1999] 3 All SA 5 (N) 15.

³³⁹ For an overview of the possible recognition of different forms of *dominium* in Roman law at other times, see G Pienaar “Ontwikkelings in die Suid-Afrikaanse Eiendomsbegrip in Perspektief” (1986) *TSAR* 295 298; AJ van der Walt & DG Kleyn “Duplex Dominium: the History and Significance of the Concept of Divided Ownership” in D P Visser (ed) *Essays on the History of Law* (1989) 213 heading 2; IJ Kroeze *Between Conceptualism and Constitutionalism: Private-law and Constitutional Perspectives on Property* LLD thesis University of South Africa (1997) 118-120.

³⁴⁰ Kroeze *Between Conceptualism and Constitutionalism* 120. See also the theories discussed by Van der Walt & Kleyn “Duplex Dominium” in *Essays on the History of Law* (1989) 236-340.

³⁴¹ It also came to be recognised with regard to other legal relationships, such as *superficies solo cedit*. DP Visser “The ‘Absoluteness’ of Ownership: The South African Common Law in Perspective” (1985) *AJ* 39 40; Van der Walt & Kleyn “Duplex Dominium” in *Essays on the History of Law* (1989) 340, 342 and 343; BC Stoop “Roman Law Antecedents of the Horizontal Division of Ownership” (1999) 5 *Fundamina* 107 122.

³⁴² See AJ van der Walt “The South African Law of Ownership: A Historical and Philosophical Perspective” (1992) 25 *DJ* 447 453, quoted in the main text corresponding to n 348 below.

³⁴³ Visser (1985) *AJ* 40; Van der Walt (1986) *THRHR* 308; Van der Walt & Kleyn “Duplex Dominium” in *Essays on the History of Law* (1989) heading 2 (but see the sources referred to at n 235 of that contribution for a different view); Kroeze *Between Conceptualism and Constitutionalism* 120-121 and 129. Van der Sijde *Reconsidering the Relationship between Property and Regulation* 51 indicates that the Bolognese law school also recognised in the Middle Ages a distinction between *dominium utile* and *dominium eminens* (or “state ownership”) and see also Van der Walt (1992) *DJ* 451.

³⁴⁴ Visser (1985) *AJ* 47; Van der Walt & Kleyn “Duplex Dominium” in *Essays on the History of Law* (1989) 349; Stoop (1999) *Fundamina* 122.

form of ownership.³⁴⁵ However, due to the influence of certain Roman-Dutch authors, notably Grotius,³⁴⁶ as well as the Pandectists, dual ownership did not become part of the South African common law.³⁴⁷ In its place Grotius's classification in his *Inleidinge tot de Hollandsche Rechtsgeleerdheid* (written in 1621) became part of South African law. Van der Walt describes this development as follows:

“Grotius then proceeds to invent the now well-known contrast between full or complete ownership and the limited real rights: less than full ownership can be divided into two parts, namely the empty title remaining with the nominal owner, and the right of use separated from the title and granted to another person. (See *Inleidinge* 2 33 1.) In medieval jurisprudence both forms were regarded as ownership and the traditional definition of *dominium* was applied to both, but Grotius, influenced by modern thinking, prefers to reserve the term ownership for the holder of the empty title, while calling the right of the user a mere entitlement. In this way the medieval plurality of property rights is replaced by the modern theory which recognizes only one form of ownership.”³⁴⁸

Often when dual ownership is mentioned in South African case law, no reference is made to the dual ownership of Roman and Roman-Dutch law. Instead, it is the dual ownership of English law that is mentioned.³⁴⁹

It is worth noting that modern Dutch law and the law of the Canadian province of Quebec, which both belong to the civil-law tradition, also do not allow for fragmented ownership.³⁵⁰

³⁴⁵ Visser (1985) *AJ* 41-42.

³⁴⁶ For Grotius' view on this topic, see Visser (1985) *AJ* 40-41; Van der Walt & Kleyn “Duplex Dominium” in *Essays on the History of Law* (1989) 346; Kroeze *Between Conceptualism and Constitutionalism* 122-123.

³⁴⁷ Visser (1985) *AJ* 39, 46-47; Pienaar (1986) *TSAR* 307; Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) n 73.

³⁴⁸ Van der Walt (1992) *DJ* 453.

³⁴⁹ Van der Walt & Kleyn “Duplex Dominium” in *Essays on the History of Law* (1989) 349 note:

“It is interesting to note that the ... rejection [by South African courts] of the fragmented concept of ownership is based on its supposedly English origin. In fact, of course, both the fragmented and the exclusive concepts of ownership were present in the Roman-Dutch law... The rejection of the one and acceptance of the other was, therefore, a choice between alternatives within the same legal tradition” (footnotes omitted).

³⁵⁰ In respect of the Netherlands, see Du Plessis *Critical Issues Regarding the OECD Model Tax Convention* 52. In respect of Quebec, see MD Brender “Beneficial Ownership in Canadian Income Tax Law: Required Reform and Impact on Harmonisation of Quebec Civil Law and Federal Legislation” (2003) 51 *Can Tax J* 311313 who explains that civil law in this Canadian province does not allow for fragmented ownership and that “[w]hile dismemberments of ownership exist – that is, usufruct, use, servitude, and emphyteusis – these dismemberments limit or expand rights enjoyed in property but do not convey ownership itself”.

3.2.3.4 Dual ownership under English law

The concept of dual ownership in English law is linked to the development of the English trust. It has been argued that this concept of dual ownership shares common roots with the dual ownership of medieval Roman law discussed above.³⁵¹ This view of legal history, which is not undisputed,³⁵² needs not be further explored in this study.

Less controversial is the assertion that the English trust developed from the medieval English institution of the “use”. The employment of the use followed the introduction of centralised feudalism in England after the Norman Conquest in 1066.³⁵³ After the conquest, the king came to own all land in England. Individuals could not own land, but could be given an interest in the land. This individual could in turn grant an interest in the land (called an “estate”) to another. This relationship between the grantor (as “lord”) and grantee (as “tenant”) was called a “tenure”.³⁵⁴ The tenant could in turn grant rights to others (under “subinfeudation”),³⁵⁵ resulting in a chain of tenures.

³⁵¹ Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) n 73 argues (after having referred to the distinction made in medieval Roman law between *dominium directum* and *dominium utile*) that “beneficial ownership in English trust law is nothing other than *dominium utile*. Trusts were developed by the English Court of Chancery from the Germanic *Saalmann* or *Treuhand* institution (*Braun v Blann and Botha NNO* 1984 (2) SA 850 (A) 859) after the Norman conquests commenced in 1066. The continental distinction that prevailed during the age of canon law between *dominium utile* and *dominium directum* in property can thus in broad historical terms be said to have been received in English trust law of the Middle Ages, which, subsequently, continued the tradition of split ownership of property.”

See also LI Coertze *Die Trust in die Romeins-Hollandse Reg* LLD thesis Stellenbosch University (1948) 14 (who argues that the *Saalmann* institution appeared in England in the form of the “use”, discussed next in the main text), as well as the sources mentioned by MJ de Waal “In Search of a Model for the Introduction of the Trust into a Civilian Context” (2001) 12 *Stell LR* 63 65-66. PA Olivier, S Strydom & GPJ van den Berg *Trustreg en Praktyk* 3 ed (2013) 1-14 also argues that the English “use” is, seemingly, a form of the *Treuhand*.

³⁵² JP Coetzee *’n Kritiese Ondersoek na die Aard en Inhoud van Trustbegunstigdes se Regte ingevolge die Suid-Afrikaanse Reg* LLD thesis University of South Africa (2006) 51-56 explains that, although it is generally accepted that the English trust developed from the medieval “use” (discussed next in the main text), the origin of the latter is controversial, and it is not accepted by all to be linked to either the *Saalmann* or *Treuhand*. See also the criticism against this view noted by L Albertus “Comparing the *Waaf* and the South African Trust” (2014) *AJ* 268 273. It also seems from sources such as Coetzee *Trustbegunstigdes se Regte* 61, De Waal (2001) *Stell LR* 64 and A McCall-Smith “Comparative Aspects of the Rights of the Beneficiary in the South African Trust” (1972) 5 *CILSA* 189 203 that split ownership did not initially form part of the use, the right of the *cestui que use* being initially of a personal, rather than a real, nature. Split ownership was thus a later development. According to Du Toit *South African Trust Law* 13 and E Cameron, M de Waal, B Wunsh, P Solomon & E Kahn *Honoré’s South African Law of Trusts* 5 ed (2002) 26 it only occurred during the fifteenth century.

³⁵³ Cameron et al *Honoré’s South African Law of Trusts* 24 indicates that uses were employed as far back as the eleventh century and was common by the thirteenth century. J Biancalana “Medieval Uses” in R Helmholz & R Zimmermann (eds) *Itinera Fiducia: Trust and Treuhand in Historical Perspective* (1998) 111 113, however, indicates that it only appeared in the 1300’s.

³⁵⁴ E Cooke & P Butt “Real Property and Registration Vol 87” in D Connolly, S McKeering, M Tulloch, G Dillow, C Ramsbottom & H Halvey (eds) *Halsbury’s Laws of England* 5th ed (2012) para 4 describe “tenure” as denoting “the holding of land by a tenant under his lord”. See also the following explanation by Cheshire, quoted by Coertze *Die Trust in die Romeins-Hollandse Reg* n 30:

Halsbury's explanation of some of the terminology that relates to the above is quoted here to provide background to terminology used in this chapter:

“The tenure of land is based on the assumption that it was originally granted as a ‘feud’³⁵ by the monarch to his immediate tenant on condition of certain services, and, where there has been subinfeudation, that the immediate tenant in turn regranted it.”³⁵⁶

Footnote 3 “‘Feudeum’, ‘feodum’, ‘fief’, ‘fee’: these appear to be all forms of the same word...The hypothesis is that the land was granted by a chieftain to his follower; in Latin as a ‘beneficium’; in the Teutonic languages as a ‘fief’, or ‘fee’ - Latinised into feudum, feodum – or their equivalents. The English terms were ‘feodum’ and ‘fee’... The grant assumed and perpetuated the relation of lord and vassal, and the interest of the donee came to be hereditary. The leading idea in ‘feud’, as used in the expression ‘feudal system’, is that of vassalage...”³⁵⁷

To overcome various challenges in everyday life,³⁵⁸ the institution known as the “use”³⁵⁹ came to be used in the Middle Ages. This entailed the tenant (called the “*feoffor*”) transferring his estate to another person or persons (called the “*feoffee to use*”), who agreed to use it for the benefit of the so-called “*cestui que use*”. Initially the common law only recognised the (legal) estate of the *feoffee to use*.³⁶⁰ However, under equity as adjudicated by the Chancery courts, the “equitable estate” of the *cestui que use* was recognised and protected, in that the *feoffee to use* could be held to his promise to deal with the estate

“Tenure signifies the relation between lord and tenant, and what it implies is that the person whom we should naturally call the owner does not own the land but merely holds it as tenant of the Crown or of [s]ome other feudal superior.”

³⁵⁵ Coetzee *Trustbegunstigdes se Regte* 40; Cooke & Butt “Real Property and Registration Vol 87” in *Halsbury’s Laws of England* (2012) para 19.

³⁵⁶ Cooke & Butt “Real Property and Registration Vol 87” in *Halsbury’s Laws of England* (2012) para 19 (footnotes omitted, except for n 3 which is quoted in the main text).

³⁵⁷ Para 19 n 3.

³⁵⁸ See the examples mentioned by Biancalana “Medieval Uses” in *Itinera Fiduciaie Trust and Treuhand* (1998) 112; MJ de Waal “Core Elements of the Trust: Aspects of the English, Scottish and South African Trusts Compared” (2000) *SALJ* 548 553; Coetzee *Trustbegunstigdes se Regte* 59-60.

³⁵⁹ Coetzee *Die Trust in die Romeins-Hollandse Reg* 24 n 64 refers to authority for the fact that the word is derived from the Latin “*ad opus*”, which in old French became “*al*”, “*al oes*”, “*al ues*” and then in English “to the use”.

³⁶⁰ However, see Biancalana “Medieval Uses” in *Itinera Fiduciaie Trust and Treuhand* (1998) heading IV, especially 145-149.

according to that promise.³⁶¹ Following legislative intervention,³⁶² the use fell in disuse, but during the seventeenth century the English trust developed from its ashes, so to speak.³⁶³

One view of English trust law is that both the trustee and trust beneficiaries have proprietary rights to the trust property: the trustee has “legal” and the trust beneficiary “beneficial” (or “equitable”)³⁶⁴ ownership of the trust property.³⁶⁵ In this way, it differs from the absolute nature of ownership in South African law, as mentioned in part 3.2.3. Dual ownership in English trust law is possible due to the way in which English law regards ownership, namely as a legal relationship between the legal subject and the right or interest of such legal subject in the object.³⁶⁶ More than one interest can exist in respect of one object and holders of certain such interests are recognised as “owners” of interests under English law.³⁶⁷ This is in contrast to ownership under South African law, which regards ownership as a direct relationship between the legal subject and the object itself.³⁶⁸

However, there remains some uncertainty regarding the nature of trust beneficiaries’ “beneficial ownership”. Notably, trust beneficiaries’ ownership is not enforceable against all

³⁶¹ Coertze *Die Trust in die Romeins-Hollandse Reg* 25-26; Coetzee *Trustbegunstigdes se Regte* 44-45 and 60. For a discussion of the development of the law of equity and the Chancery courts, see Coetzee *Trustbegunstigdes se Regte* 45-48.

³⁶² See the discussion by Coetzee *Trustbegunstigdes se Regte* 60-61 and Albertus (2014) *AJ* 269-270.

³⁶³ For a summary of the development of the English trust, see Coertze *Die Trust in die Romeins-Hollandse Reg* 27; De Waal (2000) *SALJ* 552-554; Coetzee *Trustbegunstigdes se Regte* ch 3; Cameron et al *Honoré’s South African Law of Trusts* 26.

³⁶⁴ The terminology points to the fact that this estate was initially recognised and protected only under equity (whereas the legal estate was recognised under common law), as explained in the main text corresponding to n 361 above. It should be noted, however, that AK Rowland “Beneficial Ownership in a Corporate Context: What Is It? When Is It Lost? Where Does It Go?” (1997) *BTR* 178 is unsure whether equitable and beneficial ownership means the same thing in UK case law.

³⁶⁵ De Waal (2001) *Stell LR* 64.

³⁶⁶ Van der Walt (1988) *DJ* 29 at n 52 also quotes Phillips and Hudson as follows: “Men were regarded not as owning land but as owning interests in land”. Cheshire, quoted in Coertze *Die Trust in die Romeins-Hollandse Reg* 17 n 34, explained it in the following manner:

“[W]hat is the relation of the tenant to the land. In Statutes, judicial decisions and in common speech he is always described as a ‘landowner’, but we may well ask what it is that he owns. Common law solves the problem in somewhat curious manner, for it first detaches ownership from the land itself, and then attaches to it an imaginary thing called an estate in the land. The tenant does not own the land, but he owns an estate in land.”

³⁶⁷ Coetzee *Trustbegunstigdes se Regte* 44.

³⁶⁸ As discussed in part 3.2.3. Coetzee *Trustbegunstigdes se Regte* 44 also explains that the English dual ownership does not mean that the object itself has two owners, but rather that various persons have different rights (estates) in the object. See also Lawson, quoted by Olivier et al *Trustreg en Praktyk* I-18:

“So there is not one object of ownership, the physical thing, but two separate ones, the legal estate owned by the trustee for the purpose of managing land, and the equitable estate or interest owned by the beneficiary for the purpose of enjoying the land.”

See also the following statement by Van der Walt (1988) *DJ* 30:

“Selfs al is die fee simple absolute in possession vir alle praktiese doeleindes vandag gelyk aan die absolute individuele eiendomsreg van die ander Westerse regstelsels, is dit nog steeds in teorie slegs ‘n tenure, en geen eksklusiewe reg op die saak self nie” (footnotes omitted).

and there is some debate as to whether the nature of their rights is *in personam* (and thus not in the nature of ownership) or *in rem* (and thus in the nature of ownership).³⁶⁹ Avery Jones et al therefore conclude that, bar limited circumstances (“a bare trust (where the trustee holds the asset for the beneficiary who is absolutely entitled)”), it is not clear when a person can be regarded as a “beneficial owner” under UK law.³⁷⁰

Rowland describes beneficial ownership in UK case law (beyond trusts in the strict sense) as “the bundle of rights required to allow enjoyment of an asset by the owner but falling short of, or distinct from, legal title”.³⁷¹ One of the UK cases that she considers, is the well-known decision of the CA in *Wood Preservation Ltd. v Prior (Inspector of Taxes)*.³⁷² In this case the court considered the meaning of the term “beneficial ownership” in a provision in tax legislation that allowed for the carry forward of losses for income tax purposes. The facts concerned a contract for the sale of shares that was subject to a condition for the benefit of the purchaser, which it could waive at any time. The issue before the court was whether the seller remained the beneficial owner prior to transfer of the shares. Lord Donovan held that, in light of the purpose of that particular provision, even though the seller was still the legal owner of the shares, it was “bereft of the rights of selling or disposing or enjoying the fruits of these shares” and was not the “beneficial owner” of the shares.³⁷³ Harman LJ agreed, indicating, firstly, that “beneficial ownership” referred to “an ownership which is not merely the legal ownership by the mere fact of being on the register but the right at least to some extent to deal with the property as your own”.³⁷⁴ He held on the facts that the seller was no longer entitled to deal with the shares and that there “was no benefit at all in their ownership: it was a mere legal shell”.³⁷⁵

³⁶⁹ The trust beneficiary’s right is not enforceable against a *bona fide* purchaser of a legal estate for value without notice. Cameron et al *Honoré’s South African Law of Trusts* 26. For the debate on whether the rights of the trust beneficiary in English law can be described as “rights *in rem*” (and thus “ownership”), see the discussion and sources mentioned by Du Toit *Beneficial Ownership of Royalties* 114-115; DJ Hayton *Hayton and Marshall The Law of Trusts and Equitable Remedies* 11 ed (2001) 23-27; Brown (2003) *Can Tax J* 404 and 412-415 and J Garton, G Moffat, G Bean & R Probert *Moffat’s Trusts Law: Text and Materials* 6 ed (2015) 14-15 and 270-273.

³⁷⁰ Avery Jones et al (2006) *BTR* 747.

³⁷¹ Rowland (1997) *BTR* 186.

³⁷² *Wood Preservation Ltd. v Prior (Inspector of Taxes)* [1969] 1 W.L.R. 1077.

³⁷³ 1096.

³⁷⁴ 1097.

³⁷⁵ 1097. Widgery LJ held at 1097 that the correct question was whether “the legal ownership, which unquestionably remained in [the seller], retained the attributes of beneficial ownership for the purposes of the section”.

Rowland points out that in older case law sellers, who had concluded the contract of sale, but had not yet given transfer of the *merx*, had been described as a “trustee” who held the *merx* for the benefit of the purchaser.³⁷⁶

Brown, who comments from a (Canadian) common-law perspective, says of this use of the expression:

“[T]he purchaser under a contract for the sale of real property is said to be the ‘beneficial owner’ although the vendor still holds legal title. The words ‘beneficial owner’ are used in this context *because the purchaser may have a right of specific performance (an equitable right) with respect to the property in question, which will be enforced by the common law courts if the terms of the contract are not met.*”³⁷⁷

In *Prévost Car Inc. v The Queen* (“*Prévost (TCC)*”)³⁷⁸ the TCC quoted the following excerpt from Canadian case law that gives meaning to the expression in a non-tax context in Canadian law:

“In the *Jodrey Estate* the Supreme Court approved of the meaning given by Hart J., in *MacKeen v. Nova Scotia*, who wrote:

It seems to me that the plain ordinary meaning of the expression ‘beneficial owner’ is the real or true owner of the property. The property may be registered in another name or held in trust for the real owner, but the ‘beneficial owner’ is the one who can ultimately exercise the rights of ownership in the property.”³⁷⁹

It was previously pointed out that Du Toit argues that the expression “beneficial owner” has a shared meaning in common-law countries outside the law pertaining to strict trusts. His argument is based on his analysis of case law from the US, UK, Australia and Canada.³⁸⁰ Under this shared meaning, a “beneficial owner” is the person whose ownership attributes outweigh those of all others.³⁸¹

³⁷⁶ Rowland (1997) *BTR* 182 notes that in *Lysaght v Edwards* [1876] 2 Ch.D. 499 Jessel MR stated:

“It appears to me that the effect of a contract for sale has been settled for more than two centuries ... the moment you have a valid contract for sale the vendor becomes in equity a trustee for the purchaser of the estate sold, and the **beneficial** ownership passes to the purchaser ...” (emphasis in the original).

However, Rowlands points out that in *Rayner v Preston* [1881] Ch.D. 1 the majority held that “a contract for sale did not give rise to a trustee relationship, or only in a qualified sense.”

³⁷⁷ Brown (2003) Can Tax J 409 n 28 (emphasis added).

³⁷⁸ *Prévost Car Inc. v The Queen* 2008 TCC 231.

³⁷⁹ Para [74]. The footnote to this paragraph reads: “*Covert v. Nova Scotia (Minister of Finance)*, [1980] S.C.J. No. 101 (Q.L.), [1980] 2 S.C.R. 774, at p. 784, citing *MacKeen Estate v. Nova Scotia*, [1977] C.T.C. 230 (NSSC), para. 46.”

³⁸⁰ Du Toit *Beneficial Ownership of Royalties* ch 5.

³⁸¹ 21 and see the discussion in part 2.4.1.

However, other authors question whether such a shared meaning exists and point out that case law in common-law countries is often contradictory.³⁸² This is well-illustrated by the opposite conclusions reached by the House of Lords in *Ayerst v C & K (Construction) Ltd* (“*Ayerst*”)³⁸³ and the Australian High Court in *FCT v Linter Textiles Australia Ltd (in liq)* (“*Linter Textiles*”)³⁸⁴ with regard to the question whether a company can be said to “beneficially own” its assets once it has been placed in liquidation. In both these cases provisions in tax legislation were considered.³⁸⁵

In *Ayerst* the House of Lords held that a company, having been placed in liquidation, “ceases to be the ‘beneficial owner’ of its assets as that expression has been used as a term of legal art since 1874”.³⁸⁶ The court also remarked that:

“The nature of a company’s interest in its assets after a winding-up order had been made first fell to be considered by the Court of Chancery under the Companies Act 1862. It was, perhaps, inevitable that the court should find the *closest analogy in the law of trusts*.”³⁸⁷

In *Linter Textiles* the High Court of Australia considered whether a company in liquidation “beneficially owns” the assets of the company.³⁸⁸ The majority accepted that when a company goes into liquidation “it can no longer employ its assets in its business, nor dispose of them.”³⁸⁹ The majority then held as follows:

“*Power to deal with an asset and matters of ownership or title are not interchangeable concepts*... Their Honours [in another case] said of the inclusion of ‘beneficially’:

‘This word serves more naturally the purpose of excluding the case of a holding for the benefit of others’.”³⁹⁰

The majority concluded that the company in liquidation was “not subject to direction by any third party for whose benefit it owned the” assets and that it was thus the “beneficial owner” of the company assets.³⁹¹

³⁸² Avery Jones et al (2006) *BTR* 748.

³⁸³ *Ayerst v C & K (Construction) Ltd* [1976] AC 167.

³⁸⁴ *FCT v Linter Textiles Australia Ltd (in liq)* [2005] HCA 20.

³⁸⁵ Avery Jones et al (2006) *BTR* n 332 argue that the UK decision was influenced by legislation dealing with what happened on liquidation of a company. The same legislation did not apply in Australia.

³⁸⁶ *Ayerst v C & K (Construction) Ltd* [1976] AC 167 181.

³⁸⁷ 179.

³⁸⁸ The Commissioner succeeded in the High Court in *FCT v Linter Textiles Australia Ltd (in liq)* [2005] HCA 20 on an alternative ground, so that the views of the majority on the meaning of “beneficially owns” were expressed *obiter*.

³⁸⁹ *FCT v Linter Textiles Australia Ltd (in liq)* [2005] HCA 20 para 49 (emphasis added).

³⁹⁰ Paras 55-65.

What is clear from this judgment is, firstly, the danger of using the analogy of trusts where no trust in the strict sense of the word exists. Secondly, outside the law of strict trusts (or even within that area of the law), it may be difficult to determine a shared meaning for the expression “beneficial owner” across common-law jurisdictions.

3.2.3.5 The influence of English trust terminology on South African law

With the influx of British immigrants in the 1800’s³⁹² terminology often used in English trust law found its way into South African legislation³⁹³ and legal practice.³⁹⁴ The terminology was used in areas such as wills, deeds of gift, antenuptial contracts and land transfers.³⁹⁵ One of the English terms so introduced was that of “beneficial owner”. As discussed under the next heading, South African law also developed to recognise a trust. However, unlike under (one view of) the English trust, the trust beneficiary of a South African trust does not have real rights to the trust goods.

The import of the English trust law terminology of “beneficial ownership” is not limited to South African trust law. However, its import in other areas can in many cases be explained by the fact that under English law these legal relationships are seen as trusts (including trusts in the wide sense),³⁹⁶ or as being analogous with trusts, as explained in part 3.2.3.4. This may explain why South African courts have referred to a purchaser who has not yet taken transfer

³⁹¹ Para 58.

³⁹² Cameron et al *Honoré’s South African Law of Trusts* 21; Olivier et al *Trustreg en Praktyk* 1-16 - 1-17.

³⁹³ See the summary by Coetzee *Trustbegunstigdes se Regte* 74-76.

³⁹⁴ See the summary of early case law in which reference was made to trusts by Coertze *Die Trust in die Romeins-Hollandse Reg* 54-72.

³⁹⁵ *Estate Kemp v McDonald’s Trustee* 1915 AD 491 507-508; MM Corbett “Trust Law in the 90s: Challenges and Change” (1993) 56 *THRHR* 262 263.

³⁹⁶ As Olivier et al *Trustreg en Praktyk* 1-4 note, the distinction between trusts in the wide and narrow (also known as “technical” or “strict”) sense is also made in Anglo-American law. Du Toit *South African Trust Law* 2-3 describes trusts in the wide sense as “a somewhat generic term which refers to any legal arrangement in terms of which a functionary controls and administers property on behalf of another ...[and] include agents who hold money or property for their principals...[E]ach arrangement is typified by a fiduciary relationship between the parties concerned in terms of which the trustee in the wide sense is duty bound to show utmost good faith in the administration of the property at hand for the benefit of the trust beneficiary in the wide sense...The distinctive operational feature of the trust in the wide sense is the separation between, on the one hand, the control exercised over property and, on the other hand, the benefit derived from such control.” He also explains at 2-3 that a trust in the narrow sense, being a subspecies of the trust in the wide sense, has the distinctive feature that the trustee of a narrow trust holds an office, which makes him, in South African law, subject to control by the High Court and its Master. In contrast, although trustees of a trust in the wide sense may also, in some instances, hold an office (although not in the case of agents), they are subject to different legal rules. Olivier et al *Trustreg en Praktyk* 1-4 to 1-6 agree, but does not refer to agency as an example of a trust in the wide sense. See also the statement by the South African court in *Blue Square Advisory Services (Pty) Ltd v Pogiso* 2011 JDR 1467 (GSJ) para [35], quoted at n 453 below.

of the *merx* as the “beneficial owner” of the *merx* and a company placed in liquidation as having been deprived of its “beneficial ownership” of the company assets.³⁹⁷

It also explains why the term “beneficial owner” came to be used in South African company law in situations where shares are registered in the name of a person other than the person entitled to the rights comprising the shares. Under English law, the view is that the person whose name appears in the company’s register (referred to in the quote below as the “right-holder”) holds shares in trust for the “beneficial owner”.³⁹⁸ Borrowdale provides the following explanation:

“In English law it is convenient to describe the right-holder as the owner of the shares since legal ownership and the ability to enforce the corresponding rights coincide in the same person. Of course the legal owner is not necessarily the owner in equity; if not, *he holds the rights in trust for the equitable owner*, but since he continues to be the legal owner and is alone capable of enforcing the rights comprising the shares against the company, the concept of the ownership of such rights residing in the legal holder is both convenient and appropriate.”³⁹⁹

As discussed in part 3.4, South African company law developed differently. Where a share is registered in the company’s register in the name of someone other than its holder, the first-mentioned, called a “nominee”,⁴⁰⁰ is usually an agent who acts on behalf of the owner of the shares, rather than a trustee.⁴⁰¹ The Appellate Division (as it then was) (“AD”) in *Sammel v*

³⁹⁷ See the examples of South African case law mentioned in parts 3.5.2.1 and 3.5.3. See also the arguments of the first and second appellants in *Krok and another v Commissioner, South African Revenue Service* 2015 (6) SA 317 (SCA). The case concerned sale agreements of assets between the first and second appellants as seller and purchaser respectively. The assets, at the time of the judgment, had not yet been transferred to the second appellant, who argued that he had, upon conclusion of the sale agreements, become the “beneficial owner” of the assets and that the first appellant retained only “bare dominium” of the assets. According to this argument, a preservation order could thus not be given against the first appellant in respect of these assets. The Australian Tax Office, who had requested the preservation order in terms of the South Africa/Australia DTA, had disallowed this argument on the basis that the sale agreements were shams. The SCA did not find it necessary to resolve the issue in this manner. It indicated at para [42] that the issue could be decided by determining whether ownership in the sold assets had passed from the first to the second appellant. It then considered at paras [42]-[45] whether ownership, in terms of South African law, had been transferred. On finding that this was not the case, the SCA held that the second appellant was thus not the “beneficial owner”.

³⁹⁸ *Koen v Bam* 2006 JDR 1021 (C) 14; Borrowdale (1985) *CILSA* 40-41; FHI Cassim, MF Cassim, R Cassim, R Jooste, J Shev & J Yeats *Contemporary Company Law* 2 ed (2012) 249.

³⁹⁹ Borrowdale (1985) *CILSA* 43 (emphasis added).

⁴⁰⁰ See also the definition of “nominee” in s 1 of the 2008 Companies Act. See also the discussion of the meaning of “nominee” in part 3.6.

⁴⁰¹ Borrowdale (1985) *CILSA* 40-41, but see the case law referred to by him at 41 n 32 where the position under the English law has been followed. In cases such as *Sammel and others v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A) 667 and *Sino West Shipping Co. Limited v Nyk – Hinode Line Limited* 2013 JDR 0518 (KZD) para [60] the court acknowledged that the relationship between the nominee and beneficial owner may not necessarily be one of agency.

*President Brand Gold Mining Co Ltd*⁴⁰² pointed out that the word “nominee” had also been taken over from English company law. In this case, the court had to determine the meaning of the term “nominee” in a provision contained in earlier company law legislation. It noted the following:

“The ordinary meaning [of ‘nominee’] is a person who is nominated or appointed; in the context it therefore means a person nominated or appointed by the ... company to hold the shares in his name on its behalf, that is, he is simply an agent of the ... company for that purpose. The reason why ‘nominee’ and not ‘agent’ is used is not far to seek. The word comes from the English statute. The policy of that law is that a company shall concern itself only with the registered holder and not the owner or *beneficial owner* of the shares... Hence, no one can be registered [under South African company law legislation] as holding the shares as the agent for another; he, the agent, must himself appear on the register as the holder of the shares. Consequently, such a person came to be known in ordinary commercial parlance as the ‘nominee’ of the owner of the shares, probably because the word conveniently and usefully synthesized the dual concepts that the person was nominated by the owner to hold the shares for him in his name and that he thus held them only nominally, i.e., in name only...”⁴⁰³

3.3 Aspects of South African trust law and the use of the expression “beneficial owner” in this context

As pointed out above, South African courts declined to accept the dual ownership of the English trust as part of South African law.⁴⁰⁴ That is, however, not to say that they refused to recognise trusts.⁴⁰⁵ However, under South African trust law⁴⁰⁶ there is no dual ownership: the

⁴⁰² *Sammel v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A).

⁴⁰³ 666 (emphasis added). See also the following explanation from *Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd* 1976 (1) SA 441 (A) 453:

“A nominee is an agent with limited authority: he holds shares in name only. He does this on behalf of his nominator or principal, from whom he takes his instructions; ... The principal, whose name does not appear on the register, is usually described as the ‘*beneficial owner*’. This is not, juristically speaking, wholly accurate; but it is a convenient and well-understood label. Ownership of shares does not depend upon registration. On the other hand, the company recognises only its registered shareholders” (emphasis added, footnotes omitted).

⁴⁰⁴ This was recognised early on in *Lucas’ Trustee v Ismail and Amod* 1905 TS 239 247 and, more recently, in *Braun v Blann and Botha NNO and another* 1984 (2) SA 850 (A) 859. See also the cases referred to by MJ de Waal “The Uniformity of Ownership, Numerus Clausus and the Reception of the Trust into South African Law” (2000) 8 *ERPL* 439 442 n 7.

⁴⁰⁵ It is not necessary for purposes of this study to enter into the debate as to whether, due to the non-recognition of dual ownership under South African law, the South African trust is a “trust”, or only a “trust-like” institution. The debate is discussed by De Waal (2001) *Stell LR* and Du Toit *South African Trust Law* 14-18.

⁴⁰⁶ Although South African courts initially regarded testamentary trusts as *fideicommissum* (see *Estate Kemp v McDonald’s Trustee* 1915 AD 491 and De Waal (2000) *SALJ* 555-556) this notion was rejected by the AD in *Braun v Blann and Botha NNO* 1984 (2) SA 850 (A) 866. In that case the court held at 859 that South African

trustee is (usually)⁴⁰⁷ the owner of the trust property and the trust beneficiaries only have personal rights *vis-à-vis* the trustees. It is also noteworthy that a trustee is not an agent of the trust beneficiaries.⁴⁰⁸

In the context of South African trust law, the expression “beneficial owner” is used primarily in two ways. The first is to indicate a negative: that the trustee is *not* the beneficial owner of the trust assets. It is often said that although the trustee has legal *dominium*, it is only bare or nude *dominium*. An example of this use is found in the plaintiff’s pleadings in *Adam v Jhavary*.⁴⁰⁹ The case concerned trustees of an *inter vivos* trust refusing to transfer trust property registered in their names to the trust beneficiary, the plaintiff. The plaintiff argued in his pleadings that the trustees “had no claim to the beneficial ownership” of the property. The AD explained the use of the term as follows:

“All that the words relied upon mean is that the properties were held in trust by the [trustees] ..., and that they had no beneficial interest in them. The position indeed is exactly the same as that which arose in the case of *Estate Kemp*⁴¹⁰ ... , where the CHIEF JUSTICE said, ‘The trustees to whom the estate is directly bequeathed are vested with the legal ownership: but it is clear that the testator never intended that they should have any beneficial interest.’ It would have been better, no doubt, if the word ‘interest’ had been used instead of ‘ownership’ by the pleader, but the meaning, I think, is perfectly plain.”⁴¹¹

Another example is a statement by the AD in *Crookes, NO v Watson*.⁴¹² In this case, the court stated that the trustee “does not acquire any *beneficial ownership* or right to the settlor’s goods. It is merely pro forma, and by way of more or less technical legal abstraction that [the trustee] is recognised as the holder of the dominium, denuded of all benefit to himself.”⁴¹³

trust law is a unique, evolving body of law, based on an adaption of the “trust idea” to existing principles of South African law.

⁴⁰⁷ So-called “bewind” trusts, where the beneficiary is the owner of the trust property, are rare in South Africa and are not considered in this study. For discussions of these trusts, see *Bafokeng Tribe v Impala Platinum Ltd and others* 1999 (3) SA 517 (BH) 541-542; *Commissioner, South African Revenue Service v Dyefin Textiles (Pty) Ltd* 2002 (4) SA 606 (N) 611; De Waal (2000) *SALJ* 561. The question whether the “*stigting*” is part of South African law (a possibility discussed by counsel for the respondents in *Kohlberg v Burnett NO and others* 1986 (3) SA 12 (A) 17) is not considered here.

⁴⁰⁸ Du Plessis *Critical Issues Regarding the OECD Model Tax Convention* 19.

⁴⁰⁹ *Adam v Jhavary and another* 1926 AD 147.

⁴¹⁰ *Estate Kemp v McDonald’s Trustee* 1915 AD 491.

⁴¹¹ *Adam v Jhavary* 1926 AD 147 153.

⁴¹² *Crookes, NO and another v Watson and others* 1956 (1) SA 277 (A).

⁴¹³ 305. See also the statement from *Yarram Trading CC t/a Tijuana Spur v ABSA Bank Ltd* 2007 (2) SA 570 (SCA) 576, quoted at n 415 below.

The second manner in which the term “beneficial owner” is used in the context of South African trust law is to refer to the trust beneficiary,⁴¹⁴ who is also occasionally described as the person with “*utile dominium*”.⁴¹⁵ The beneficiary, although not the owner of the trust goods, does have a “beneficial interest” in the goods.⁴¹⁶ The extent of this interest varies, depending on the beneficiary’s personal rights *vis-à-vis* the trustee.⁴¹⁷ The relationship between the trust beneficiaries and the trust assets may thus be less or more “specific”, to borrow from the judgment in *Rosen*.⁴¹⁸ In this case the argument was advanced that a trust that had received dividends could only serve as a “conduit pipe” in respect of those dividends if the trust beneficiary had a *ius in personam ad rem acquirendam* with regard to the dividends.⁴¹⁹ The court, having rejected this argument, explained that such a *ius in personam ad rem acquirendam* would only be present in “the comparatively rare case where the beneficiary is entitled to receive from the trustee the very dividend cheque issued to him by the company.”⁴²⁰ It then made the following comparison:

“It is true that in some cases the beneficiary’s entitlement to share in dividends received by the trustee is more specific than in others. Thus in *Bell’s Trust v C.I.R.*⁴²¹ the major beneficiaries

⁴¹⁴ See the examples mentioned by Cameron et al *Honoré’s South African Law of Trusts* 56 n 160.

⁴¹⁵ See *The Princess Estate and Gold Mining Co. Ltd. v The Registrar of Mining Titles* 1911 TPD 1066 1078, where the court noted:

“It appears, therefore, that our law is also acquainted to a certain extent with a *nuda proprietas* as distinguished from an interest which, for want of a better term, we may call a *utile dominium*, though always bearing in mind that this is not, like the equitable estate of English law, an estate in land. The trustee under an ante-nuptial contract may be registered as the owner of land for the benefit of one of the spouses or of the children of the marriage. Here the trustee is vested with the *nuda proprietas*, whilst the person entitled to the benefits flowing from the property may be said to be beneficially interested.”

Also, in *Yarram Trading CC t/a Tijuana Spur v ABSA Bank Ltd* 2007 (2) SA 570 (SCA) 576 the court stated:

“[It] confirms the common-law rule with reference to ownership - that the trustee is not the beneficial owner of trust assets. His title is usually described as ‘bare ownership’ (*nudum dominium*) - sometimes also called ‘legal ownership’ - while ‘beneficial ownership’ (*utile dominium*) is said to vest in the beneficiaries of the trust”.

For a discussion of this case, see Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.10.

⁴¹⁶ See, for example, *Commissioner for Inland Revenue v Estate Merensky* 1959 (2) SA 600 (A) 603, where the court said:

“The first argument presented in support of this contention was that what [the estate duty legislation] describes ... is the equivalent of what counsel called ‘beneficial ownership’. For the same concept INNES, C.J., used ‘right to the beneficial enjoyment’ in *Estate Kemp and Others v MacDonald’s Trustee*, 1915 AD 491, while SOLOMON, J.A., used ‘beneficial interest’.”

Another example includes the statement from *The Princess Estate and Gold Mining Co. Ltd. v The Registrar of Mining Titles* 1911 TPD 1066 1078 quoted at n 415 above.

⁴¹⁷ See the discussion by Olivier et al *Trustreg en Praktyk* 4-11 to 4-17; Cameron et al *Honoré’s South African Law of Trusts* 23.

⁴¹⁸ *SIR v Rosen* 1971 (1) SA 172 (A). This case is discussed in part 9.4.1.2.9.

⁴¹⁹ The taxation of trusts is beyond the scope of this study, but see part 9.4.1.2.9 where case law in which the conduit pipe principle was used, is mentioned.

⁴²⁰ *SIR v Rosen* 1971 (1) SA 172 (A) 190.

⁴²¹ *Bell’s Trust v Commissioner for Inland Revenue* (1948) 15 SATC 255, discussed in part 9.4.1.2.7.

were entitled to share in determinable proportions in the dividends derived from specified shares in a particular company; on the other hand in *Armstrong v C.I.R.*, *supra*,⁴²² the appellant beneficiary was entitled to a fixed amount out of composite trust funds comprising dividends and other income and no beneficiary was entitled to any particular item of such funds; in the present case Mrs. Rosen has a voice in what shares the trustees shall buy and sell, and the trustees have to vote on them as she directs, but she is only entitled to certain portions of the trust's composite income. But whether the beneficiary's entitlement is more specific, as in *Bell's Trust v C.I.R.* ..., or less specific as in *Armstrong's* and the present cases, the common factor is that the trust shares and income were vested in ownership in the trustees. The beneficiary therefore had merely a *jus in personam* against the trustees for securing the payments to him, and not a *jus in personam ad rem acquirendam* in any sense."⁴²³

3.4 Aspects of South African company law and the use of the expression “beneficial owner” in this context

Historically, South African company law is strongly influenced by English law.⁴²⁴ In this part of South African law, the term “beneficial owner” is used in two distinct ways. From early on⁴²⁵ it has been used to refer to persons who are owners of shares.⁴²⁶ It is thus an indication that those persons are, indeed, owners.⁴²⁷ This is true notwithstanding the fact that their names do not appear in the company's register⁴²⁸ and they may themselves thus not be entitled to enforce their rights *vis-à-vis* the company.⁴²⁹ “Beneficial owner” used in this manner, more commonly refers to the person who is the holder of the bundle of personal

⁴²² *Armstrong v Commissioner for Inland Revenue* (1938) 10 SATC 1, discussed in part 9.4.1.2.9.

⁴²³ *SIR v Rosen* 1971 (1) SA 172 (A) 190.

⁴²⁴ Cilliers et al *Corporate Law* 19-20.

⁴²⁵ An early example is *Hertzog and Brebner v Wessels* 1927 OPD 142.

⁴²⁶ And also to a member who holds a member's interest in a close corporation, for example in *Distinct Investments (Pty) Ltd v Arhay CC; Bloom v Das Neves and another* [1997] 2 All SA 513 (W) 514 and 516. Other terms used in case law to describe the holder of shares include the “real owner” (as in *Bell's Trust v CIR* (1948) 15 SATC 255 265) or “beneficial holder” (which is the terminology favoured in Cilliers et al *Corporate Law*) and see *Smyth v Investec Bank Ltd* 2015 JDR 2278 (GP) for a recent example of where the court used “beneficial owner” and “beneficial holder” interchangeably. At times the courts have abbreviated the reference to state that the holder of all the issued shares in a company was the “beneficial owner of the company”, for example in *National Director of Public Prosecutions v Rautenbach and others* 2005 (4) SA 603 (SCA) para [33] and *ITC 1818* (2006) 69 SATC 98 102.

⁴²⁷ Borrowdale (1985) *CILSA* 37; MS Blackman, RD Jooste, GK Everingham, JL Yeats, FHI Cassim, R de la Harpe, M Larkin & CH Rademeyer *Commentary on the Companies Act* (2012) 5-172.

⁴²⁸ However, holders of shares have also been referred to as “beneficial owners” in judgments with no indication in the written judgment itself that they were not also the registered holders of the shares. *S v Chalmers* 1963 (1) SA 525 (N) 526 and *S v Shepard and others* 1967 (4) SA 170 (W) 171 are examples.

⁴²⁹ R Rachlitz “Disclosure of Ownership in South African Company Law” (2013) 24 *Stell LR* 406 408-409.

rights that comprise the share conjunctively, rather than a person who holds only one such right.⁴³⁰

The second manner in which the term “beneficial owner” is used, is to describe the interest that a shareholder has in company assets. Although shares are regarded as a complex of personal rights, these rights do not include ownership in the assets of the company.⁴³¹ The same principle applies to groups of companies; that is, a holding company is not the owner of the assets of its subsidiaries and neither are the individuals who hold the shares in the holding company. Thus, in *Rex v Milne and Erleigh*⁴³² the AD held:

“The fact that in a group bargaining between companies may often be non-existent, because the controllers decide, does not support the idea of a single persona with single interests. *No business man would be deceived into thinking that in a group there is, in effect, a pooling of assets...*”⁴³³

The exception to this principle is where piercing of the corporate veil occurs, discussed in part 5.7. In *The Shipping Corporation of India Ltd v Evdomon Corporation*⁴³⁴ the court explained:

“It seems to me that, generally, it is of cardinal importance to keep distinct the property rights of a company and those of its shareholders, even where the latter is a single entity, and that the only permissible deviation from this rule known to our law occurs in those (in practice) rare cases where the circumstances justify ‘piercing’ or ‘lifting’ the corporate veil. And in this regard it should not make any difference whether the shares be held by a holding company ...”⁴³⁵

Although it is thus clear that a shareholder is not the owner of company assets, shares do “entitl[e] their owner to a certain *interest* in the company, its assets and dividends.”⁴³⁶ Of this

⁴³⁰ Delpont et al *Henochsberg on the Companies Act 71 of 2008* 220.

⁴³¹ See the passage from *Francis George Hill Family Trust v South African Reserve Bank and others* 1992 (3) SA 91 (A) 102, quoted in the main text corresponding to n 446 below. See also Cilliers et al *Corporate Law* 224; Van der Walt & Sutherland (2003) *SA Merc LJ* 96; Cassim et al *Contemporary Company Law* 198. As the court in *Jowell v Bramwell-Jones and others* 1998 (1) SA 836 (W) 869 pointed out, though, a layman may not always appreciate this fact.

⁴³² *Rex v Milne and Erleigh* 1951 (1) SA 791 (A).

⁴³³ 827-828 (emphasis added). See MJD Wallis *The Associated Ship and South African Admiralty Jurisdiction* PhD thesis University of KwaZulu-Natal (2010) 100-101 where the context of this statement is explained.

⁴³⁴ *The Shipping Corporation of India Ltd v Evdomon Corporation and another* 1994 (1) SA 550 (A).

⁴³⁵ 566.

⁴³⁶ *Randfontein Estates Ltd v The Master* 1909 T.S. 978 981 (emphasis added) and see also *Harris v Fisher NO* 1960 (4) SA 855 (A) 861 and the statements quoted at n 291 above.

“interest”, Van der Walt and Sutherland say that it is likely to be nothing more than “an element” of the shareholder’s personal rights *vis-à-vis* the company.⁴³⁷

Due to the shareholder’s interest in company assets, such shareholder has at times been referred to as the “beneficial owner” of those assets.⁴³⁸ In *Nedbank Ltd v Thorpe*⁴³⁹ one finds an example of where an individual, who had tried to hide his interest in company assets, was called the “beneficial owner” of these assets. In this case, the respondent was interdicted due to past transgressions from carrying on a brokerage business. It was argued that he had continued to retain an interest in a company that was carrying on such a business. The court held:

“In my view the evidence referred to above establishes that there is reason to believe that the Respondent is being dishonest in denying his beneficial interest in, and involvement in the operation of, [the company] ... Levinsohn DJP [in the court *a quo*]⁴⁴⁰ was fully justified in concluding that this evidence:

‘all points in one direction and that is that the Respondent despite having been interdicted was the *beneficial owner* (either through shareholding, trusts or otherwise) of a substantial brokerage business’.⁴⁴¹

A shareholder’s interest is recognised in some instances to have consequences in law, whilst in others it is not. *The Princess Estate and Gold Mining Co. Ltd. v The Registrar of Mining*

⁴³⁷ Van der Walt & Sutherland (2003) *SA Merc LJ* 101. As authority for their statement they refer to the “basic distinction” made in a number of statements, including the statement in *Standard Bank of South Africa Ltd v Ocean Commodities Inc* 1983 (1) SA 276 (A) 288 quoted at n 291 above. They also refer to the following statement in *Botha v Fick* 1995 (2) SA 750 (A) 762:

“*Wat die tersaaklike regsbeginnels betref, bestaan ’n aandeel in ’n maatskappy uit ’n konglomeraat of versameling van vorderingsregte wat die reghebbende daarvan geregtig maak op ’n sekere belang in die maatskappy, sy bates en dividende (Randfontein Estates Ltd v The Master 1909 TS 978 te 981) en in hierdie verband is die reghebbende die persoon in wie die vorderingsregte setel, dit wil sê óf die geregistreerde aandeelhouer óf die persoon namens wie hy die aandele hou (Standard Bank of South Africa Ltd and Another v Ocean Commodities Inc and Others 1983 (1) SA 276 (A) te 288H-289C).*”

They also refer lastly to the following statement in *Smuts v Booyens; Markplaas (Edms) Bpk en ’n ander v Booyens* 2001 (4) SA 15 (SCA) para [14]:

“*In ’n bekende passasie [in Borland’s Trustee v Steel Brothers & Co Ltd] stel Farwell R dit soos volg: ‘A share is the interest of a shareholder in the company measured by a sum of money...’*”

⁴³⁸ Examples other than the ones in the main text include: *De Beers Holdings (Pty) Ltd v Commissioner for Inland Revenue* 1986 (1) SA 8 (A) 25; *Bellairs v Hodnett and another* 1978 (1) SA 1109 (A) 1126; *MV Heavy Metal; Belfry Marine Ltd v Palm Base Maritime SDN BHD* 1999 (3) SA 1083 (SCA) para [64] (where Farlam AJA uses the expression “ultimate beneficial owner”, which was also used in the pleadings); *Blastrite (Pty) Ltd v Mineral Sands Resources (Pty) Ltd* 2015 JDR 2232 (WCC) para [18]. See also *Nedbank Ltd v Fraser and another and four other cases* 2011 (4) SA 363 (GSJ), referred to in the main text corresponding to n 448 below.

⁴³⁹ *Nedbank Ltd v Thorpe* 2009 JDR 0975 (KZP).

⁴⁴⁰ *Nedbank Ltd v Thorpe* 2008 JDR 1237 (N).

⁴⁴¹ *Nedbank Ltd v Thorpe* 2009 JDR 0975 (KZP) para [38].

Titles (“*The Princess Estate and Gold Mining Co Ltd*”)⁴⁴² falls in the latter category. The case dealt with the meaning of the expression “beneficial interest” in old stamp duty legislation. This legislation levied stamp duty on the transfer of immovable property unless no change in the “beneficial interest” of the property was affected. The applicant was the sole shareholder of a company, which was the owner of immovable property and which had been placed in liquidation. Since this company did not have any creditors, the applicant was awaiting registration of the transfer of the immovable property in its name. It disputed the levying of stamp duty on this transfer since it argued that, on becoming the sole shareholder of the company, it acquired a “beneficial interest” in the immovable property. No change in “beneficial interest” would thus take place upon transfer of the property to it.

The court held that the term “beneficial interest” in stamp duty legislation did not include a shareholder’s interest in the company’s assets, for the following reasons:

“[Shareholders] have no *dominium* in the land of the company, neither a *nuda proprietas* nor a *utile dominium*. A shareholder has no *jus in re* in any of the assets of the company; he can only lay claim to such a share of the profits as are awarded to him, or in case of liquidation to such a share in the surplus as he is entitled to according to the liquidation account. There is no severance of interests between the company and the shareholder, and, therefore, I fail to see how the latter can be said to have any ‘beneficial interest.’ Nor does it appear to me to make any difference that one person has bought up all the shares. This can make no difference to the relationship between the sole shareholder and the company.

Unless we go to the length of giving to ‘beneficial interest’ so wide a meaning as to include all persons who may in some way or other eventually derive a benefit from immovable property, I cannot see how a shareholder of a company or the successor to all the shareholders can be said to have a beneficial interest in the land of the company.”⁴⁴³

A shareholder’s “interest” in company assets also did not suffice to obtain the relief that the applicant in *Francis George Hill Family Trust v South African Reserve Bank*⁴⁴⁴ sought. In this case, the applicant was a 50 per cent shareholder in the second respondent, the assets of which had been attached. The applicant applied for a review of this attachment under a regulation that allowed a review application to be made by “any person who feels himself aggrieved by the attachment”. The applicant argued that anyone who had a “substantial

⁴⁴² *The Princess Estate and Gold Mining Co. Ltd. v The Registrar of Mining Titles* 1911 TPD 1066.

⁴⁴³ 1079-1080.

⁴⁴⁴ *Francis George Hill Family Trust v SARB* 1992 (3) SA 91 (A).

interest” in the attached assets could qualify as a “person aggrieved” and that, as a 50 per cent shareholder in the second respondent, it would so qualify.⁴⁴⁵ In reply, the court held:

“The word ‘interest’ comprehends a very broad concept. ... In one sense a shareholder may no doubt be said to have an ‘interest’ in the property of the company. The shareholder may derive pecuniary benefit from an increase of such property, and he may suffer pecuniary loss from its destruction. It seems to me, however, that such interest as the [applicant] may have as shareholder in [second respondent] is insufficient in law to make the [applicant] a ‘person aggrieved’ by the attachment....

The critical question in the present case is whether the attachment by the Reserve Bank of the assets of [the second respondent] represents an invasion of the legal rights of the [applicant].”⁴⁴⁶

In other cases, though, a shareholder’s interest in company assets was sufficient to obtain the relief that the shareholder had sought.⁴⁴⁷ An example of such as case is *Nedbank Ltd v Fraser*,⁴⁴⁸ which dealt with protection granted under the Uniform Rules of Court to judgment debtors in respect of the attachment of immovable property. In this case, the court considered a rule that only allowed for a writ of execution to be issued under order of court if the immovable property sought to be attached “is the primary residence of the judgment debtor”. The court had to decide whether the rule also applied where the judgment debtor is a company that owns immovable property that serves as the residence of a shareholder. The court held as follows:

“Where the home is held through the vehicle of a company, close corporation or trustees, the constitutional protection afforded by the provisions of s 26(3) [of the 1996 Constitution] extends equally to members of such companies and close corporations and beneficiaries of the trusts, who are living in the immovable properties concerned and might be considered as what might loosely be called ‘*beneficial owners*’, as it does to persons who own the immovable properties in their personal capacities.”⁴⁴⁹

⁴⁴⁵ 101.

⁴⁴⁶ 102.

⁴⁴⁷ Apart from the example mentioned in the main text, see also *Otto v Road Accident Fund* [2004] 2 All SA 328 (W) 330-331. Otto, who had sustained injuries when he was struck by a motor vehicle, sued the Road Accident Fund for loss of earnings. Otto was the managing director of an operating company and also the sole shareholder of the holding company that held all the shares in the operating company. Otto’s claims for loss of earnings related to the loss of sales suffered by the operating company due to him being injured and unable to generate new sales. The court allowed a claim for loss of earnings.

⁴⁴⁸ *Nedbank Ltd v Fraser* 2011 (4) SA 363 (GSJ).

⁴⁴⁹ Para [12] (emphasis added). See also para [20], where the court referred to a “person in the position of a *beneficial owner* occupying through the judgment debtor” (emphasis added).

3.5 The use of the expression “beneficial owner” in South African case law

3.5.1 Overview

The expression “beneficial owner”⁴⁵⁰ has been used in more than 350 South African judgments.⁴⁵¹ A survey of these shows that the expression does “not constitute a clearly defined juristic concept”.⁴⁵² It is, nevertheless, in some contexts a “convenient and well-understood” label despite not being “juristically speaking, wholly accurate”.⁴⁵³

There is no South African case law on the meaning of “beneficial owner” as a term used in legislation.⁴⁵⁴ There is, however, some case law on the meaning of the expression as used in pleadings,⁴⁵⁵ including *Adam v Jhavary*,⁴⁵⁶ *CSARS v Metlika Trading Ltd* (“*Metlika* (2003)”) ⁴⁵⁷ and *Krok v CSARS* (“*Krok*”).⁴⁵⁸

Upon a consideration of South African case law in which the expression is used, it becomes apparent that the expression is used in diverse sets of facts, by no means limited to facts involving companies and trusts in the strict sense. A brief survey of the South African case

⁴⁵⁰ The variants “beneficial owners” and “beneficial ownership”, as well as the Afrikaans equivalents of “voordeeltrekkende eienaar” (used in legislation, quoted and discussed in *Boland Bank Bpk v Picfoods Bpk en andere* 1987 (4) SA 615 (A)), “genotseienaar” (used in *Strydom en n ander v De Lange en n ander* 1970 (2) SA 6 (T)), “voordelige eienaar” (used in *Van Staden v Fourie* 1989 (3) SA 200 (A) 210) and “voordelige eiendomsreg” (used in *Smit NO v Ferreira NO* 1979 (4) SA 590 (C) 600), are included here. Oliver et al (2000) *BFIT* 311 noted in the year 2000 that the Afrikaans equivalent of the term “beneficial owner” in DTAs was the phrase “vir eie voordeel besit”. Examples of DTAs appearing in Afrikaans on the IBFD database, including the 2012 South Africa/Chile DTA and the 2015 South Africa/Qatar DTA, suggest that “voordelige eienaar” is currently favoured.

⁴⁵¹ Included in this list are judgments from Namibia (or South West Africa) and Zimbabwe (or Rhodesia) that are included in the databases of LexisNexis and Juta.

⁴⁵² *Commissioner, South African Revenue Service v Metlika Trading Ltd and others* (2003) 66 SATC 345 350.

⁴⁵³ *Oakland Nominees (Pty) Ltd v Gelia Mining & Investment Co (Pty) Ltd* 1976 (1) SA 441 (A) 453. See also *Standard Bank of South Africa Ltd v Ocean Commodities Inc* 1983 (1) SA 276 (A) 289 and the following statement from *Blue Square Advisory Services (Pty) Ltd v Pogiso* 2011 JDR 1467 (GSJ) para [35]:

“[T]he concept of a ‘beneficial owner’ is a concept of equitable ownership as distinct from legal ownership applicable in English trust law but inappropriate to characterise the personal rights of a beneficiary in a trust or a principal in a principal agent relationship in South African law. *This is a common practice and well understood commercially* although the employment of trust terminology is done perhaps in the wide sense” (emphasis added).

⁴⁵⁴ In *Boland Bank Bpk v Picfoods Bpk* 1987 (4) SA 615 (A) the court considered a provision in banking legislation in which the phrase “voordeeltrekkende eienaar” appeared. However, the court did not have to consider the meaning of this phrase.

⁴⁵⁵ See also the statement in *CIR v Estate Merensky* 1959 (2) SA 600 (A) 603, quoted at n 416 above, where the court discussed the argument raised by one of the parties that estate duty legislation describes “beneficial ownership”.

⁴⁵⁶ Mentioned in part 3.3.

⁴⁵⁷ Discussed in part 3.5.2.2.

⁴⁵⁸ *Krok v CSARS* 2015 (6) SA 317 (SCA), discussed in this context at n 397 above.

law follows, using as starting point the distinction between those cases in which the expression was used to refer to the owner of property and those in which it was not.

3.5.2 The use of the expression as an indication that the person is the owner or the holder of property

There are numerous examples of cases where a South African court used the expression “beneficial owner” to refer to the owner or the holder of property in the following manner: where a person is referred to as the “beneficial owner” of X where X is a thing, it means that the person is the owner of X (or the holder of a limited real right in respect of X). Alternatively, if X is a subjective right (other than a real right), then it means that the person is the holder of that subjective right. These possibilities will in the rest of this chapter simply be referred to as the “owner of the property”.

By including the word “beneficial”, these judgments usually wish to point out either of two alternatives. The first is that the owner’s entitlements (usually relating to the use and enjoyment of the property) have not been curtailed and that such owner thus owns the property “beneficially”. The second alternative is that the person is the real owner and not just the “apparent” owner.

3.5.2.1 The expression as indication that the owner’s entitlements have not been curtailed

Avery Jones et al state the following of the manner in which the expression “beneficial owner” was at first used in English statutes:

“Initially the main statutory use of the expression [‘beneficial owner’] was in relation to implied covenants for title given on the sale of land in English law, which therefore dealt necessarily with sales by the legal owner. *This use made a distinction between a beneficial legal owner and a non-beneficial legal owner*, such as a trustee; no issue relating to the beneficiary’s interest was involved.”⁴⁵⁹

⁴⁵⁹ Avery Jones et al (2006) *BTR* 747 (emphasis added).

One also finds this use of the expression “beneficial owner” in South African case law, that is where the expression has been used to refer to an owner whose entitlements have *not* been curtailed.⁴⁶⁰ This is often done to contrast such ownership with a trustee’s bare ownership.⁴⁶¹

An example of this is the case of *Commissioner of Customs and Excise v Randles Brothers & Hudson Ltd*.⁴⁶² In this case, in order to qualify for a rebate of customs duty, a manufacturer was required to declare that material was his own property. After equating the position of the manufacturer in this particular set of facts with that of a trustee, De Wet CJ in his minority judgment held:

“It seems to me that this expression [‘my own property’] made it clear that the intention of the regulation was to require *beneficial ownership* in the ordinary sense of the term and not to concern itself with the legal niceties of nude *dominium*.”⁴⁶³

Another example is the Rhodesian case of *The Master v Thompson’s Estate*,⁴⁶⁴ where the court considered whether a donation could be made to a company. The court held:

“It would seem to me that where the company is not acting as mere trustee to pass on the property donated or its benefits, but is to become the *beneficial owner* of what is donated, though, through its own shares, others may benefit, it is all the clearer that there can be a donation.”⁴⁶⁵

In contrast to the cases discussed so far, in a number of cases the courts have used the expression “beneficial owner” to highlight the fact that an owner’s entitlements had, indeed, been curtailed. In *Wiseman v De Pinna*⁴⁶⁶ the curtailment was the result of the application of mining legislation. There the court remarked that “by reason of the proclamation of a public

⁴⁶⁰ Brown (2003) *Can Tax J* 403 n 3 and 424 reaches a similar conclusion with regard to the manner in which Canadian law uses the expression “beneficial owner”.

⁴⁶¹ In addition to the examples mentioned in the main text, see also *Mostert NO v Old Mutual Life Assurance Co (SA) Ltd* 2001 (4) SA 159 (SCA) paras [47]-[48]. In this case the issue was whether a pension fund, which was recognised under legislation as the owner of the fund property, was a legal person. In holding that it was, the court explained as follows:

“[The pension fund] therefore owns, in the sense of *beneficially owns*, its assets, which distinguishes it from a non-legal *persona* such as a trust ... There is no language in the Act which suggests that the assets of the fund vest in the person controlling it. That a fund beneficially owns its assets also follows from the wording of ... [the act and its wording] ...reinforce the conclusion of *beneficial ownership*” (emphasis added).

⁴⁶² *Commissioner of Customs and Excise v Randles Brothers and Hudson Ltd* 1941 AD 369.

⁴⁶³ 380 (emphasis added).

⁴⁶⁴ *The Master v Thompson’s Estate* 1961 (2) SA 20 (FC).

⁴⁶⁵ 27 (emphasis added).

⁴⁶⁶ *Wiseman v De Pinna and others* 1986 (1) SA 38 (A).

digging the owner would have been deprived of his *beneficial ownership* of the land: while the land remains proclaimed his ordinary proprietary rights are suspended.”⁴⁶⁷

Another example can be found in *Re African Farms, Ltd.*⁴⁶⁸ Here the court was asked to recognise the position and status of a foreign liquidator of a foreign company under voluntary liquidation. Probably under influence of English case law,⁴⁶⁹ the court described a company under liquidation as having been deprived of the “beneficial ownership” of its assets, despite remaining the owner thereof.⁴⁷⁰

The curtailment of “beneficial ownership” can also take place other than by legislation. In *KBI v Anglo American (OFS) Housing Co Ltd*⁴⁷¹ the owner of land, the “Estate company”, had entered into oral agreements with the respondent in terms of which the latter would take possession of, and build houses on, the Estate company’s land. It was also agreed that the Estate company would at a later stage sell the land to the respondent. According to the court, this gave rise to a limited real right in the hands of the respondent in the form of a right of retention.⁴⁷² Ramsbottom JA⁴⁷³ recognised the Estate company as owner of the land with the houses, but nevertheless indicated that it was not the “beneficial owner” of the houses.⁴⁷⁴

⁴⁶⁷ 54 (emphasis added). See also *Witwatersrand Gold Mining Co Ltd v Municipality of Germiston* 1963 (1) SA 311 (T) 311, where the court stated:

“[I]t may be stated that the effect of the provisions of the Gold Law as to the ownership of ground which has been proclaimed is to deprive the owner of the beneficial use or occupation of the surface of the ground; the *beneficial ownership is suspended* so far as the surface rights are concerned.”

See also *Modderfontein B Gold Mining Co, Ltd v Commissioner for Inland Revenue* 1923 AD 34 44.

⁴⁶⁸ *Re African Farms, Ltd.* 1906 TS 373.

⁴⁶⁹ See the case law discussed in *Ayerst v C & K (Construction) Ltd* [1976] AC 167, mentioned in part 3.2.3.4.

⁴⁷⁰ *Re African Farms, Ltd.* 1906 TS 373 378-379, also referred to in *Ex Parte Gettliffe and another, NNO: In Re Dominion Reef (Klerksdorp) Ltd (in liq)* 1965 (4) SA 75 (T) 77. However, in *The Princess Estate and Gold Mining Co. Ltd. v The Registrar of Mining Titles* 1911 TPD 1066 1079, discussed in part 3.4, the court held that, upon being placed in liquidation, a company does not sever with its “beneficial interest” in its assets, as the court interpreted this phrase in stamp duty legislation.

⁴⁷¹ *KBI v Anglo American (OFS) Housing Co Ltd* 1960 (3) SA 642 (A). M Wiese “Aard van ’n Verrykingsretensiereg in die lig van *Kommissaris van Binnelandse Inkomste v Anglo American (OFS) Housing Co Ltd* 1960 (3) SA 642 (A)” (2013) TSAR 733 740 argues that, although it was held in this case that the right of retention arose under the law of enrichment, it arose by contract.

⁴⁷² *KBI v Anglo American (OFS) Housing Co Ltd* 1960 (3) SA 642 (A) 657. The finding that a right of retention is a limited real right has been criticised by Wiese (2013) TSAR. It is not necessary for purposes of this study to enter into this debate.

⁴⁷³ He delivered a separate judgment, in which he agreed with the majority judgment.

⁴⁷⁴ He stated at *KBI v Anglo American (OFS) Housing Co Ltd* 1960 (3) SA 642 (A) 655:

“When possession of the land was given [to the respondent], it was not intended that the right to possess should ever revert to the Estate company... The respondent was given the right to build houses for its own use... There was no intention on either side that the Estate company should ever become the *beneficial owner* of the houses, and if ownership passed by accessio the intention was that nothing more than the bare *dominium* in the houses would vest in the Estate company” (emphasis added).

To conclude: it is not unusual to refer to an owner who has all the entitlements associated with ownership (or at least the entitlements relating to the use and enjoyment of the property) as the “beneficial owner” of the property. If an owner relinquished some of these entitlements, it has been said that such owner has been deprived of his or her “beneficial ownership”, notwithstanding the fact that he or she is still the (only) owner.

3.5.2.2 The expression as a way of distinguishing between the real and an apparent owner

Another reason for courts referring to a person as the “beneficial owner” of property is to confirm the fact that the person is the owner. This happens in situations where it may not be immediately apparent whether such person, or another person, is the owner.

Uncertainty may, for example, be caused by the existence of a property register. This may give rise to the question whether the person whose name appears on the register is the owner of the property. Possibly also under influence of English trust law as explained in part 3.2.3.5, this question is often formulated to ask whether the person whose name appears on the register is the “beneficial owner” of the property. In most cases, this simply means whether such person is the owner. The most well-known example in this regard is the registration of the holders of shares in a company, as discussed earlier.⁴⁷⁵ Other examples relate to the registration of motor vehicles,⁴⁷⁶ aircrafts,⁴⁷⁷ liquor licences⁴⁷⁸ and immovable property.⁴⁷⁹

A second cause for confusion as to who the owner of property may be, is due to the owner attempting to deliberately hide this legal fact. It may also be due to owners trying to divorce themselves of their ownership by using legal entities or trusts, but doubt exists as to whether such attempts have been successful. This doubt may be the result of an argument that the

⁴⁷⁵ See the discussion in part 3.4.

⁴⁷⁶ In *Van der Westhuizen v Arnold* 2002 (6) SA 453 (SCA) para [13] the court indicated that “the beneficial owner and sole user” of a vehicle was a third party, although it was registered in the appellant’s name as security for a loan. However, it should be noted that it was indicated at para [8] that the owner of the vehicle was, in fact, a bank. Here, “beneficial owner” thus does not refer to the owner of the motor vehicle.

⁴⁷⁷ In *Commissioner, South African Revenue Service v Hawker Air Services (Pty) Ltd; In Re Commissioner, South African Revenue Service v Hawker Aviation Services Partnership and others* 2006 (4) SA 292 (SCA) para [4] the court referred to a company, who was a partner in a partnership, as the “registered owner” of an aircraft, but the “partnership” as having “beneficial ownership”.

⁴⁷⁸ In *Behnke v Liquor Licensing Board, South-West Africa; Karbaum v Liquor Licensing Board, South-West Africa* 1972 (2) SA 210 (SWA) 212 the court explained that a company was “the beneficial owner” of licences and that these were “held by and in the name of a nominee”.

⁴⁷⁹ In *Salie v Bales NO* 2012 JDR 0639 (WCC) the court held at para [17]: “There can be little doubt that... the beneficial owner of the property in question was the applicant ... (notwithstanding that the title deeds continued to reflect [the fourth respondent] as sole owner)”.

attempt was a sham, or that piercing of the corporate veil or the veneer of a trust should take place.

In *Metlika (2003)*⁴⁸⁰ the Commissioner sought a declaratory order that certain assets were owned by an individual, King (the fourth defendant), alternatively a company, Ben Nevis (the second defendant). The Commissioner made a number of alternative claims and the judgment concerned exceptions raised by the defendants. One of the Commissioner's claims was that, notwithstanding the fact that Metlika (the first defendant) "purportedly" held certain assets,⁴⁸¹ the "beneficial owner" was King.⁴⁸² Ben Nevis and King raised an exception to the Commissioner's pleadings, arguing that it was "unclear what was meant by 'beneficial owner'". They also argued that a conclusion of beneficial ownership could only be drawn if the corporate veil is lifted or if it could be found that there had been simulated transactions that could be set aside" and that facts establishing this had to be fully pleaded, but that the Commissioner had not done so.⁴⁸³

The court disallowed the exception and stated:

"I agree ... that the claim ... are not aimed at a piercing of the corporate veil. The use of the word purportedly with relation to the ownership of the first defendant ... is in itself an indication of an allegation that a false picture of ownership is being portrayed. In para 6.2 it is explicitly stated that it is being falsely held out that the assets in question are owned by the first defendant. Then it is alleged that the *beneficial owner* is the fourth defendant. The word '*beneficial owner*' do not constitute a clearly defined juristic concept⁴⁸⁴ ..., but [it is] appropriate in the context of a situation where it is alleged that someone who is the ostensible owner of property is in fact not its real owner.

The plaintiff alleges that the fourth defendant is the actual owner in spite of the fact that it appears that the first defendant is the owner. He alleges that the defendants concerned falsely maintain the appearance that first defendant is the owner."⁴⁸⁵

⁴⁸⁰ *CSARS v Metlika Trading Ltd* (2003) 66 SATC 345.

⁴⁸¹ These assets are not listed in the judgment, but from *Commissioner, South African Revenue Service v Metlika Trading Limited* 2010 JDR 1060 (GNP) paras [31] and [32] it appears that these included shares and immovable property.

⁴⁸² Alternatively, Ben Nevis. See paras 6.1 and 10.1 of the Commissioner's Particulars of Claim, summarised at *CSARS v Metlika Trading Ltd* (2003) 66 SATC 345 348-349.

⁴⁸³ *CSARS v Metlika Trading Ltd* (2003) 66 SATC 345 350.

⁴⁸⁴ The court referred to the paragraph from *Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd* 1976 (1) SA 441 (A) quoted at n 403 above.

⁴⁸⁵ *CSARS v Metlika Trading Ltd* (2003) 66 SATC 345 350-351 (emphasis added). The court also held that the Commissioner needed not have pleaded evidence as to who the owner was.

The Commissioner also argued in the alternative that Ben Nevis had transferred the assets to Metlika in order to prevent the Commissioner from attaching the assets, that the separate corporate personalities of Ben Nevis and Metlika should be disregarded and that Ben Nevis was the “beneficial owner” of the assets.⁴⁸⁶ The court dismissed the exception raised to this claim and held that the Commissioner’s allegations were sufficient to find an *actio pauliana* and an order for lifting the corporate veil.⁴⁸⁷

In *Dadabhay v Master of the High Court*⁴⁸⁸ it was argued that transfer of immovable property was a simulated transaction and that the transferor thus remained the “beneficial owner” of the property. The court agreed.⁴⁸⁹

*Banco de Mocambique v Inter-Science Research and Development Services (Pty) Ltd*⁴⁹⁰ is an example of a case where “piercing of the corporate veil” was argued, but dishonesty as such was not suggested. The respondent in this case had in an earlier judgment obtained an order to attach property of the applicant (Banco de Mocambique) to found jurisdiction. Banco de Mocambique, which was a separate juristic entity whose sole shareholder was the Government of Mozambique, applied to have this order set aside. Its argument was that, as an entity separate from the Government of Mozambique, its assets were not those of the Government. The respondent, in turn, argued that the corporate veil of Banco de Mocambique should be lifted and that the Government be regarded as the “real or beneficial owner” of the assets of Banco de Mocambique. The court, however, was left unconvinced by this argument and, apart from referring to the pleadings, never used the expression “beneficial owner” itself.⁴⁹¹

The use of the expression “beneficial owner” in piercing situations also arose in a number of cases concerning divorces and assets held by trustees of family trusts.⁴⁹² In this regard, *YB v*

⁴⁸⁶ Para 11 of the Commissioner’s Particulars of Claim, summarised at *CSARS v Metlika Trading Ltd* (2003) 66 SATC 345 349.

⁴⁸⁷ This claim was granted in favour of the Commissioner in *CSARS v Metlika Trading Limited* 2010 JDR 1060 (GNP).

⁴⁸⁸ *Dadabhay v Master of the High Court* 2014 JDR 1654 (GP).

⁴⁸⁹ Para [138].

⁴⁹⁰ *Banco de Mocambique v Inter-Science Research and Development Services (Pty) Ltd* 1982 (3) SA 330 (T).

⁴⁹¹ 344-345, also quoted in *Dithaba Platinum (Pty) Ltd v Erconovaal Ltd and another* 1985 (4) SA 615 (T) 623-624.

⁴⁹² It is not always clear whether the expression “beneficial ownership” was used in these cases due to the association of the expression with trusts (or nominee-relationships), or because of the arguments relating to sham transactions and piercing the veneer of the trust that were raised in these cases. The cases of *BC v CC and others* 2012 (5) SA 562 (ECP) paras [8] and [12] and *WT and others v KT* 2015 (3) SA 574 (SCA) paras [23]-[24] (where the court refers to the judgment of the court *a quo* in that matter) are not discussed here.

*SB*⁴⁹³ concerned the calculation of the value of the accrual of the husband's estate. The wife (the plaintiff) argued that assets that were "ostensibly" held by trustees of a family trust should be taken into account in determining the value of the accrual of her husband's estate. The court summarised her argument as follows: "[P]laintiff avers that the acquisitions of assets in the name of the trustees ... were simulated transactions and fall to be set aside so as to reflect the [plaintiff's husband] as the *beneficial owner* of such assets."⁴⁹⁴

The judgment only concerned procedural issues, relating to whether the relief sought by the plaintiff was good in law and whether the trustees had been misjoined. In deciding these issues, the court used the same terminology as that used by the plaintiff in her pleadings in the following conclusions:

"[A] crucial issue which the trial court will have to determine ... is whether the assets *ostensibly* held in the name of the trustees are in fact *beneficially* owned by the first defendant ...

I will have to accept as correct the allegations as contained in the particulars of claim ... that the acquisition of assets in the name of the Trust at all material times represented simulated transactions and falls to be set aside to reflect that the first defendant is the *beneficial owner* of such assets."⁴⁹⁵

3.5.3 The use of the expression not as an indication that the person is the owner of the property

The second main group of cases in which the expression "beneficial owner" is used, represents those in which the intention is not to convey that the "beneficial owner" is the owner of the property.⁴⁹⁶ Du Toit and Hattingh explain that "the concept of 'beneficial

⁴⁹³ *YB v SB and others NNO* 2016 (1) SA 47 (WCC).

⁴⁹⁴ Para [5]. See also para [2], where the plaintiff's legal basis for her claims is set out in more detail. In particular, see the following:

"[2.4] At the time the first defendant caused the trustees to acquire the assets, first defendant intended to retain control of such assets for his personal benefit and to treat them as if they were his personal assets, and the trustees intended for him to acquire and retain *beneficial ownership* of the trust assets... [2.5] At all material times thereafter the first defendant and the trustees intended the first defendant to be the *beneficial owner* of the assets ostensibly held in the name of the trustees...[2.7] Accordingly, the first defendant is the *beneficial owner* of the assets ostensibly held in the name of the trustees and the acquisitions in the name of the trustees constitute simulated transactions (ie a sham)."

⁴⁹⁵ Para [36] (emphasis added).

⁴⁹⁶ The "beneficial owner" may, of course, hold rights (and not mere "interests") that are related in some way to the property in respect of which he or she is said to be the "beneficial owner". For example, a trust beneficiary, who is often described as the "beneficial owner" of the trust assets, usually does not have subjective rights to the trust assets itself. The trust beneficiary does, however, have a personal right *vis-à-vis* the trustees as mentioned in part 3.3. Also, a shareholder in a company, who is often described as the "beneficial owner" of company

ownership' features mostly in South African cases concerned with the procedural remedies of persons that have some *interest* in property."⁴⁹⁷

The classic examples in South African law already referred to are the "beneficial interests" of trust beneficiaries in trust property⁴⁹⁸ and the "interest" of shareholders in company assets.⁴⁹⁹

A few other examples are mentioned here. *Afvin Industrial Finance (Pty) Ltd v Interjet Maintenance (Pty) Ltd*⁵⁰⁰ concerned a hire-purchase agreement in respect of the purchase of an aircraft. In its discussion of the contractual arrangements between the purchaser and seller, the court referred to the purchaser as the "beneficial owner" (and the seller as the "nominal owner").⁵⁰¹ This is despite the fact that the purchaser under a hire-purchase agreement does not become owner of the *merx* before payment of the final instalment.⁵⁰²

Another example⁵⁰³ is the decision in *ITC 1625*.⁵⁰⁴ This case involved a sale agreement in which transfer of the property was postponed in order to avoid paying transfer duty. Meanwhile, after conclusion of the sale and before transfer of the property, the purchaser earned rent in respect of the property. During this time, restrictions were imposed on the purchaser's rights regarding use and disposal of the property and it was obliged to maintain and insure it. The court described the purchaser as "the *beneficial owner* of the property in the sense that it enjoyed all the income derived from the property and was responsible for all the expenses incurred in respect of it."⁵⁰⁵

assets, does not have subjective rights to the company assets. The shareholder does, however, hold a share, which is a bundle of personal rights as mentioned in part 3.4.

⁴⁹⁷ Du Toit & Hattingh "Beneficial Ownership" in *Silke on International Tax* (2010) para 9.10 (emphasis added).

⁴⁹⁸ Part 3.3.

⁴⁹⁹ Part 3.4.

⁵⁰⁰ *Afvin Industrial Finance (Pty) Ltd v Interjet Maintenance (Pty) Ltd* 1997 (1) SA 807 (T).

⁵⁰¹ 812.

⁵⁰² This was confirmed by the SCA in *Info Plus v Scheelke and another* 1998 (3) SA 184 (SCA) 190-191.

⁵⁰³ See also *Gungudoo and another v Hannover Reinsurance Group Africa (Pty) Ltd and another* 2012 (6) SA 537 (SCA). In that case the court was at para [27] prepared to go along with the terminology used by the appellant to describe the lender under a share lending agreement as the "beneficial owner" of the shares. Under such an agreement, though, the lender ceases to hold the shares upon "lending" them and only has a personal right against the borrower to deliver similar shares at expiry of the loan.

⁵⁰⁴ *ITC 1625* (1996) 59 SATC 383.

⁵⁰⁵ 393 (emphasis added). Although the purchaser was the holder of a *ius in personam ad rem acquirendam*, the case is discussed here, rather than in part 3.5.2 since the court referred to the purchaser not as the "beneficial owner" of this personal right, but rather as the "beneficial owner" of the immovable property itself.

It may be observed that the use of the expression “beneficial owner” in this context may very well have been influenced by the UK case of *Wood Preservation Ltd. v Prior*,⁵⁰⁶ as discussed in part 3.2.3.4.

This approach should be contrasted with an *obiter dictum* of the AD in *The Princess Estate and Gold Mining Co Ltd.*⁵⁰⁷ In this case, the court held that a purchaser of immovable property with a *ius in personam ad rem acquirendam* to claim delivery thereof does not have a “beneficial interest” (which is arguably a wider expression than “beneficial ownership”) in the property. The AD made the following statement:

“If we abstract the notion underlying the word ‘benefit’ and give to the words ‘beneficially interested’ the meaning of one who is interested in the property and who ought to have in justice and equity the benefit to be derived from the property, then we would go far beyond what the Legislature ever intended, and then ... we might speak of the purchaser who has paid for land and obtained physical possession, but who has not got transfer, as a person beneficially interested in the land. So wide a meaning would lead to startling results.”⁵⁰⁸

3.6 The (dictionary) meanings of “beneficial owner”, “agent”, “nominee”, “fiduciary” and “administrator” in the Commentary to Article 10

The phrases “beneficial owner” and “beneficial ownership” are defined in a number of dictionaries.

Perhaps the most noteworthy is the American legal dictionary *Black’s Law Dictionary*, which scholars and courts have in the past used when interpreting DTAs.⁵⁰⁹ The definition of “beneficial owner” in this dictionary reads as follows:

“1. One recognized in equity as the owner of something because use and title belong to that person, even though legal title may belong to someone else; esp., one for whom property is held in trust. – Also termed *equitable owner*. 2. A corporate shareholder who has the power to buy or sell the shares, but who is not registered on the corporation’s books as the owner. 3. *Intellectual property*. A person or entity who is entitled to enjoy the rights in a patent, trademark, or copyright even though legal title is vested in some else. The beneficial owner has standing to sue for infringement. A corporation is typically a beneficial owner if it has a

⁵⁰⁶ *Wood Preservation Ltd. v Prior* [1969] 1 W.L.R. 1077.

⁵⁰⁷ *The Princess Estate and Gold Mining Co. Ltd. v The Registrar of Mining Titles* 1911 TPD 1066.

⁵⁰⁸ 1077.

⁵⁰⁹ Du Toit *Beneficial Ownership of Royalties* 199-200; Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.5. See also part 7.6.1 and the reference to this dictionary in *Velcro Canada Inc. v the Queen* 2012 TCC 57 (CanLII), referred to at n 1206 below.

contractual right to the assignment of the patent but the employee who owns the patent has failed to assign it. Similarly, a patent or copyright owner who has transferred title as collateral to secure a loan would be a beneficial owner entitle to sue for infringement.”⁵¹⁰

In addition, Brown quotes the following definition of beneficial ownership from “*The Dictionary of Canadian Law*”:

“ownership through a trustee, legal representative, agent or other intermediary”.⁵¹¹

Furthermore, a South African law and economics dictionary, the *Woordeboek van Regs- en Handelsterme*, defines a “beneficial owner” (“*genottrekker*” in Afrikaans) as “a person who has the use, benefit of something”.⁵¹² It is perhaps noteworthy that the Afrikaans for “beneficial owner” used here, a “*genottrekker*”, is also an expression often used for a usufructuary.⁵¹³

Where undefined expressions used in the Commentary to Article 10 are concerned, De Broe argues that courts “may be induced” to consider the meaning of these terms under the law that governs the agreements between the parties.⁵¹⁴ If the role of the Commentaries is to further a uniform interpretation of DTAs,⁵¹⁵ this approach is problematic and giving a uniform meaning to expressions used in the Commentaries would generally be more preferable. The problem, though, is that the expressions “agents”, “nominees”, “fiduciaries” and “administrators” have different meanings in different countries and even within the same country, depending on the context in which they are used.

Starting with “agent”, the expression is used in civil law in at least two ways. Firstly, it refers to a person, the agent (or “representative”), who concludes a contract that has a legally binding effect on someone else, his “principal”. This is sometimes referred to as “direct representation” and usually involves the agent disclosing to the other contracting party that he or she is acting in the name a principal.⁵¹⁶ This may be contrasted with the “less technical”

⁵¹⁰ See “beneficial owner” in the definition of “owner” in *Black’s Law Dictionary* B A Garner (ed) 10 ed (2014).

⁵¹¹ Brown (2003) *Can Tax J* 412.

⁵¹² *Woordeboek van Regs- en Handelsterme: Verklarend en Vertalend* J Smuts & I J Smuts (ed) (1992). Author’s own translation. The original reads: “*Persoon wat die nut, voordeel van iets ontvang of geniet; voordeeltrekker, bevoordeelde*”.

⁵¹³ See also the connection made with a *usufruct* in a dictionary meaning quoted in *Prévost Car Inc. v The Queen* 2008 TCC 231 para [72].

⁵¹⁴ De Broe *International Tax Planning* 686 and 720.

⁵¹⁵ Part 4.4.

⁵¹⁶ JF Avery Jones & DA Ward “Agents as Permanent Establishments under the OECD Model Tax Convention” (1993) 33 *Euro Tax* 154 156-157; J Kleinschmidt “Representation” in J Basedow, K J Hopt, R Zimmermann & A Stier (eds) *The Max Planck Encyclopedia of European Private Law Volume II* (2012) 1455 1456; Van der

use of the term,⁵¹⁷ which refers to “indirect representation”. In these cases, the agent acts “on account of” (rather than “in the name of”) the principal.⁵¹⁸ The principal, who needs not be disclosed to the third party, can usually not enforce the contract against the third party, but has rights against the agent that arise from the contract of mandate between him or her and the agent. An example of such indirect representation would be if the principal had mandated the agent to buy goods on his or her account. In terms of this mandate, the agent may be obliged to cede to the principal his or her rights to the goods upon having purchased them.⁵¹⁹ Should the agent fail to do so, the principal will (at least in a number of civil-law jurisdictions) not have any direct claim against the third party.⁵²⁰

Agency in common law is less concerned with whether the agent acts in the name of, or on account of, a principal.⁵²¹ It requires only that the principal and the agent agree that the agent may act on behalf of the principal.⁵²² Where the agent in accordance with this contract enters into a contract with a third party, the principal would usually have rights *vis-à-vis* the third party directly.⁵²³ In this sense, it thus refers to “a person who can represent the principal in such a way as to affect the principal’s legal position”.⁵²⁴ South African law also recognises this form of agency through the doctrine of the undisclosed principal.⁵²⁵

A subsidiary can be an “agent” of its holding company in any of the above ways. It should also be pointed out that, despite the lack of a formal agreement, an analysis of the legal relationship between the subsidiary and its holding company may show that the former acted in that capacity.⁵²⁶ However, the word “agent” has also been used to describe a basis for disregarding the separate existence of the subsidiary in so-called “piercing of the corporate veil” cases. In such cases subsidiaries have been referred to as the (implied) “agents” of their

Merwe et al *Kontraktereg Algemene Beginsels* 232-233; JF Avery Jones & J Lüdicke “The Origins of Article 5(5) and 5(6) of the OECD Model” (2014) 6 *World Tax J* 203 204-205.

⁵¹⁷ Avery Jones & Lüdicke (2014) *World Tax J* 204.

⁵¹⁸ Van Weeghel *The Improper Use of Tax Treaties* 71 makes a similar distinction. In respect of South African law, see DJ Joubert *Die Suid-Afrikaanse Verteenwoordigingsreg* (1979) 1; Van der Merwe et al *Kontraktereg Algemene Beginsels* 235; M Dendy & JC De Wet “Agency and Representation” in *The Law of South Africa Vol I* 3 ed (2014) para 125. Although the use of the words “agent” and “principal” is much less common in the case of indirect representation, they are used in this study to facilitate a comparison between civil- and common-law “agency”.

⁵¹⁹ Joubert *Verteenwoordigingsreg* 1; Van der Merwe et al *Kontraktereg Algemene Beginsels* 235.

⁵²⁰ Kleinschmidt “Representation” in *Max Planck Encyclopedia* (2012) 1458.

⁵²¹ Avery Jones & Lüdicke (2014) *World Tax J* 206.

⁵²² Guenter Treitel, quoted by Kleinschmidt “Representation” in *Max Planck Encyclopedia* (2012) 1456.

⁵²³ Avery Jones & Lüdicke (2014) *World Tax J* 205-206.

⁵²⁴ 205-206. See also *Velcro Canada Inc. v the Queen* 2012 TCC 57 (CanLII) para [46] (discussed in part 6.6).

⁵²⁵ Van der Merwe et al *Kontraktereg Algemene Beginsels* 243; Dendy & De Wet “Agency and Representation” in *The Law of South Africa Vol I* (2014) para 172.

⁵²⁶ See also Du Toit *Beneficial Ownership of Royalties* 233.

holding companies, so that the holding company could be treated as a principal and thus be held liable for acts of the subsidiary or be treated as the owners of assets ostensibly owned by the subsidiary. The circumstances under which such an argument may arise, are discussed in part 5.7.3. It should be noted, however, that there has been criticism against the use of the term “agent” in this regard.⁵²⁷

The question is which of these meanings apply to the word “agent” in the Commentary to Article 10? It is unlikely to include an “agent” in the “piercing of the corporate veil” sense since this meaning is far removed from any of the legal relationships discussed above. The more problematic question is whether it includes indirect representation as understood in civil law. Van Weeghel argues that it does.⁵²⁸ However, it is unclear whether civil-law countries will under their domestic tax rules uniformly attribute the income directly to the principal (rather than the agent) in these scenarios.⁵²⁹ If not, it may be problematic to disregard the agent as beneficial owner since one of the supposed reasons for having the term (that double taxation may otherwise arise)⁵³⁰ falls away. Baker’s “insolvency” test,⁵³¹ which has been

⁵²⁷ In *Banco de Mocambique v Inter-Science Research and Development Services (Pty) Ltd* 1982 (3) SA 330 (T) 344-345 (the facts of which are summarised in the main text in part 3.5.2.2) the court noted:

“Of this and other cases where the corporate veil was apparently lifted by the English Courts, the following is stated in Pennington *Company Law* 4th ed at 54:

‘...The description of the subsidiary as the holding company’s agent or trustee often appears to be merely an epithet used to indicate the subsidiary’s complete subjection to the holding company, and not a statement of their legal relationship at all. For example, in *Smith, Stone and Knight Ltd v Birmingham Corporation* ATKINSON J described the subsidiary company as “the agent or employee, or tool or *simulacrum*” of the holding company, words which are obviously intended to be read in a metaphorical rather than a legal sense...’

And Professor Gower in his *Principles of Modern Company Law* 4th ed says the following at 124:

‘When, however, they have been asked to treat the company as an agent of its individual controlling shareholder and to make the shareholder liable on that basis they have ... coupled the description of the company as an agent with more pejorative descriptions, such as “sham”, “cloak”, “device”, “stratagem”, “puppet”, “creature”, etc. In truth they themselves seem to have been using a cloak, that of agency principles, to give legal respectability to the use of a sledge-hammer.’”

See also ns 967 and 989 below.

⁵²⁸ Van Weeghel *The Improper Use of Tax Treaties* 72. He argues that “the only meaningful interpretation of the term ‘agent’ as used in the Commentary on Article 10 ... is one in which the agent - after all - may act in ‘indirect representation’ only (i.e., in its own name), for only in that situation would there be a person that would be *prima facie* entitled to treaty benefits while the income would belong to the principal”.

Pijl (2000) *BFIT* 257 and De Broe *International Tax Planning* 681-682 raise a similar argument. In the *Decision by the Hoge Raad* (6 April 1994) 28638 BNB 1994/217 (discussed in part 6.2) the court held that a direct recipient, who was neither a “zaakwaarnemer”, nor a “lasthebber”, was the beneficial owner of dividends. As discussed at n 1023 below, these include persons who act “on account of” another, but not necessarily in the name of that other person.

⁵²⁹ De Broe *International Tax Planning* 681-682 states that intermediaries acting in their own names on account of a principal would not under Belgian law be regarded as the recipients of income for income tax purposes. In his view, these should thus not be regarded as “beneficial owners” since a risk of double taxation does not arise.

⁵³⁰ See n 529 above and the first paragraph of the statement quoted in the main text corresponding to n 134 above.

referred to by courts⁵³² and scholars,⁵³³ may also be problematic in the case of indirect representation in civil-law jurisdictions. Under this test one must consider what happens on the insolvency of the direct recipient: if the ultimate recipient can claim the income “as its own”, then the ultimate recipient (and not the direct recipient) is the “beneficial owner”. If “agent” in the Commentary is meant to include indirect representation, this test may not necessarily lead to the supposed desired outcome in all civil-law jurisdictions. Where the agent did not cede (and is not deemed to have ceded) the right to the income to the principal before becoming insolvent, the income may fall in the agent’s insolvent estate and the principal may not be able to claim the income “as its own”.⁵³⁴

Turning to the meaning of “nominee”, foreign case law on beneficial ownership has noted that *Black’s Law Dictionary* defines the word as meaning “a person designated to act in place of another, usually in a limited way”.⁵³⁵ That same dictionary also adds a further meaning, being someone “who holds bare legal title for the benefit of others or who receives and distributes funds for the benefit of others”.⁵³⁶ De Broe describes a nominee⁵³⁷ as someone acting in his or her own name but on account of a principal.⁵³⁸

The word “nominee” has been described by a South African court as “a commercial rather than a legal one”⁵³⁹ and has been used in a number of ways. It has, for example, been equated with “agent”.⁵⁴⁰ One such example is in the context of company law, if shares are registered in the name of a “nominee” who is not the holder of the shares (although a nominee will not necessarily be an “agent” in this context).⁵⁴¹ It has been said in this context that the word “conveniently and usefully synthesized the dual concepts that the person was nominated by the owner to hold the shares for him in his name and that he thus held them only nominally, i.e., in name only.”⁵⁴² There are, furthermore, examples in South African case law where the

⁵³¹ Baker *Double Taxation Conventions* B-15. The term “insolvent” is here used to include concepts such as “becoming bankrupt”, “liquidated” and “wound up”.

⁵³² See the discussion in part 6.3.2.

⁵³³ De Broe *International Tax Planning* 687.

⁵³⁴ Kleinschmidt “Representation” in *Max Planck Encyclopedia* (2012) 1458.

⁵³⁵ See *Velcro Canada Inc. v the Queen* 2012 TCC 57 (CanLII) para [50], discussed in part 6.6.

⁵³⁶ See “nominee” in *Black’s Law Dictionary* (2014).

⁵³⁷ Known in Belgium law as a “naamlener”.

⁵³⁸ De Broe *International Tax Planning* 682.

⁵³⁹ *Dadabhay v Dadabhay and another* 1981 (3) SA 1039 (A) 1047. See also Van Weeghel *The Improper Use of Tax Treaties* 58.

⁵⁴⁰ *Dadabhay v Dadabhay* 1981 (3) SA 1039 (A) 1047. See also *Strydom v De Lange* 1970 (2) SA 6 (T) 12-13 and *Hadebe v Hadebe and another* [2000] 3 All SA 518 (LCC) para [17].

⁵⁴¹ See n 401 above.

⁵⁴² *Sammel v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A) 666 (emphasis added).

word was used to refer to a trustee⁵⁴³ and the dictionary definition quoted above confirms this possibility. Lastly, the expression “nominee” is often used with regard to so-called “nominee” contracts. In these contracts a party to a contract agrees that he or she can “nominate” someone else to replace him or her as a party to the contract.⁵⁴⁴ The legal nature of the nomination contract may be agreed upon by the parties and may include assignment of the rights and obligations under the contract.⁵⁴⁵ Usually, however, the relationship is not one of representation.⁵⁴⁶

It is doubtful whether the word “nominee” adds much in addition to agent.⁵⁴⁷ It is also unlikely that it includes a “trustee”. There is support for the view that a trustee can be a “beneficial owner” in terms of Article 10 of the OECD, at least with regard to certain trusts.⁵⁴⁸ The 2014 Commentary also states this explicitly.⁵⁴⁹ It would, accordingly, be contradictory if the word “nominee” in the Commentary includes a “trustee” since it is widely accepted that “nominees” cannot be beneficial owners.⁵⁵⁰

With regard to a “fiduciary”, the concept is recognised in both civil and common law.⁵⁵¹ Such a person has been described as “someone who undertakes to act for or on behalf of another in some particular matter or matters. That undertaking may be of a general character. It may be specific and limited. It is immaterial whether the undertaking is gratuitous. And the undertaking may be officiously assumed without request.”⁵⁵² It is further said that a fiduciary must act “selflessly”, “in the interests of the other” and that this distinguishes the fiduciary from a person who merely has a contractual obligation.⁵⁵³

⁵⁴³ *Dadabhay v Dadabhay* 1981 (3) SA 1039 (A) 1047. The use of the word in this manner in South African law is especially prevalent in case law dealing with legislation that prohibited people belonging to a certain race (e.g. “Asiatics”) from owning immovable property. To get past the prohibition, immovable property would be registered in the name of a non-Asiatic “nominee”, who was regarded as a trustee. In *Ex Parte Hassan* 1954 (3) SA 536 (T), for example, the word “nominee” is used in this manner. The Asiatic would in turn sometimes be referred to as the “beneficial owner” although the courts recognised that he had no real rights to the property. See, e.g. *Administrators Estate Cachalia v Dabhel Madressa Trust and another* 1940 WLD 14.

⁵⁴⁴ RCD Franzsen “Hereregte-Implikasies van Nominasiekontrakte” (1992) 25 *DJ* 237 239; Van der Merwe et al *Kontraktereg Algemene Beginsels* 236.

⁵⁴⁵ Franzsen (1992) *DJ* 247-252.

⁵⁴⁶ 251.

⁵⁴⁷ See also Du Toit *Beneficial Ownership of Royalties* 214 n 472.

⁵⁴⁸ See n 207 above.

⁵⁴⁹ Para 12.1 n 1 of the Commentary (2014) to Art 10.

⁵⁵⁰ Part 2.4.1.

⁵⁵¹ De Waal (2000) *SALJ* 558.

⁵⁵² AJ Oakley *Parker and Mellows: The Modern Law of Trusts* 9 ed (2008) m.nr. 10-047, quoting “Finn: *Fiduciary Obligations* (1977)” 201.

⁵⁵³ Oakley *The Modern Law of Trusts* m.nr. 10-047, quoting “Finn: *Equity, Fiduciaries and Trusts* (ed. Youdan, 1989)” 1 and 4.

There is, however, no single definition⁵⁵⁴ and no closed list of fiduciary relationships. Typical examples include trustees, executors, tutors, curators, guardians, company directors (towards the company), partners (towards the other partners in a partnership), employers (towards employees) and agents.⁵⁵⁵ Oakley suggests that the following characteristics are often (but not necessarily) present between the (supposed) fiduciary and the other party to the relationship, with the first two being the most important: an undertaking by the fiduciary to the other party; vulnerability of that other party since the fiduciary has power or discretion which can be used to affect the other party's legal or practical interests; reliance of the other party on the fiduciary; and the fiduciary having control over property of the other party.⁵⁵⁶ Oakley's analysis of case law from various common-law jurisdictions shows, however, that there are diverse views on when courts will consider a fiduciary relationship to exist in commercial transactions outside the recognised categories.⁵⁵⁷

The last undefined term discussed in this section is that of "administrator". *Black's Law Dictionary* defines "administration" (and, accordingly, "administrator") as follows:

"1. The management or performance of the executive duties of a ... business...3. A judicial action in which a court undertakes the management and distribution of property. Examples include the administration of a trust, the liquidation of a company, and the realization and distribution of a bankrupt estate ... 4. The management and settlement of the estate of an intestate decedent, or of a testator who has not executor, by a person legally appointed and supervised by the court."⁵⁵⁸

As is evident from this definition, it can have a wide range of meanings, but is unlikely to have a wider meaning than that of a "fiduciary"⁵⁵⁹ and thus to contribute much.

3.7 Conclusion

Ownership is a real right. A person with such a real right, known as an "owner", has certain entitlements to deal with the legal object of that real right. This includes the entitlements of

⁵⁵⁴ Oakley *The Modern Law of Trusts* m.nr. 10-048; Garton et al *Moffat's Trusts Law* 796.

⁵⁵⁵ Oakley *The Modern Law of Trusts* m.nr. 10-048; De Waal (2000) *SALJ* 557.

⁵⁵⁶ Oakley *The Modern Law of Trusts* m.nr. 10-051. See also Garton et al *Moffat's Trusts Law* 797-801.

⁵⁵⁷ Oakley *The Modern Law of Trusts* m.nrs. 10-051 - 10-056. For the view of a South African court on the meaning of the term outside the recognised categories, see *Volvo (Southern Africa) (Pty) Ltd v Yssel* 2009 (6) SA 531 (SCA) paras [16]-[18].

⁵⁵⁸ See "administration" in *Black's Law Dictionary* (2014).

⁵⁵⁹ Although it seems that in *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] STC 1195 para 42 (discussed in part 6.3.3) the court might have regarded the direct recipient as an "administrator", but not a "fiduciary" (in the capacity of a trustee).

use, possession and disposal. The entitlement of possession requires a person to be in physical control of a thing. Therefore, in the case of incorporeals, possession is not possible. *Quasi*-possession is, however, recognised in South African law and refers to the exercise of the right.

Dividends, being payment rights that arise from shares, are personal rights.

Roman civil law has a history of fragmentation of ownership. Under this fragmented ownership both the holder of the title and the holder of the entitlement to use and enjoy the thing were in certain situations simultaneously recognised as owners. The latter was known as the person with *dominium utile* or “beneficial ownership”.

In certain circumstances more than one person can today still under English law be recognised as an owner, each in respect of an interest in an asset. The meaning ascribed to the expression is, however, inconsistent and there is no uniform meaning amongst common-law jurisdictions.

The terminology of “beneficial owner” was adopted from English law into modern South African law, notwithstanding the fact that South African law does not recognise fragmentation of ownership. An analysis of South African case law shows that the expression “beneficial owner” is used to describe diverse sets of situations.

One way of using the expression is to refer to the owner of property. This may, firstly, indicate that ownership attributes of the person, being the owner of the property, has not been curtailed. It may, secondly, also be used to confirm that the person is, indeed, the owner of the property in the case of uncertainty. Such uncertainty may arise, for example, if the property is registered in the name of a nominee. A second cause for uncertainty may be where the owner tries to hide this legal fact. The expression is used in this last manner in circumstances where the existence of a sham has been argued or where it has been argued that piercing of the corporate veil (or the veneer of a trust) should take place.

The expression “beneficial owner” can also refer to a person who only has an interest in property. A trust beneficiary, who may be said to have an “interest” in the trust property, is thus sometimes referred to as a “beneficial owner” of the trust property. Another example of this use of the expression is to refer to a shareholder in a company as the “beneficial owner” of company assets. This refers to the shareholder’s “interest” in such assets. Whether such an

“interest” would have legal consequences for the shareholder will depend on the context. However, in *The Princess Estate and Gold Mining Co Ltd*⁵⁶⁰ the AD was not prepared to accept that a shareholder holds a “beneficial interest” (which is a wider expression than “beneficial owner”) in company assets, which would have reduced the shareholder’s stamp duty liability. This was the case even though the shareholder was the sole holder of shares in the company.

A third example of this use of the expression, is to refer to such person as having a *ius in personam ad rem acquirendam*. In such a case the person may be referred to as the “beneficial owner” of the property relating to the *ius*.

In conclusion it is agreed that, as argued by Du Toit and Hattingh, the expression “beneficial owner” does not have a “settled and well-defined meaning in South African law”.⁵⁶¹ The following statement by them is also supported:

“Beneficial ownership is really more of a description of a typical set of legal arrangements. Claiming that you are the beneficial owner or the legal owner will not of itself procure legal consequences already known. An underlying legal fact, such as a contractual agreement or deed (in the case of a trust) or even a statute is what appears to give rise to the particular legal consequences.”⁵⁶²

⁵⁶⁰ *The Princess Estate and Gold Mining Co. Ltd. v The Registrar of Mining Titles* 1911 TPD 1066.

⁵⁶¹ Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) paras 9.3, 9.4 and 9.9. See also para 9.10 where they refer to it as “a fluid label of practice”.

⁵⁶² Para 9.10.

CHAPTER 4

THE INTERPRETATION OF DOUBLE TAXATION AGREEMENTS

Chapter overview

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4.1 Introduction

DTAs become part of the domestic law of their contracting parties and thus have a dual nature: they are both international agreements and domestic law.⁵⁶³ To the extent that there are differences in the rules of interpretation under public international and domestic law, it is thus not always clear which rules should govern the interpretation of DTAs. Scholars

⁵⁶³ Baker *Double Taxation Conventions* para E.02; J Schwarz *Schwarz on Tax Treaties* 3 ed (2013) para 12-000. The incorporation of treaties in the domestic law of South Africa, which is governed by s 231 of the Constitution of the Republic of South Africa 1996, is not discussed in this thesis. For a discussion of this topic, see J Hattingh “Elimination and Avoidance of International Double Taxation” in A P de Koker & E Brincker (eds) *Silke on International Tax* (2010) para 36.14; I du Plessis “Some Thoughts on the Interpretation of Tax Treaties in South Africa” (2012) *SA Merc LJ* 31 32-41; D Costa & L Stack “The Relationship between Double Taxation Agreements and the Provisions of the South African Income Tax Act” (2014) 7 *Journal of Economic and Financial Sciences* 271; A Marais “Kenya/Mauritius/Nigeria/South Africa The Risk for Tax Treaty Override in Africa – A Comparative Legal Analysis” (2014) 68 *BFIT* 607; AW Oguttu *International Tax Law: Offshore Tax Avoidance in South Africa* (2015) 177-182; Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) n 6.

generally favour the view that the international rules should apply⁵⁶⁴ and, according to Baker, so do courts.⁵⁶⁵ This chapter explores aspects of these public international rules that are relevant to this study whilst chapters 7 and 8 provide a South African perspective on these aspects.

This chapter first considers the goals of common and uniform interpretation with regard to the interpretation of treaties. This is followed by a discussion of the public international law rules in respect of the interpretation of treaties set out in the VCLT, as well as the role played by the Commentaries in the interpretation of DTAs. The chapter concludes with an introduction to the role played by general *renvoi* clauses in the interpretation of DTAs.

4.2 Treaties as international agreements: common and uniform interpretation

The fact that DTAs are international agreements give rise to a number of considerations that are not present when domestic legislation (unrelated to treaties) is interpreted.⁵⁶⁶ One consideration is the principle of reciprocity,⁵⁶⁷ which encourages contracting states to seek a common interpretation of treaty terms (the “goal of common interpretation”).⁵⁶⁸ This increases the probability that the objects of the DTA will be met.⁵⁶⁹ Roberts notes, though, that despite the advantages that common interpretation brings, Articles 31 and 32 of the VCLT, discussed in part 4.3.1, do not *require* a common interpretation.⁵⁷⁰ Common

⁵⁶⁴ JA Becerra *Interpretation and Application of Tax Treaties in North America* 2 ed (2013) 111; Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 1.

⁵⁶⁵ Baker *Double Taxation Conventions* para E.02.

⁵⁶⁶ Olivier & Honiball *International Tax* 309, 311 and 319. See Arnold (2010) *BFIT* para 4 for a more complete list of arguments that are sometimes raised for why the approach to the interpretation of treaties should differ from the approach followed in respect of domestic legislation. See also his views on whether these arguments are valid.

⁵⁶⁷ See the description of this principle in part 1.3.

⁵⁶⁸ Proponents of this view include K Vogel & RG Prokisch “Interpretation of Double Taxation Conventions - General Report” in *IFA Cahiers De Droit Fiscal International Vol. 78a* (1993) 55 55 and 62; N Orow “Comparative Approaches to the Interpretation of Double Tax Conventions” (2005) 26 *Adelaide Law Review* 73 91; Arnold (2010) *BFIT* 10 and the sources mentioned at 11; JF Avery Jones, CJ Berg, H Depret, MJ Ellis, P Fontaneau, R Lenz, T Miyatake, SI Roberts, C Sandels, J Strobl & DA Ward “The Interpretation of Tax Treaties with Particular Reference to Article 3(2) of the OECD Model - I” (1984) *BTR* 14 15; F Pötgens *Income from International Private Employment An Analysis of Article 15 of the OECD Model* (2007) 81; MS Garibay “An Analysis of the Case Law on Article 3(2) of the OECD Model (2010)” (2011) 65 *BFIT* ; K Vogel & A Rust “Introduction” in E Reimer & A Rust (eds) *Klaus Vogel on Double Taxation Conventions Volume I* (2015) 1 41-42 m.nr. 90.

⁵⁶⁹ Vogel & Prokisch “Interpretation - General Report” in *Cahiers Vol. 78a* (1993) 55; K Vogel “Double Tax Treaties and Their Interpretation” (1986) 4 *International Tax & Business Law* 4 37-38; Orow (2005) *Adelaide Law Review* 91; AG Becerra “The Interpretational Approaches to the Vienna Convention - Application to (Tax) Treaty Analysis” (2011) 65 *BFIT* 1 10.

⁵⁷⁰ A Roberts “Comparative International Law? The Role of National Courts in Creating and Enforcing International Law” (2011) 60 *International and Comparative Law Quarterly* 57 84.

interpretation of a treaty may also be a difficult goal to achieve.⁵⁷¹ Furthermore, there may be circumstances where parties to a DTA do not intend for terms to have a common (or uniform) meaning due to differences in their domestic tax laws with which the DTA has to relate.⁵⁷²

Another consideration when it comes to the interpretation of DTAs is that they have an “international character”.⁵⁷³ One implication of this is that, where treaties use similar wording, they should as far as possible be interpreted uniformly across all states that use that wording,⁵⁷⁴ that is, the “goal of uniform interpretation” should be pursued. DTAs that are modelled on the OECD MTC would be an example of treaties that lend themselves to such a uniform interpretation. Becerra points out that this goal is justifiable due to the argument that the meaning given to that term internationally may be an indication of the meaning that was intended when the term was used in the treaty under consideration.⁵⁷⁵

Baker also explains how the goal of common interpretation links with that of uniform interpretation:

“Suppose there is a treaty between State A and State B. If the courts of State A have interpreted a provision of the treaty in a particular way, the revenue authority of State A should apply that interpretation to all taxpayers affected by that treaty. It is desirable that the authority of State B should, so far as possible, apply the same interpretation so that the treaty does not mean two different things in the two contracting states. If state A has other treaties (with states C, D, E, etc) which contain the same terminology, it seems appropriate that the interpretation concerning the treaty with State B should also apply to those treaties. Similarly for State B’s other treaties. From there it is a short step to the view taken ... that provisions in treaties based upon the OECD Model should, so far as possible, be given a uniform interpretation in all countries.”⁵⁷⁶

⁵⁷¹ This is illustrated, for example, by the various interpretations that have been given by courts in different jurisdictions to a provision in the Warsaw Convention. These interpretations are summarised in the South African case of *Potgieter v British Airways plc* 2005 (3) SA 133 (C) 136-140. It is acknowledged that a common interpretation may be more difficult to achieve in the case of a multilateral treaty (such as the Warsaw Convention) than in the case of a bilateral treaty.

⁵⁷² Arnold (2010) *BFIT* 11.

⁵⁷³ Orow (2005) *Adelaide Law Review* 80.

⁵⁷⁴ Baker *Double Taxation Conventions* paras E-26 - E-28 and the sources mentioned there; Vann *Interpretation of Tax Treaties in Australia* (2001), quoted in Olivier & Honiball *International Tax* 311. E van der Bruggen “Unless the Vienna Convention Otherwise Requires: Notes on the Relationship between Article 3(2) of the OECD Model Tax Convention and Articles 31 and 32 of the Vienna Convention on the Law of Treaties” (2003) 43 *Euro Tax* 142 150 notes that there is support for this view in the judgments of the World Court.

⁵⁷⁵ Becerra (2011) *BFIT* 6, citing “F. Berman, *Treaty Interpretation in a Judicial Context*, 29 *Yale J. Intl. L.* 2” (2004) 216, and see also Becerra *Interpretation* 124.

⁵⁷⁶ Baker *Double Taxation Conventions* para E-27.

If the goals of common and uniform interpretation are pursued, one would expect that the “ordinary meaning” given to a treaty term would be a meaning that is accepted by both treaty parties⁵⁷⁷ and accords with international practice.⁵⁷⁸ This implies that, when interpreting DTAs, terms should be given an autonomous⁵⁷⁹ rather than a domestic meaning. The Commentaries as well as case law are often mentioned as sources as to what may be an “international” meaning of a term in a DTA.⁵⁸⁰ Arguably, the work of scholars may also be included here.

In this context, reference is often made to the existence of an “international tax language”.⁵⁸¹ This expression is usually attributed to the UK case of *Ostime v Australian Mutual Provident Society* (“*Ostime*”).⁵⁸² In that case, the court stated that the particular DTA employed “language ... what may be called international tax language, and that such categories [as some of the terms being interpreted] have no exact counterpart in the taxing code of the United Kingdom.”⁵⁸³

Prokisch explains that this “international tax language” refers to the “common international understanding” of a treaty term and that, by using this term, the contracting parties intend for the term to have this meaning, unless they “prefer to give the term a special meaning, either by formulating a special definition of the term or by using a term which has a clear relation to domestic law.”⁵⁸⁴

⁵⁷⁷ Avery Jones et al (1984) *BTR* 15.

⁵⁷⁸ Or, as Olivier & Honiball *International Tax* 309, put it, the “international uniform legal use” of the word.

⁵⁷⁹ This is the wording used by Schwarz *Schwarz on Tax Treaties* para 12-300, who seems to equate the term with the “international fiscal meaning”. See also the following statement in *Macklin v Revenue and Customs Commissioners* 2015 WL 685562 para [17]:

“The task of the Court when interpreting a treaty is to determine the ‘autonomous meaning’ of the relevant provision (see *R v Secretary of State for the Home Department, ex p Adnan* [2001] 2 AC 477, at 515, per Lord Steyn). That principle, Lord Steyn said, is ‘part of the very alphabet of customary international law’.”

See also the discussion in Van der Bruggen (2003) *Euro Tax* 151; Du Plessis *Critical Issues Regarding the OECD Model Tax Convention* 98.

⁵⁸⁰ Vogel & Prokisch “Interpretation - General Report” in *Cahiers Vol. 78a* (1993) 63; Orow (2005) *Adelaide Law Review* 94; Becerra (2011) *BFIT* 10; Roberts (2011) *International and Comparative Law Quarterly* 84 (said in relation to treaties generally, not only DTAs); Baker *Double Taxation Conventions* para 10B-14.

⁵⁸¹ The “international tax language” has been described by Wattel & Marres (2003) *Euro Tax* 226 as “the language used by international tax advisers, international tax officials, international tax scholars and the international business community”.

⁵⁸² *Ostime (Inspector of Taxes) v Australian Mutual Provident Society* [1960] AC 459.

⁵⁸³ 480.

⁵⁸⁴ Prokisch, quoted in Du Toit *Beneficial Ownership of Royalties* 182.

4.3 The interpretation of treaties

4.3.1 The Vienna rules

The rules of interpretation pertaining to treaties, including DTAs, are contained primarily in Articles 31 to 33⁵⁸⁵ of the VCLT (“the Vienna rules”). These rules are generally regarded as a codification of customary international law⁵⁸⁶ and are consequently law in South Africa even though South Africa is not a signatory to the VCLT.⁵⁸⁷ For the same reason these rules are binding on countries that have ratified the VCLT with regard to treaties entered into both before⁵⁸⁸ and after the VCLT came into force.⁵⁸⁹

The Vienna rules read as follows:

“Article 31 GENERAL RULE OF INTERPRETATION

1. A treaty shall be interpreted in good faith⁵⁹⁰ 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*.
2. The *context* for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
 - (a) Any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;
 - (b) 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.

⁵⁸⁵ Art 33, dealing with the interpretation of treaties in different languages, is not repeated here and is not addressed in this study.

⁵⁸⁶ FA Engelen *Interpretation of Tax Treaties under International Law* (2004) 54-57; Ward et al *Interpretation of Income Tax Treaties* 15; Linderfalk & Hilling (2015) *Nordic Tax Journal* 36; Baker *Double Taxation Conventions* para E.03.

⁵⁸⁷ *Krok v CSARS* 2015 (6) SA 317 (SCA) para [27] and s 232 of the Constitution, discussed in part 7.5. See also Du Plessis (2012) *SA Merc LJ* 41; J Schwarz “Tax Treaty Interpretation after *Ben Nevis (Holdings) Ltd v Her Majesty’s Revenue and Customs (2013)*” (2014) 68 *BFIT* 20 21; I du Plessis “The Interpretation of Double Taxation Agreements: A Comparative Evaluation of Recent South African Case Law” (2016) *TSAR* 484 491-492; Burt (2017) *BTCLQ* 12-14.

⁵⁸⁸ JF Avery Jones “Interpretation of Tax Treaties” (1986) 40 *BFIT* 75 76; Vogel & Prokisch “Interpretation - General Report” in *Cahiers Vol. 78a* (1993) 66; H Pijl “The Theory of the Interpretation of Tax Treaties, with Reference to Dutch Practice” (1997) 51 *BFIT* 539 539-540; Engelen *Interpretation of Tax Treaties* 57; PJ Wattel & O Marres “Characterization of Fictitious Income under OECD-Patterned Tax Treaties” (2003) 43 *Euro Tax* 66 70; Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 3.1; Linderfalk & Hilling (2015) *Nordic Tax Journal* 37; Burt (2017) *BTCLQ* 12. But see DA Ward “Principles to be Applied in Interpreting Tax Treaties” (1980) 34 *BFIT* 545 549. For a further discussion on this topic, see Ward et al *Interpretation of Income Tax Treaties* n 31.

⁵⁸⁹ Canada, the UK and the Netherlands have all ratified the VCLT, as indicated at https://treaties.un.org/pages/ViewDetailsIII.aspx?src=TREATY&mtdsg_no=XXIII-1&chapter=23&Temp=mtdsg3&clang=_en#9 (accessed on 9-08-2017).

⁵⁹⁰ See a discussion of the element of “good faith” in Engelen *Interpretation of Tax Treaties* 122-137; Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 3.4.3.

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.
4. A *special meaning* shall be given to a term if it is established that the parties so intended.

Article 32 SUPPLEMENTARY MEANS OF INTERPRETATION

Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

- (a) Leaves the meaning ambiguous or obscure; or
- (b) Leads to a result which is manifestly absurd or unreasonable.”⁵⁹¹

4.3.2 The “ordinary” and “special” meanings of words

Article 31(1) of the VCLT makes it clear that the “ordinary meaning” of a treaty term should be determined⁵⁹² in the context in which the words are used and in light of the treaty’s object and purpose. Therefore, the “ordinary meaning” should never, or even cannot, be determined without regard to these elements. Garibay’s description of an “ordinary meaning” takes this, as well as the goal of common interpretation, into account:

“The ordinary meaning of a term is the meaning that naturally flows from a reading of the text considering its object and purpose and taking into account the common intention of the parties. This refers to the way that a specific term would be understood in that particular context.”⁵⁹³

The discussion that follows is not an endorsement of an approach whereby the meaning of a treaty term is determined in isolation. However, when considering Article 31 it is important to understand what is meant by the “ordinary meaning” of a term separate from the other elements found in Article 31. To this end, contrasting the “ordinary” meaning of a word with any “special” meaning that it conveys, may be useful. Although the discussion here will focus on paragraphs (1) and (4) of Article 31 of the VCLT, the manner in which South African scholars understand these words with regard to domestic law is also mentioned since it is

⁵⁹¹ Emphasis added.

⁵⁹² Or rather, as Engelen *Interpretation of Tax Treaties* 146 explains, meaning should be “given” to the term.

⁵⁹³ Garibay (2011) *BFIT* para 2.3.

representative of the legal culture on which South African courts may fall back when interpreting the Vienna rules.⁵⁹⁴

Linderfalk explains the concepts of “ordinary” and “special” meanings as follows:

“One ...variety [of language] is the one we somewhat loosely refer to as everyday language; the language all people use and most consider generally applicable. In addition to this everyday form, a language possesses many less extensive varieties adapted to specific situations of use, or developed for specific purposes. These more specialised forms of usage are often found within particular occupational groups or among people sharing some similar interest: the language of economists differs from that of lawyers, which in turn differs from that of computer specialists, and so on. Therefore, to refer to them we often use the term technical language.”⁵⁹⁵

Linderfalk’s “everyday meanings” are often established by reference to general dictionaries,⁵⁹⁶ whilst “technical meanings” are often established by expert witnesses.⁵⁹⁷ One would expect legal dictionaries or other subject dictionaries relating to specific disciplines to be also useful in the latter regard.

The “everyday language” that Linderfalk describes at the start of this passage is comparable with the description given by South African scholars to the “ordinary meaning” of terms, namely the meaning “in common parlance” or in “ordinary colloquial speech”.⁵⁹⁸ It is clear that this “everyday language” is an example of the “ordinary meaning” contemplated in Article 31(1) of the VCLT.⁵⁹⁹

⁵⁹⁴ As R Vann “Hill on Tax Treaties and Interpretation” (2013) *Australian Tax Forum* 87 89 indicates, with reference to a statement by Justice Graham Hill, “it is difficult for judges to escape their domestic legal cultures”.

⁵⁹⁵ U Linderfalk *On the Interpretation of Treaties: The Modern International Law as Expressed in the 1969 Vienna Convention on the Law of Treaties* (2007) 63 (footnotes omitted).

⁵⁹⁶ DA Ward “The Role of the Commentaries on the OECD Model in the Tax Treaty Interpretation Process” (2006) 60 *BFIT* 97 98-99 indicates that the “ordinary meaning” of words are usually determined with reference to dictionaries, or “intuitively”. Linderfalk & Hilling (2015) *Nordic Tax Journal* 44 confirm that dictionary and “grammar books” are often used. See also Du Toit *Beneficial Ownership of Royalties* 192; Engelen *Interpretation of Tax Treaties* 147; Kandev (2007) *Can Tax J* 62. These contributions do not differentiate between ordinary and legal dictionaries.

⁵⁹⁷ Linderfalk & Hilling (2015) *Nordic Tax Journal* 44.

⁵⁹⁸ LM du Plessis *The Interpretation of Statutes* (1986) 106. He also describes it at L du Plessis *Re-Interpretation of Statutes* (2002) 93 as the “language in the sense that the normal speaker of a language will understand it”. See, however, EA Kellaway *Principles of Legal Interpretation of Statutes, Contracts and Wills* (1995) 69-70, where that author includes the possibility that it refers to the “sense which people conversant with the subject-matter with which the statute deals would attribute to it”.

⁵⁹⁹ See n 1275 below for examples of South African cases in which the court referred to the everyday meanings of words when interpreting DTAs.

In the context of this study on beneficial ownership it is unlikely that the expression “beneficial owner” will have such an everyday meaning.⁶⁰⁰ The more relevant and difficult question is whether the technical language that Linderfalk describes above is included in the “ordinary meaning” under Article 31(1), or whether it constitutes a “special meaning” under Article 31(4).

This technical language is a familiar concept to South African courts, which, somewhat reluctantly, accept that words used in domestic legislation do not always bear their everyday meaning.⁶⁰¹ Instead, they may also (or only) have a technical, or legal, meaning or more than one such meaning.⁶⁰² South African courts generally accept that words must be given a technical or legal meaning if they are “usually identified with a particular trade, craft, profession or discipline”;⁶⁰³ or are “peculiar to the law”,⁶⁰⁴ due to an “established association” with legislation of a certain kind,⁶⁰⁵ or derive from the common law, for example by regular use in case law.⁶⁰⁶ The courts also accept that legal terms that originate in one area of the law do not necessarily bear the same meaning when used in other, unrelated areas of the law. Even within the same area of the law, if a word bears a legal meaning for a specific purpose it does not follow without further consideration that it bears that meaning for other purposes too.⁶⁰⁷

Du Plessis also points out that a word that is defined in legislation acquires a technical meaning that often differs from the ordinary meaning and any other technical meanings that

⁶⁰⁰ In the UK case of *Parway Estates Ltd. v. Inland Revenue Commissioners* (1957) 45 T.C. 135 148 Jenkins LJ remarked (as quoted by Lloyd LJ in *J. Sainsbury Plc. v O'Connor (Inspector of Taxes)* [1991] 1 W.L.R. 963 970-971) with regard to the use of the term when interpreting tax legislation:

“I find it difficult as at present advised to derive any assistance from consideration of what the ordinary person would understand by the words ‘beneficial owner’ in their ordinary sense. I am open to conviction, but *prima facie* it seems to me difficult to ascribe any different meaning to those words from their legal meaning, and that little assistance can be derived from speculation as to what an ordinary person would take them to mean in their popular sense.”

See also Oliver (2001) *BTR*.

⁶⁰¹ Du Plessis *Interpretation of Statutes* 110; Du Plessis *Re-Interpretation of Statutes* 202. In *Interlink Postal Courier SA (Pty) Ltd v South African Post Office Ltd* 2003 (5) SA 111 (SCA) 120 the court states:

“But that apart, as a general rule, statutes are addressed to the general public and not to a particular trade or section of the community. Furthermore, courts are reluctant to draw the conclusion that words and expressions in a statute are used in a technical sense.”

⁶⁰² Kellaway *Legal Interpretation* 69.

⁶⁰³ Du Plessis *Interpretation of Statutes* 110. See also *Association of Amusement and Novelty Machine Operators and another v Minister of Justice and another* 1980 (2) SA 636 (A) 660; Kellaway *Legal Interpretation* 70; Du Plessis *Re-Interpretation of Statutes* 202.

⁶⁰⁴ Du Plessis *Interpretation of Statutes* 110. See also Du Plessis *Re-Interpretation of Statutes* 202.

⁶⁰⁵ Du Plessis *Interpretation of Statutes* 111.

⁶⁰⁶ Du Plessis *Re-Interpretation of Statutes* 203.

⁶⁰⁷ 204.

the word may have in other areas of the law. This defined meaning usually only applies to the legislation in which the word is defined.⁶⁰⁸

It may sometimes be difficult to determine whether a court has given an ordinary or technical meaning to a word.⁶⁰⁹ For example, with reference to words used in their legal sense, Du Plessis explains that judges would often refer to the “ordinary meaning” of words which in reality bear a technical legal meaning.⁶¹⁰

Since technical words are usually used in their particular discipline to convey a certain meaning, it is sometimes said that this technical meaning becomes the “ordinary” meaning when used in that discipline. With regard to the interpretation of DTAs it has similarly been said that the technical meaning given to a term in the DTA is its “ordinary” meaning; put differently, this international tax language has become the “ordinary technical language” in the context of DTAs.⁶¹¹ Accordingly, it has been argued that these technical meanings fall within the ordinary meaning of the word in Article 31(1) and that Article 31(4) of the VCLT is rarely applied in the case of DTAs.⁶¹²

The argument is also raised in the commentary to the VCLT:

“Some members doubted the need to include a special provision on this point, although they recognized that parties to a treaty not infrequently employ a term with a technical or other special meaning. They pointed out that technical or special use of the term normally appears from the context and *the technical or special meaning becomes, as it were, the ordinary meaning in the particular context*. Other members, while not disputing that the technical or special meaning of the term may often appear from the context, considered that there was a

⁶⁰⁸ Du Plessis *Interpretation of Statutes* 112.

⁶⁰⁹ An example is *ITC 1878 (2015) 77 SATC 349*, discussed in part 7.5.4. In this case the court gave at para [30] a meaning to the phrase “includes especially” which it described as the “natural and ordinary meaning” of the phrase. However, this meaning would possibly be more aptly described as a (technical) legal meaning. See in this regard also Kellaway *Legal Interpretation* 81.

⁶¹⁰ Du Plessis *Interpretation of Statutes* 111. See also Du Plessis *Re-Interpretation of Statutes* 203.

⁶¹¹ Du Toit *Beneficial Ownership of Royalties* 194 and 211 and see the sources mentioned there. See also Wattel & Marres (2003) *Euro Tax* 226. Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 3.4.11 argues that

“[i]n context, a technical meaning may become the ordinary meaning. This is particularly true in the context of tax treaties where tax expressions frequently have a meaning that is different from the ordinary meaning of the words”.

⁶¹² Du Toit *Beneficial Ownership of Royalties* 211; Engelen *Interpretation of Tax Treaties* 164. But see Van der Bruggen (2003) *Euro Tax* 149, where that author indicates that “[t]here seems to be a certain eagerness among tax scholars to make use of Art. 31(4)” of the VCLT. The author himself, though, states that reference to Art 31(4) should be “exceptional”.

certain utility in laying down a specific rule on the point, if only to emphasize that the burden of proof lies on the party invoking the special meaning of the term.”⁶¹³

This paragraph appears to indicate that the drafters of the VCLT agreed that these meanings will still be regarded as “special” and, therefore, that Article 31(4) will apply. Scholars, including Linderfalk, also support this reading of the commentary.⁶¹⁴ However, upon an analysis of case law Linderfalk found that courts generally interpret Article 31(4) otherwise.⁶¹⁵ Based on the research by Linderfalk, the better view is that the “ordinary meaning” in Article 31(1) includes technical meanings that are usually used in the particular context.⁶¹⁶

The implication of this view for this study is that, if one can argue that the term “beneficial owner” has a technical meaning due to its association with DTAs in the context of withholding taxes, such technical meaning will be (another) “ordinary” meaning as contemplated in Article 31(1).⁶¹⁷ Other possible “ordinary” meanings of the expression “beneficial owner” are evaluated in part 7.7.⁶¹⁸

4.3.3 The context

Scholars often divide context between so-called “intra-textual” (or intrinsic/internal) and “extra-textual” (extrinsic/external) context.⁶¹⁹ The former includes the words appearing immediately before and after the text being interpreted, as well as the rest of the document. “Extra-textual context”, as the name suggests, includes context other than the document under consideration.

Both paragraphs 2 and 3 of Article 31 are relevant for determining the “context” that can be taken into account under Article 31 and contain a combination of intra-textual and extra-textual context.⁶²⁰ It is noteworthy that all the material mentioned in these two paragraphs

⁶¹³ Para 17 of the commentary to the VCLT (emphasis added). See also the discussion of the drafting process of this paragraph by Engelen *Interpretation of Tax Treaties* 149-166, especially 158 and 162-163.

⁶¹⁴ Linderfalk *Interpretation of Treaties* 67. See also Pijl (1997) *BFIT* 540.

⁶¹⁵ Linderfalk *Interpretation of Treaties* 67.

⁶¹⁶ See also Linderfalk & Hilling (2015) *Nordic Tax Journal* 44.

⁶¹⁷ As Linderfalk & Hilling (2015) *Nordic Tax Journal* 44 point out, if a word has both “everyday” meanings and “technical” meanings, both of these will be “ordinary” meanings as contemplated in Art 31(1).

⁶¹⁸ See also Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.5.

⁶¹⁹ JF Avery Jones, CJ Berg, H Depret, MJ Ellis, P Fontaneau, R Lenz, T Miyatake, SI Roberts, C Sandels, J Strobl & DA Ward “The Interpretation of Tax Treaties with Particular Reference to Article 3(2) of the OECD Model - II” (1984) *BTR* 90 92; Du Plessis *Re-Interpretation of Statutes* 225.

⁶²⁰ Avery Jones et al (1984) *BTR* 95; Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 3.4.5.

have been agreed to, or accepted in some or other way, by the treaty parties.⁶²¹ There is thus no place for a consideration as part of this “context” of material that has not been accepted by all the treaty parties.

Article 31(2) of the VCLT includes, in the first place, the entire text of the treaty. One implication of this is that identical terms used in a treaty are presumed to have the same meaning, unless a “very convincing argument” to the contrary is made.⁶²² Such an argument has in the past succeeded since identical terms do not necessarily serve the same purposes throughout the same document.⁶²³

Article 31(2) includes in the “context” agreements and instruments “relating to the treaty” that was entered into, or accepted by, all the treaty parties “in connection with the conclusion of the treaty”⁶²⁴ and Article 31(3) includes only limited extra-textual context.

4.3.4 Article 31(1): “its object and purpose”

Article 31(1) also indicates that the ordinary meaning should be interpreted “in the light of its object and purpose”. This requires the interpreter to take into account the object and purpose, or the objects and purposes of there are more than one, of the treaty as a whole.⁶²⁵ The purpose of a specific treaty provision (as opposed to the treaty as a whole) would also have to be taken into account, but probably as part of the “context”.⁶²⁶

With regard to the material that can be considered to determine the object and purpose of the treaty (and probably also a specific treaty provision), the more widely held view seems to be

⁶²¹ J Déry & DA Ward “Interpretation of Double Taxation Conventions - Canada” in *IFA Cahiers De Droit Fiscal International Vol. 78a* (1993) 259 269; Becerra (2011) *BFIT* 9; Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 3.4.5.2.

⁶²² Vogel & Prokisch “Interpretation - General Report” in *Cahiers Vol. 78a* (1993) 68. See also Vann (2013) *Australian Tax Forum* 104 where he argues that it will take “clear and specific text or context” to depart from this approach.

⁶²³ Vogel & Prokisch “Interpretation - General Report” in *Cahiers Vol. 78a* (1993) 68.

⁶²⁴ There is some debate on the meaning of the phrase “in connection with the conclusion of the treaty” in Art 31(2). According to para 12 of the commentary to the VCLT, these are regarded as agreements made before or at the time of conclusion of the treaty. See also Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 3.4.5.4.

⁶²⁵ Arnold (2010) *BFIT* 6 argues that Art 31(1) does not indicate whether it is the purpose and object of the treaty as a whole, or of the provision being interpreted that is relevant. However, it seems to be more generally accepted that it refers to the treaty as a whole. Vogel & Prokisch “Interpretation - General Report” in *Cahiers Vol. 78a* (1993) 72; Pijl (1997) *BFIT* 541; Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) paras 3.4.10 and 3.5.1.2. That there can be more than one purpose is confirmed by Linderfalk & Hilling (2015) *Nordic Tax Journal* 44.

⁶²⁶ Vogel & Prokisch “Interpretation - General Report” in *Cahiers Vol. 78a* (1993) 73; Engelen *Interpretation of Tax Treaties* 178-179. See also the general statement by Arnold (2010) *BFIT* n 30 and Vann (2013) *Australian Tax Forum* 92.

that it should be determined with reference to the same material than that included in the context in Article 31(2) and (3).⁶²⁷ However, Vann argues that case law suggests that the “object and purpose” of a treaty can be determined by considering other material too.⁶²⁸ This would include the history of treaty provisions (such as was done in chapter 2).⁶²⁹ Others, however, have argued that historical research falls within Article 32 of the VCLT.⁶³⁰

The OECD MTC initially included in its title a statement regarding the purposes of DTAs. One such purpose was the prevention of tax evasion.⁶³¹ Although the OECD MTC since 1992 no longer contains any purposes in its title, DTAs often do include purposes, including the prevention of tax evasion, in their titles and preambles.⁶³² The same holds true for a number of South African DTAs.⁶³³ The 2017 draft update to the OECD MTC also again propose that this purpose be stated in the title.⁶³⁴ Furthermore, the MLC and the 2017 draft update to the OECD MTC also make provision for a preamble which reads:

“Intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions)”.⁶³⁵

⁶²⁷ Engelen *Interpretation of Tax Treaties* 175; Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 3.4.10.

⁶²⁸ Vann (2013) *Australian Tax Forum* 93.

⁶²⁹ South African courts have in the past not been much concerned with historical analyses of provisions in DTAs, but the Rhodesian case of *Commissioner of Taxes v Aktiebolaget Tetra Pak* (1966) 28 SATC 213, discussed in part 7.3, is a noteworthy example of where a court carried out such an analysis. The South African case of *Cohen Brothers Furniture (Pty) Ltd & another v Minister of Finance of the National Government, RSA & others* 1998 (2) SA 1128 (SCA) is worth mentioning too. In this case, the court was interpreting an amendment made to domestic legislation (rather than a DTA) of the former South African “homeland”, the Ciskei. In interpreting the amending decree, the court considered the reason for the amendment. It pointed out at 1133 that the amendment was brought about by an issue identified in *ITC 1544* (1992) 54 SATC 456, which concerned the wording of a DTA to which South Africa was a party.

⁶³⁰ Becerra *Interpretation* 121.

⁶³¹ Arnold (2004) *BFIT* refers to the argument that “tax evasion” was meant to be “tax avoidance”, but is not convinced of this argument. P Baker “Improper Use of Tax Treaties, Tax Avoidance and Tax Evasion” in A Trepelkov, H Tonino & D Halka (eds) *United Nations Handbook on Selected Issues in Administration of Double Tax Treaties for Developing Countries* (2013) 383 386, however, also argues that this includes “avoidance” and not only “evasion”.

⁶³² Introduction to the OECD MTC paras 8, 16 and 41; Pijl (1997) *BFIT* 541; Arnold (2004) *BFIT* 247.

⁶³³ See the list in National Treasury of South Africa *SA Status of List of Reservations and Notifications* 21-24.

⁶³⁴ *Draft 2017 Update* Part 1B para 3.

⁶³⁵ MLC Art 6.1 and *Draft 2017 Update* Part 1B para 4.

South Africa has also adopted the following additional purpose in the version of the MLC that it signed:

“Desiring to further develop their economic relationship and to enhance their co-operation in tax matters”.⁶³⁶

Purposes stated in the titles and preambles to DTAs can clearly be considered under Article 31,⁶³⁷ as discussed above. Du Toit has argued in the past that the treaty purpose of preventing tax evasion does not assist in giving meaning to the term “beneficial owner”,⁶³⁸ since the opportunity for tax avoidance by way of treaty shopping is created by the very existence of the DTA.⁶³⁹ The formulation in the MLC is probably aimed at addressing this argument. It has been questioned whether even the purpose in the MLC will have an influence on the interpretation of DTAs,⁶⁴⁰ but there are indications that courts have taken a treaty purpose (of preventing tax evasion) into account when giving meaning to the term “beneficial owner”. This is seen in the reasoning of the UK court in *Indofood International Finance Ltd v JP Morgan Chase Bank NA* (“*Indofood (CA)*”),⁶⁴¹ discussed later.⁶⁴²

The Commentaries as a source of the purposes of DTAs is more controversial although Linderfalk and Hillings support this possibility.⁶⁴³ The 1977 Commentary initially only stated one purpose (the fostering of international trade and investment by the elimination of double taxation) and merely mentioned that tax treaties “should not, however, help tax avoidance or evasion”. The Commentary was amended in 2003 (probably to bring into play Article 31(1) of the VCLT)⁶⁴⁴ to state that it was a purpose of DTAs to prevent tax avoidance and evasion.⁶⁴⁵

⁶³⁶ National Treasury of South Africa *SA Status of List of Reservations and Notifications* 21. This purpose is set out in Art 6.3 of the MLC. See also the *Draft 2017 Update* Part 1B para 4 for the proposed amendments to the preamble to the OECD MTC.

⁶³⁷ See also *Draft 2017 Update* Part 1A para 2 for the proposed para 16.1 of the Introduction to the OECD MTC.

⁶³⁸ Du Toit *Beneficial Ownership of Royalties* 208.

⁶³⁹ See also part 2.2.

⁶⁴⁰ E Pinetz “Final Report on Action 6 of the OECD/G20 Base Erosion and Profit Shifting Initiative: Prevention of Treaty Abuse” (2016) 70 *BFIT* 113 119.

⁶⁴¹ *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] STC 1195.

⁶⁴² Parts 6.3.3 and 6.3.4.4.

⁶⁴³ Linderfalk & Hilling (2015) *Nordic Tax Journal* 44-45.

⁶⁴⁴ BJ Arnold & S van Weeghel “The Relationship between Tax Treaties and Domestic Anti-Abuse Measures” in G Maisto (ed) *Tax Treaties and Domestic Law* (2006) 81 90.

⁶⁴⁵ Para 7 of the Commentary to Art 1 (2003). According to Arnold (2004) *BFIT* 248, this “new” purpose was only ancillary to the main one (being the elimination of international double taxation). De Broe & Luts (2015) *Intertax* 123 agree. Arnold (2004) *BFIT* 248-249 also questions whether it is truly one of the purposes of DTA and see also the view expressed by Van Weeghel in Arnold & Van Weeghel “Tax Treaties and Domestic Anti-Abuse Measures” in *Tax Treaties and Domestic Law* (2006) 90. The *Draft 2017 Update* Part C para 24 proposes

With regard to the purpose of the beneficial ownership requirement itself, it was noted above that this purpose is, strictly speaking, part of the “context” referred to in Article 31(1). Since 2003, the Commentaries expressly state that the beneficial ownership should be interpreted “in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance”.⁶⁴⁶ This thus serves as evidence of the OECD’s view that the beneficial ownership requirement serves an anti-avoidance purpose. Vann’s historical research, discussed in chapter 2, shows, however, that there is no clear indication that the term was inserted to combat treaty shopping through conduit companies. As indicated above, is it unclear where historical research fits into the Vienna rules and, as will be seen in part 4.4.1, the same applies to the Commentaries.

4.3.5 Supplementary means

Article 32 provides for “supplementary means” to interpret a treaty. The fact that the supplementary means have been given a less prominent role than the Article 31 material is seen as being reflective of the fact that the VCLT favours an objective or textual approach to interpretation. The intention of the parties should thus primarily be ascertained from the text of the treaty.⁶⁴⁷

The provision is repeated here, to assist with its examination:

“Recourse *may be had* to *supplementary* means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

- (a) Leaves the meaning *ambiguous or obscure*; or
- (b) Leads to a result which is manifestly *absurd or unreasonable*.”⁶⁴⁸

an amendment to the Commentary to Art 1 (new para 54) regarding the purpose(s) of DTAs. The proposed paragraph 54 reads as follows:

“The principal purpose of double taxation conventions is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons. As confirmed in the preamble of the Convention, it is also part of the purposes of tax conventions to prevent tax avoidance and evasion.”

⁶⁴⁶ Para 12 of the Commentary (2003) to Art 10. See also para 12.1 of the Commentary (2014) to Art 10.

⁶⁴⁷ Engelen *Interpretation of Tax Treaties* 83, but see especially n 656 below. To the limited extent explained in the main text above and below, a teleological approach is also prescribed. Engelen *Interpretation of Tax Treaties* 172; Becerra (2011) *BFIT* 9; Davis Tax Committee *Addressing Base Erosion and Profit Shifting in South Africa Interim Report Action Plan 6: Prevent Treaty Abuse* (2015) 34.

⁶⁴⁸ Emphasis added.

The first observation that can be made regarding Article 32 material is that the use of the material is discretionary, as evidenced by the use of the words “may be had”.⁶⁴⁹ Secondly, Article 32 does not limit the circumstances under which Article 32 material may be referred to, but it does limit the circumstances under which the material may be applied.⁶⁵⁰ Therefore, a meaning must be reached with reference to Article 31 material only;⁶⁵¹ and only then may Article 32 material be used either to “confirm” the meaning reached under Article 31, or to “determine” a different meaning. The following has been said regarding the distinction between these two uses of Article 32 material:

“The difference between those *modi*, however, is smaller than one might think... [T]he elements to be examined under Article 32 are distinct from those to be analysed under Article 31, but it is the same elements that are examined under Article 32 irrespective of the outcome of the Article 31 analysis. Instead, what may differ, depending on the result of the application of Article 31, is the weight that will be attributed to the elements analysed under Article 32.”⁶⁵²

Regarding the confirmative use of Article 32 material, such material can only confirm an Article 31 meaning, rather than override it. However, this point should not be overemphasised. Avery Jones indicates that, “in practice”, should Article 32 material not confirm an Article 31 meaning, it may be an indication that another meaning is possible under Article 31, which can then be confirmed by the Article 32 material. Also, Article 32 material can be an indication that there is an ambiguity that was not initially recognised.⁶⁵³ As a result, the circumstances under which Article 32 material can serve a determinative role will come into play.⁶⁵⁴

Article 32 itself mentions only two circumstances under which Article 32 material can be decisive:⁶⁵⁵ if the Article 31 material leaves the meaning of a term ambiguous or obscure, or if the result of an interpretation reached with reference to Article 31 material would be

⁶⁴⁹ O Dörr “Article 32 Supplementary Means of Interpretation” in O Dörr & K Schmalenbach (eds) *The Vienna Convention on the Law of Treaties: A Commentary* (2012) 571-582; Vann (2013) *Australian Tax Forum* 92.

⁶⁵⁰ Arnold (2010) *BFIT* 7.

⁶⁵¹ Dörr “Article 32” in *The Vienna Convention* (2012) 581-582 states that the article places a “procedural” restriction in that Art 32 material may only be “employed” *after* the rule in Art 31 has been applied.

⁶⁵² Quoted in Dörr “Article 32” in *The Vienna Convention* (2012) 582.

⁶⁵³ As Burt (2017) *BTCLQ* 10 confirms, the confirmative use of Art 32 material is not dependent on there being ambiguity following the application of Art 31.

⁶⁵⁴ Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 3.5.1.2 and see also Burt (2017) *BTCLQ* 19. Dörr “Article 32” in *The Vienna Convention* (2012) 583 makes a similar argument and concludes that the confirmative mode has “*de facto* a relevance similar to that of the general rule” in Article 31.

⁶⁵⁵ See, e.g. the discussions by Pijl (1997) *BFIT* 541-542; Dörr “Article 32” in *The Vienna Convention* (2012) 583-584; Vann (2013) *Australian Tax Forum* 93; Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) paras 3.3 and 3.5.1.2.

manifestly absurd or unreasonable. These circumstances are themselves quite widely worded,⁶⁵⁶ again leaving much scope for Article 32 material to be decisive. Engelen's view that occurrences where Article 32 will be decisive will be rare (mainly limited to drafting errors or "materially defective" texts)⁶⁵⁷ is thus not universally accepted.

Turning to the material that may be included in Article 32, the provision refers to the "preparatory work of the treaty and the circumstances of its conclusion". This is not a closed list, as the word "includes" indicates,⁶⁵⁸ but Linderfalk and Hilling argue that the only material that would be recognised (other than the two listed in Article 32 itself) is existing customary international law.⁶⁵⁹ However, tax scholars have argued for the inclusion of materials that may not necessarily meet these criteria.

These include, firstly, foreign case law.⁶⁶⁰ However, it appears that courts often refer to foreign case law without any apparent regard for the limitations imposed under Article 32.⁶⁶¹ The possibility has thus been raised that foreign case law falls to be considered under Article 31 as a guide to the "ordinary" meaning of a treaty term.⁶⁶² Baker agrees that this material does not "fit easily into any of the categories of external aids" in the VCLT.⁶⁶³ Works of international scholars are also often included in Article 32,⁶⁶⁴ but the same reservations apply.

As will become apparent from the discussion in part 4.4.1, there is also an argument that the Commentary can be included under Article 32.

⁶⁵⁶ See Dörr "Article 32" in *The Vienna Convention* (2012) 584, where he states: "In essence, the **elastic concept of ambiguity** (or, for that purpose, of obscurity) clearly outweighs the – alleged – supplementary character of the interpretative means identified in Art 32" (emphasis in the original). See also Pijl (1997) *BFIT* 542. But see the discussion in Engelen *Interpretation of Tax Treaties* 331 for his view on which "forms of ambiguity" may result in the Art 32 material being used.

⁶⁵⁷ Engelen *Interpretation of Tax Treaties* 421.

⁶⁵⁸ Linderfalk *Interpretation of Treaties* 238; Linderfalk & Hilling (2015) *Nordic Tax Journal* 49.

⁶⁵⁹ Linderfalk & Hilling (2015) *Nordic Tax Journal* 49. For this reason they exclude the Commentaries as other Art 32 material, but they do argue that the Commentaries may form part of the circumstances of the conclusion of the treaty and be included in Art 32 for that reason. See the main text corresponding to n 721 below.

⁶⁶⁰ Avery Jones et al (1984) *BTR* 101; Avery Jones "Treaty Interpretation" in *Global Tax Treaty Commentaries* (2015) 3.4.9, 3.5.1.4 and 3.5.2; Du Plessis (2016) *TSAR* 497. See also the sources mentioned by Pötgens *Income from International Private Employment* 80.

⁶⁶¹ Vann (2013) *Australian Tax Forum* 108.

⁶⁶² Becerra (2011) *BFIT* 10.

⁶⁶³ Baker *Double Taxation Conventions* para E.26.

⁶⁶⁴ Avery Jones "Treaty Interpretation" in *Global Tax Treaty Commentaries* (2015) para 3.4.9; Du Plessis (2016) *TSAR* 497.

4.3.6 Different approaches under the Vienna rules

Treaties regularly use terms that are more general than those used in domestic legislation.⁶⁶⁵ This may be due to the fact that treaties have to cover legal concepts used in more than one country,⁶⁶⁶ as well as the fact that treaties are long-lasting and thus have to take into account changes that will take place in the domestic law of the contracting states.⁶⁶⁷

It is often said that, due to this difference in style of drafting when compared to domestic legislation, treaties should be interpreted more liberally or broadly than domestic law.⁶⁶⁸ This, in turn, seems to suggest that the interpretation approach should be less literal, and more purposive,⁶⁶⁹ although it should be pointed out that a “purposive” approach may just as well lead to a restrictive interpretation.

Article 31(1) does not provide much clarity on the interpretation approach to be followed and domestic courts are thus given much latitude.⁶⁷⁰ Arnold mentions three possibilities that he regards as being supported by the wording of this paragraph:⁶⁷¹

- (a) a “literal” approach, in terms of which, if the meaning of words of a treaty provision is “reasonably clear”, this meaning should be adopted without regard to the other elements in Article 31(1), namely that of context and purpose;
- (b) a more “nuanced” approach, meaning that the text of the treaty will be the primary or dominant consideration. Although the context and purpose of the treaty should always be taken into account, they can never override the clear meaning of the text. It has been

⁶⁶⁵ In *Commissioner for the South African Revenue Service v Tradehold Ltd* [2012] 3 All SA 15 (SCA) para [18] the SCA notes that DTAs “use wording of a wide nature”. See also Déry & Ward “Interpretation - Canada” in *Cahiers Vol. 78a* (1993) 261; Vogel & Prokisch “Interpretation - General Report” in *Cahiers Vol. 78a* (1993) 55; Orow (2005) *Adelaide Law Review* 81; Pötgens *Income from International Private Employment* 70; Vann (2013) *Australian Tax Forum* 99 and the sources mentioned by Arnold (2010) *BFIT* 11 n 72.

⁶⁶⁶ Vann (2013) *Australian Tax Forum* 99.

⁶⁶⁷ *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA) para [18].

⁶⁶⁸ Ward (1980) *BFIT* 548 and the sources mentioned there; Vogel & Prokisch “Interpretation - General Report” in *Cahiers Vol. 78a* (1993) 60; De Broe *International Tax Planning* 247-251; the source mentioned by Arnold (2010) *BFIT* n 62; Schwarz *Schwarz on Tax Treaties* para 12-000 and the case law quoted there; E Brincker “The Conclusion and Force of Double Taxation Agreements” in A P de Koker & E Brincker (eds) *Silke on International Tax* (2010) para 12.8.1.

⁶⁶⁹ The argument is mentioned by Arnold (2010) *BFIT* 12, but he disagrees that it should have an influence on the approach to interpretation.

⁶⁷⁰ Arnold (2010) *BFIT* 6; Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 3.3.

⁶⁷¹ Arnold (2010) *BFIT* 6. The labels given to the approaches in the main text are his.

argued that the commentary to the VCLT indicates that this was the approach that its drafters had in mind;⁶⁷²

- (c) a “contextual or teleological” approach, in terms of which it is possible to “stretch” or ignore the meaning of the words being interpreted in favour of context or purpose.

Although the “literal” approach has its supporters,⁶⁷³ the fact that Article 31(1) refers to the ordinary meaning “in their context and in the light of its object and purpose” suggests that these should always be considered and not only in the case of, for example, ambiguity.⁶⁷⁴ The choice between the “nuanced” and “contextual or teleological” approaches is more difficult. Both approaches have their proponents⁶⁷⁵ and no uniform approach is followed by courts internationally in respect of the interpretation of DTAs.⁶⁷⁶ The most likely approach that South African courts will currently adopt when interpreting DTAs is discussed in part 7.3.

4.4 The Commentaries

As explained in part 1.2, the Commentaries are drafted by the CFA. The CFA consists of representatives of the governments of the OECD member states, as well as experts. These experts are usually employees of Ministries of Finance and tax authorities, who are often involved in negotiations of DTAs.⁶⁷⁷ The Commentaries more often than not represent a compromise of various viewpoints of these persons. This explains the frequently less precise wording of the Commentaries,⁶⁷⁸ which is also seen in the various versions of the Commentary to Article 10, discussed earlier.⁶⁷⁹

⁶⁷² Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 3.2.

⁶⁷³ This seems to be the approach put forward by Ward (1980) *BFIT* 547. See also the source mentioned by Pijl (1997) *BFIT* n 30.

⁶⁷⁴ Becerra (2011) *BFIT* 5; E Bjorge “The Vienna Rules on Treaty Interpretation before Domestic Courts” (2015) 131 *LQR* 78 83.

⁶⁷⁵ The “more nuanced” approach may be supported by the following scholars: Engelen *Interpretation of Tax Treaties* 429; Becerra (2011) *BFIT* (who refers at 5 to a “flexible prevalence of the textual element” and see also 7); Vogel & Rust “Introduction” in *Klaus Vogel* (2015) 39 m.nr. 82 (where the argument is raised that the objective purpose of the treaty as a whole is “subordinate” to the wording since the ordinary meaning is merely “influenced” by it, as evidenced by the fact that the words should be read “in light of” the purpose). The “teleological” approach may be supported by Pijl (1997) *BFIT* 540-541; Bjorge (2015) *LQR* 83, although this is by no means clear. Pötgens *Income from International Private Employment* 71-72 acknowledges that the text can be displaced by the context and object, but at the same time argues that this can only happen if the text is unclear, or if the “common explanation” leads to absurd and unreasonable consequences.

⁶⁷⁶ This has been said generally, not only with regard to the last two of the approaches mentioned in the main text above. Vogel & Prokisch “Interpretation - General Report” in *Cahiers Vol. 78a* (1993) 60; Baker *Double Taxation Conventions* E.04-E.08.

⁶⁷⁷ Linderfalk & Hilling (2015) *Nordic Tax Journal* 41.

⁶⁷⁸ 41.

⁶⁷⁹ Ch 2.

Two reasons are often put forward as to why the Commentaries are useful guides in the interpretation of DTAs.⁶⁸⁰ Firstly, they may be seen as reflecting the intention of the parties at signature of the DTA.⁶⁸¹ This view was advanced in the decision of the UK Special Commissioners in *Re the Trevor Smallwood Trust; Smallwood and another v HMRC*,⁶⁸² where they noted:

“Our view is that the negotiators on both sides could be expected to have the Commentary in front of them and can be expected to have intended that the meaning in the Commentary should be applied in interpreting the Treaty when it contains the identical wording. This is as much true of the United Kingdom which is a member of the OECD as it is of Mauritius, which is not. The difference is that the United Kingdom had the opportunity of stating that it disagreed with any part of the Commentary by making an Observation, while Mauritius did not, although the Commentary does now contain Observations by a number of non-OECD member countries, but not including Mauritius.⁶⁸³ ... *If the Commentary contains a clear explanation of the meaning [of] the term it seems clear that the parties to the Treaty intended that such explanation should be more important than the ordinary meaning to be given to the terms of that phrase...*”⁶⁸⁴

Secondly, the Commentaries are seen as furthering the goals of common and uniform interpretation, as acknowledged by a South African court in *ITC 1878*.⁶⁸⁵ Pijl explains that “the Commentary has the important role of developing a consensus in a diversified world and is an impressive attempt to bring fiscal cultures together.”⁶⁸⁶

Some scholars, however, caution that the Commentaries are only useful guides if they do not depart from the “literal” meaning of the undefined treaty term.⁶⁸⁷ This word of caution is dependent on a “literal” meaning of an undefined term existing so that the meaning in the

⁶⁸⁰ It is stated in para 29 of the Introduction to the OECD MTC that the Commentaries are meant to “illustrate” or “interpret” the provisions of each respective article.

⁶⁸¹ Brincker “Silke on International Tax” in *Silke on International Tax* (2010) 12.11.2; Burt (2017) *BTCLQ* 19. See also the source mentioned at n 709 below.

⁶⁸² *Re the Trevor Smallwood Trust; Smallwood and another v HMRC* [2008] STC (SCD) 629.

⁶⁸³ South Africa may take positions, as pointed out at n 15 above.

⁶⁸⁴ *Re the Trevor Smallwood Trust; Smallwood and another v HMRC* [2008] STC (SCD) 629 para 98 (emphasis added).

⁶⁸⁵ *ITC 1878* (2015) 77 SATC 349 para [15].

⁶⁸⁶ H Pijl “The OECD Commentary as a Source of International Law and the Role of the Judiciary” (2007) 46 *Euro Tax* 216 219. See also Vogel & Rust “Introduction” in *Klaus Vogel* (2015) 45 m.nr. 99 and Burt (2017) *BTCLQ* 14.

⁶⁸⁷ Ward et al *Interpretation of Income Tax Treaties* 35; Burt (2017) *BTCLQ* 20-21. See also the statement in *Prévost Car Inc. v Canada* 2009 FCA 57 (CanLII) para [11], where the court recognised the Commentaries as a valuable guide “when they represent a *fair interpretation* of the words of the Model Convention” (emphasis added).

Commentaries can be measured against it.⁶⁸⁸ To the extent that the argument in part 4.3.2 is that the “technical” meaning of a word becomes its “ordinary meaning” if used in a particular context, and the Commentaries can provide such a technical meaning, one should be careful not to overemphasise the need for the Commentaries to accord with the “ordinary”, if thereby is meant “everyday”, meaning of the word.

4.4.1 The Commentaries as source of international law and their place within the Vienna rules

A controversial issue in the interpretation of DTAs is to what extent the Commentaries may or must be used in interpreting a DTA. The Commentaries are non-binding recommendations made by the OECD to its members.⁶⁸⁹ Furthermore, the CFA itself expressly states that the Commentaries are merely of “great assistance” in the interpretation of treaties and that tax officials “give great weight to the guidance contained in the Commentaries”,⁶⁹⁰ an indication that the Commentaries are not regarded as binding by the CFA.⁶⁹¹

As discussed below and in part 7.5, it has been proposed by some scholars, though, that the Commentaries may be binding on domestic courts as customary international law. In order for a legal rule to be regarded customary international law, two requirements have to be met: the rule must be settled practice among states (*usus*) and states must believe that they are legally obliged to follow the rule (*opinio iuris sive necessitates*, or “*opinio iuris*” for short).⁶⁹² Therefore, even if a rule is frequently (or habitually) followed by states,⁶⁹³ but they do not believe that they are legally obliged to do so, the rule will not form part of customary international law. This latter requirement is especially difficult to prove.⁶⁹⁴

Many scholars reject the view that the Commentaries qualify as customary international law. They argue, firstly, that state practice has not been proven since the Commentaries change

⁶⁸⁸ Du Toit (2010) *BFIT* 504-505 thus argues that whatever the place of the Commentaries within the Vienna rules, a court cannot refer to the Commentaries “as the first or only source of the meaning of beneficial ownership.”

⁶⁸⁹ Pijl (2007) *Euro Tax* 218.

⁶⁹⁰ Introduction to the OECD MTC para 29 and 29.1.

⁶⁹¹ Ward et al *Interpretation of Income Tax Treaties* 21; 83 and 110. C Elliffe *Cross Border Tax Avoidance: Applying the 2003 OECD Commentary to Pre-2003 Treaties* available at https://www.researchgate.net/publication/255855946_Cross_Border_Tax_Avoidance_Applying_the_2003_OECD_Commentary_to_Pre-2003_Treaties (accessed on 26-01-2017) para 3.1.2 argues, though, that members of the “OECD tax administrations” have an “obligation” to follow the Commentary if it is “opportune”.

⁶⁹² Ward et al *Interpretation of Income Tax Treaties* 40; J Dugard *International Law A South African Perspective* 4 ed (2011) 26-29 and 51-53.

⁶⁹³ Evidence thereof will include national and international court decisions. Dugard *International Law* 26.

⁶⁹⁴ 29-30.

often and there is no proof that they have been adopted widely in state practice. Secondly, *opinio iuris* cannot be proved.⁶⁹⁵

There is, however, tentative support for regarding only parts of the Commentaries as customary international law. In this regard, Engelen argues:

“It is obvious from a mere look at the formative process of the model Convention and its Commentaries that they cannot per se constitute customary international law. Nevertheless, several provisions may and do reflect current customary international tax law. Furthermore, the progressive development of the Commentaries can, depending on the corresponding state practice, contribute to the further development of customary international tax law. This must, however, be ascertained on a case-to-case basis, and the customary character cannot be extended to the Model Convention and the Commentaries as a whole.”⁶⁹⁶

A South African view on this argument is set out in part 7.5. The discussion there will show that South African case law does not support the argument that the Commentaries are binding as customary international law.⁶⁹⁷

Apart from the argument discussed above, Engelen also argues that the Commentaries may in appropriate circumstances be binding on OECD members as part of the “general principles of international law”.⁶⁹⁸ He refers to the principles of “acquiescence” and “estoppel”: the failure of the OECD member states to note observations to the Commentaries is either an indication of them having “acquiesced” to the interpretation of the Commentaries, or it may estop them (based on the principle of estoppel and legitimate expectation) from departing from the interpretation in the Commentaries.⁶⁹⁹

Ward indicates that Engelen’s view is not widely held.⁷⁰⁰ Above it was explained that the Introduction to the OECD MTC indicates that the Commentaries are non-binding.⁷⁰¹ The

⁶⁹⁵ Ward et al *Interpretation of Income Tax Treaties* 41-42; Pijl (2007) *Euro Tax* 216 and 217 and the sources mentioned by Elliffe *Applying the 2003 OECD Commentary to Pre-2003 Treaties* n 83.

⁶⁹⁶ FA Engelen “How ‘Acquiescence’ and ‘Estoppel’ Can Operate to the Effect that the States Parties to a Tax Treaty are Legally Bound to Interpret the Treaty in accordance with the Commentaries on the OECD Model Tax Convention” in S Douma & F A Engelen (eds) *The Legal Status of the OECD Commentaries* (2008) 51 202.

⁶⁹⁷ Part 7.5.6.

⁶⁹⁸ FA Engelen “Some Observations on the Legal Status of the Commentaries on the OECD Model” (2006) 60 *BFIT* 105 109 expressly limits his arguments to treaty parties that are OECD member countries and the version of the Commentary that existed at time of conclusion of the treaty.

⁶⁹⁹ Engelen (2006) *BFIT* 109. See also the other sources mentioned by Ward et al *Interpretation of Income Tax Treaties* 48 and 52.

⁷⁰⁰ DA Ward *Access to Tax Treaty Benefits Research Report Prepared for the Advisory Panel on Canada’s System of International Taxation* (2008) available at <https://www.fin.gc.ca/access/tt-it/apcsit-gcrctfi/pdf/RR12%20-%20Ward%20-%20en%20-%20final%20-%20090618.pdf> (accessed on 29-06-2017) 13.

⁷⁰¹ See n 690 above.

main argument against Engelen's view is accordingly that there cannot be an obligation on countries to declare that they do not consider themselves to be bound by the Commentaries, failing which they will be bound.⁷⁰²

The better view is arguably that the Commentaries are not a source of public international law and, therefore, not binding on courts.⁷⁰³ That notwithstanding, courts internationally often refer to the Commentaries⁷⁰⁴ and in many instances place significant weight on them.⁷⁰⁵ The same can be said of scholars.⁷⁰⁶

The next question is on what basis courts may refer to the Commentaries if regard is had to the Vienna rules. To this, there is no single answer.⁷⁰⁷ Elliffe compares the attempt to fit the Commentaries within the Vienna rules to "trying to fit Cinderella's slipper to her unfortunate stepsisters' feet". He also notes that the "courts do not seem to be as obsessed as the Prince in the Cinderella story with finding the right sized foot."⁷⁰⁸

At the outset it should be pointed out that a number of international scholars have argued that the Commentaries may not have to be fitted within Articles 31 and 32 in order for them to be recognised as an interpretation tool under public international law. They argue that, if parties adopt treaty provisions based on the OECD MTC, there may be a "reasonable presumption, in the absence of evidence to the contrary" that they intended that these provisions should

⁷⁰² Pijl (2007) *Euro Tax* 216 and 222; Ward et al *Interpretation of Income Tax Treaties* 51-53. Linderfalk & Hilling (2015) *Nordic Tax Journal* 42-43 also disagree with this argument.

⁷⁰³ Baker *Double Taxation Conventions* para E.15. The Commentaries are sometimes described as "soft law" by the sources mentioned at Ward et al *Interpretation of Income Tax Treaties* 38. This is since they are "directed to the member countries and as such have great authority and are often complied with", as mentioned by Ward et al *Interpretation of Income Tax Treaties* 38. That contribution describes at 38 "soft law" as a "non-binding written instrument setting out international principles". There has been criticism against the use of the term by Pijl (2007) *Euro Tax* 219 and Ward et al *Interpretation of Income Tax Treaties* 38. The reason for their criticism is that "soft law" is not binding and labelling the Commentaries as such does not take the debate regarding their status any further. Vogel & Rust "Introduction" in *Klaus Vogel* (2015) 47 m.nr. 101 argue that the recommendation by the OECD to its members with regard to the Commentaries give rise to a "soft obligation". This means that they must be applied, unless OECD member countries had entered reservations or "unless material reasons, such as peculiarities of the domestic law of the Contracting State, weigh against the adoption of the model with regard to an individual treaty provision." However, the Commentaries are "less important" in the case of non-OECD members, as argued at 48 m.nr. 104.

⁷⁰⁴ Baker *Double Taxation Conventions* para E.12. See also the statement in the Canadian case of *Prévost Car Inc. v Canada* 2009 FCA 57 (CanLII) para [10] that the Commentaries are "a widely-accepted guide"; and *ITC 1878* (2015) 77 SATC 349 para [14] where the South African court indicated that it would not be "uncommon" to rely on the Commentaries.

⁷⁰⁵ Pötgens *Income from International Private Employment* 84; Baker *Double Taxation Conventions* para E.12 and see paras 29.1-29.3 of the Introduction to the OECD MTC.

⁷⁰⁶ See the summary at Pötgens *Income from International Private Employment* 85.

⁷⁰⁷ See the sources mentioned by Ward et al *Interpretation of Income Tax Treaties* 18 and Baker *Double Taxation Conventions* para E-12.

⁷⁰⁸ Elliffe *Applying the 2003 OECD Commentary to Pre-2003 Treaties* para 3.1.1.

have the meaning given under the Commentaries that were available to them when negotiating the DTA.⁷⁰⁹ In this regard, they point out that the commentaries to the VCLT state that the Vienna rules are not a codification of all principles of interpretations that has been used internationally and that other “principles of logic and good sense” have been recognised as “valuable guides” to assist with the interpretation of treaty terms.⁷¹⁰ They also point out that, if either of the parties to a DTA is not an OECD member, the argument in favour of such a view diminishes. However, in the case of those non-member states that are entitled to participate and enter positions (such as South Africa), the argument would, again, be stronger.⁷¹¹

Turning to the Vienna rules, some scholars regard the Commentaries as falling within either Article 31(2)⁷¹² or Article 31(3).⁷¹³ There is, however, not wide support for these arguments. A more widely-held view is, firstly, that the Commentaries may be considered under Article 31(1) or Article 31(4) of the VCLT. There are two possibilities under this view.⁷¹⁴ The first is that the Commentaries are a guide to the “ordinary meaning” of the treaty term⁷¹⁵ (and the “purpose” and “object” of the treaty).⁷¹⁶ Alternatively, they fall under Article 31(4) as a guide to the “special meaning” of the treaty term.⁷¹⁷ Ward et al prefer the second alternative since they regard the reference to “ordinary meaning” in Article 31(1) as a reference to the

⁷⁰⁹ Ward et al *Interpretation of Income Tax Treaties* 34-35 and 42-43.

⁷¹⁰ 28-29 and 31. This is also one of the possibilities mentioned by the Special Commissioners in the UK case of *UBS AG v HMRC* [2005] STC (SCD) 589 para 10.

⁷¹¹ Ward et al *Interpretation of Income Tax Treaties* 34-36. Baker *Double Taxation Conventions* para E.18 indicates that the weight of the Commentaries will only diminish for those non-OECD member states that had no part in the making of the Commentaries.

⁷¹² See an explanation of this argument and a list of supporters of this view at Ward et al *Interpretation of Income Tax Treaties* 23. For criticism, see Linderfalk & Hilling (2015) *Nordic Tax Journal* 47-48.

⁷¹³ For a view that it falls within Art 31(3)(a), see the sources referred to at Ward et al *Interpretation of Income Tax Treaties* 24. The possibility that it falls within Art 31(3)(b) is discussed by Pijl (2007) *Euro Tax* 220 and Linderfalk & Hilling (2015) *Nordic Tax Journal* 45-46. Art 31(3)(c) is another possibility, as discussed by DM Broekhuijsen “A Modern Understanding of Article 31(3)(c) of the Vienna Convention (1969): A New Haunt for the Commentaries to the OECD Model?” (2013) 67 *Bulletin for International Taxation* 1 7-8. For a list of opponents (who do not regard Art 31(3) as a fitting place for the Commentaries), see Elliffe *Applying the 2003 OECD Commentary to Pre-2003 Treaties* n 39 and see also the criticism in Ward et al *Interpretation of Income Tax Treaties* 24 and Linderfalk & Hilling (2015) *Nordic Tax Journal* 48.

⁷¹⁴ Vogel & Rust “Introduction” in *Klaus Vogel* (2015) 48 n 105 seem to support both possibilities.

⁷¹⁵ Wattel & Marres (2003) *Euro Tax* 226; Danon *Switzerland’s Taxation of Trusts* 332; Becerra *Interpretation* 124. See also the sources mentioned by Ward et al *Interpretation of Income Tax Treaties* 18-19 and 26. Linderfalk & Hilling (2015) *Nordic Tax Journal* 43-47 argue that reference to the Commentaries may be justified by a number of the sub-paras in the VCLT, depending on the circumstances. At 43 they agree that para 31(1) is one possibility.

⁷¹⁶ Part 4.3.4.

⁷¹⁷ See the sources mentioned by Ward et al *Interpretation of Income Tax Treaties* 19, 21 and 26-27. This is also one of the possibilities expressed by the Special Commissioners in the UK case of *UBS AG v HMRC* [2005] STC (SCD) 589 para 10.

“everyday” meaning of words, not their technical meanings. Since the meanings given in the Commentaries are often far removed from the “everyday” meaning of the words, they accordingly do not regard the Commentaries as a fitting guide (at least not always) to Article 31(1) meanings.⁷¹⁸

It has been explained earlier in part 4.3.2 that Linderfalk’s analysis of case law shows that courts usually include the technical meaning that a word has in a particular context within Article 31(1), rather than Article 31(4). Based on this analysis, the better argument seems to be that the Commentaries should be a tool that falls under Article 31(1). Also, as Ward et al themselves indicate, if the meaning in the Commentaries falls under Article 31(4) such a meaning would be almost impossible to displaced.⁷¹⁹ However, neither the CFA, nor international and local precedent on the use of the Commentaries supports this result.

A second widely-held view is that the Commentaries are supplementary means of interpretation contemplated in Article 32.⁷²⁰ Linderfalk and Hilling, for example, argue that the Commentaries are included in Article 32 as forming part of “the circumstances of its conclusion”.⁷²¹ If this view is correct, the Commentaries may only be taken into account in the limited ways foreseen by that provision,⁷²² as discussed in part 4.3.5. However, a

⁷¹⁸ Ward et al *Interpretation of Income Tax Treaties* 19.

⁷¹⁹ Ward et al *Interpretation of Income Tax Treaties* 19-22. Even if a technical meaning should be classified as falling in Art 31(4), the elements of context and object and purpose still apply, although their role is likely to be reduced. Special meanings under Art 31(4) are also subject to context and purpose, as accepted by the UK First-Tier Tribunal Tax Chamber in *Martin Frederick Fowler v The Commissioners for Her Majesty’s Revenue & Customs* [2016] UKFTT 0234 (TC) para 100, a case which dealt with the interpretation of the 2002 South Africa/UK DTA. However, Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 3.4.11 argues that “as the special meaning applies only if it is established that the parties so intended, it is closer to a contemporaneous agreement on interpretation, which is ‘to be regarded as forming part of the treaty’ [as per para 14 of the commentary to the VCLT] and is, therefore, determinative, leaving no room for the application of the other elements. This conflict may be more apparent than real, as there seems little scope for the other elements to apply in practice if the parties intend a term to have special meaning”.

Ward et al *Interpretation of Income Tax Treaties* 21 likewise argues that since Art 31(4) states that the special meaning “shall” be given, this meaning is binding.

⁷²⁰ See the sources mention by Ward et al *Interpretation of Income Tax Treaties* 24-25 and 27. See also Brincker “Silke on International Tax” in *Silke on International Tax* (2010) 12.11.2; Linderfalk & Hilling (2015) *Nordic Tax Journal* 45-46; Burt (2017) *BTCLQ* 18-20.

⁷²¹ Linderfalk & Hilling (2015) *Nordic Tax Journal* 49.

⁷²² Ward et al *Interpretation of Income Tax Treaties* 24-25; Baker *Double Taxation Conventions* para E.12.

statement made by the Supreme Court of Canada (“SCC”)⁷²³ has made Baker question whether the Commentaries should fall within Article 32.⁷²⁴

With no clear picture emerging, the most probable views when trying to fit the Commentaries within the Vienna rules are arguably that the Commentaries fall within either Article 31(1), or Article 32 of the VCLT.⁷²⁵ Under both these views reference to the Commentaries are not mandatory⁷²⁶ and, given the fact that in practice a court will usually be able to justify an application of Article 32 material,⁷²⁷ it is proposed that finding which of these two possibilities fit Cinderella’s slipper, is perhaps not of much practical importance.

4.4.2 Commentaries amended after conclusion of the treaty

The next issue is which version of the Commentaries should be considered if the Commentaries are amended after conclusion of the DTA: the version at the time of conclusion of the DTA (the static approach), or at the application of the treaty (the ambulatory approach). This is particularly relevant to this study, given the fact that the Commentaries on the meaning of “beneficial owner” in Article 10 were amended on a number of occasions.⁷²⁸

The CFA recommends “as far as possible” the use of the revised Commentaries since they reflect the agreed view of the OECD members on the interpretation of the term.⁷²⁹ International case law on the subject has not given a clear picture of the preferred approach.

⁷²³ In *Crown Forest Industries Ltd. v Canada* [1995] 2 SCR 802 para 44 the SCC indicated that the Commentaries form part of the “extrinsic material which form part of the legal context ... *without the need first to find an ambiguity before turning to such materials*” (emphasis added). However, see the Australian case law referred to by Elliffe *Applying the 2003 OECD Commentary to Pre-2003 Treaties* para 3.1.1, which may support Art 32 as a fitting place for the Commentaries.

⁷²⁴ Baker *Double Taxation Conventions* para E.12. See also n 659 above.

⁷²⁵ Burt (2017) *BTCLQ* 27 agrees.

⁷²⁶ Although giving an “ordinary” meaning to words is compulsory under Art 31(1), that provision does not prescribe which guides must be taken into account to establish such “ordinary meaning”.

⁷²⁷ Part 4.3.5.

⁷²⁸ Discussed in parts 2.3.4 and 2.3.5.

⁷²⁹ Paras 33-35 of the Introduction to the OECD MTC. However, the CFA also indicates at para 36 that it disagrees

“with any form of *a contrario* interpretation that would necessarily infer from a change to ... the Commentaries that the previous wording resulted in consequences different from those of the modified wording. Many amendments are intended to simply clarify, not change, the meaning of the Articles or the Commentaries, and such *a contrario* interpretations would clearly be wrong in those cases”.

Burt (2017) *BTCLQ* 14 questions the relevance of statements by the CFA on this issue.

Neither has academic writing,⁷³⁰ although Baker suggests that the static approach seems to be the preferred approach amongst scholars.⁷³¹

Proponents of the static approach argue that,⁷³² if revised Commentaries are taken into account, at least one of the reasons for allowing the use of the Commentaries (that they reflect the common intention of the parties at the time of conclusion of the treaties) is no longer valid.⁷³³ Furthermore it may have the (sometimes intended)⁷³⁴ result that DTAs based on the OECD MTC are amended,⁷³⁵ without these amendments being made through the difficult and time-consuming process of renegotiating the DTAs⁷³⁶ and without these amendments being subject to parliamentary approval.⁷³⁷

However, even amongst the supporters of the static approach few go so far as to give no place to revised Commentaries.⁷³⁸ Ward et al argue that, if the revised Commentaries represent interpretations (rather than “attempted amendments”), they may still play a role in the interpretation of a DTA concluded before the amendments.⁷³⁹ Thus, whereas amendments that were made to “fill gaps” in a previous version or that contradict previous versions are problematic, amendments that merely “amplify” matters already covered by a previous version are less so.⁷⁴⁰ This view is echoed in the *Prévost Car Inc. v Canada* (“*Prévost*

⁷³⁰ See the discussion at Ward et al *Interpretation of Income Tax Treaties* 104-111; Pötgens *Income from International Private Employment* 89.

⁷³¹ Baker *Double Taxation Conventions* para E.13. Burt (2017) *BTCLQ* 22 agrees. See also the sources mentioned by Linderfalk & Hilling (2015) *Nordic Tax Journal* 34 n 2. Vogel & Rust “Introduction” in *Klaus Vogel* (2015) 48 105 supports this view.

⁷³² See a brief list of the arguments for and against the static approach by JF Avery Jones “The Effect of Changes in the OECD Commentaries after a Treaty is Concluded” (2002) 56 *BFIT* 102 103-104.

⁷³³ Ward et al *Interpretation of Income Tax Treaties* 44; Pötgens *Income from International Private Employment* 88; Vogel & Rust “Introduction” in *Klaus Vogel* (2015) 48 m.nr.105; Burt (2017) *BTCLQ* 22. See also *Re the Trevor Smallwood Trust; Smallwood and another v HMRC* [2008] STC (SCD) 629 para 99.

⁷³⁴ Ward et al *Interpretation of Income Tax Treaties* 4; Pijl (2007) *Euro Tax* 219.

⁷³⁵ MN Kandev & B Wiener “Some Thoughts on the Use of Later OECD Commentaries After *Prévost Car*” (2009) 54 *Tax Notes International* 667 668.

⁷³⁶ DTAs have an average life of between 10 and 20 years, according to Linderfalk & Hilling (2015) *Nordic Tax Journal* 41. It may take five to ten years after amendments have been made to the OECD MTC for these changes to be reflected in DTAs, according to J Owens “International Taxation: Meeting the Challenges – The Role of the OECD” (2006) 46 *Euro Tax* 555 556.

⁷³⁷ Pötgens *Income from International Private Employment* 88. See also Ward et al *Interpretation of Income Tax Treaties* 79-80; Wattel & Marres (2003) *Euro Tax* 224; Vallada “Beneficial Ownership” in *Update 2014* (2015) 34.

⁷³⁸ Pötgens *Income from International Private Employment* 88-89 states that it is “interesting” to take into account the views of the FCA indicated in the amendments to the Commentary, but that the revised Commentary is “of less importance than the original version”. In *Martin Frederick Fowler v The Commissioners* [2016] UKFTT 0234 (TC), a UK case mentioned here because it is such a recent case, the court regarded revised Commentaries as having “limited value”.

⁷³⁹ Ward et al *Interpretation of Income Tax Treaties* 44.

⁷⁴⁰ Ward et al *Interpretation of Income Tax Treaties* 79. Ward mentions four different categories of amendments: the amendment merely “amplifies” matters already covered (by giving new examples or

(FCA)”) judgment.⁷⁴¹ Here the court held, after having accepted the Commentaries as a “widely accepted guide to the interpretation and application of the provisions of *existing*” DTAs, as follows:

“[11] The same may be said with respect to later Commentaries, when they represent a fair interpretation of the words of the Model Convention and *do not conflict with* Commentaries in existence at the time a specific treaty was entered and when, of course, neither treaty partner had registered an objection to the new Commentaries...

[12] I therefore reach the conclusion, ... [that amendments to the Commentary] are a helpful complement to the earlier Commentaries, insofar as they are *eliciting, rather than contradicting, views* previously expressed.”⁷⁴²

If one accepts that the reason why the Commentaries are relevant is the fact that they reflect the intention of the parties at signature of the DTA, then amendments after that date may indeed be problematic. The distinction based on the types of amendments made is then defensible and amendments to Commentaries that either amend or fill gaps in previous versions, should not be taken into account.

The possibility discussed above is, however, not the only argument for allowing an ambulatory approach. Another possibility is that the parties may have intended for the meaning of a treaty term to develop as tax law practice develops and that such tax practice may be reflected in the Commentaries.⁷⁴³ This possibility is arguably only available if the Commentaries are regarded as a source for the “ordinary meaning” of a treaty term in Article 31(1).⁷⁴⁴

arguments); “records” the practice of countries; “fills a gap” by governing matters that have not previously been covered; or “contradicts” the existing Commentary. As mentioned in the main text, the last two versions are problematic, but it should be noted that the second category may also be problematic if it reflects practices that serve the same purpose as the last two categories. See also Vogel & Rust “Introduction” in *Klaus Vogel* (2015) 49 m.nr.106. Also refer to Baker *Double Taxation Conventions* para E.14, who has less of an objection with regard to amendments that are “clarificatory”. Baker “‘Beneficial Ownership’ as Applied to Dividends” in *Taxation of Intercompany Dividends* (2012) 94 also argues in favour of allowing revisions that “simply elaborate previous understandings” and which do not represent a “fundamental change of meaning”.

⁷⁴¹ *Prévost Car Inc. v Canada* 2009 FCA 57 (CanLII), discussed in part 6.5.3. For a discussion of prior Canadian case law on this topic, see Kandev & Wiener (2009) *Tax Notes International* 668.

⁷⁴² *Prévost Car Inc. v Canada* 2009 FCA 57 (CanLII) para 10 (emphasis added).

⁷⁴³ Avery Jones (2002) *BFIT* 103 and 106; Baker *Double Taxation Conventions* para E.14.

⁷⁴⁴ Linderfalk & Hilling (2015) *Nordic Tax Journal* 54-55.

In support of this argument the following statement by the International Court of Justice is noteworthy:

“It is true that the terms used in a treaty must be interpreted in light of what is determined to have been the parties’ common intention, which is, by definition, contemporaneous with the treaty’s conclusion. ... This does not however signify that, where a term’s meaning is no longer the same as it was at the date of conclusion, no account should ever be taken of its meaning at the time when the treaty is to be interpreted for purposes of applying it. ... [T]here are situations in which the parties’ intent upon conclusion of the treaty was, or may be presumed to have been, to give the terms used - or some of them - a meaning or content capable of evolving, not one fixed once and for all, so as to make allowance for, among other things, developments in international law. In such instances it is indeed in order to respect the parties’ common intention at the time the treaty was concluded, not to depart from it, that account should be taken of the meaning acquired by the terms in question upon each occasion on which the treaty is to be applied.”⁷⁴⁵

Burt thus argues that a dynamic approach may be followed if the amended Commentaries “are genuinely interpretative” and “if there is evidence that the treaty parties had intended the meaning of a treaty term to evolve”.⁷⁴⁶

Even if both these bases for accepting the ambulatory approach are not accepted, it may be that a court will follow a more practical approach.⁷⁴⁷ The Special Commissioners in the UK decision in *Re the Trevor Smallwood Trust* followed such a practical approach,⁷⁴⁸ where they noted:

“The relevance of Commentaries adopted later than the Treaty is more problematic because the parties cannot have intended the new Commentary to apply at the time of making the Treaty. However, to ignore them means that one would be shutting one’s eyes to advances in international tax thinking... *The safer option is to read the later Commentary and then decide in the light of its content what weight should be given to it.*”⁷⁴⁹

In part 7.5.7 I consider the question as to how one may regard the amendments made in 2003 and 2014 to the Commentaries to Article 10.

⁷⁴⁵ *Dispute Regarding Navigational and Related Rights (Costa Rica v Nicaragua)* Judgment of 13 July 2009 paras 63-64 (emphasis added).

⁷⁴⁶ Burt (2017) *BTCLQ* 24.

⁷⁴⁷ Baker *Double Taxation Conventions* para E.15, for example, argues in favour of a “pragmatic approach”, under which both versions could be consulted, but possibly different weight should be attached to the versions. For criticism against such a practical approach, see Burt (2017) *BTCLQ* 25-26.

⁷⁴⁸ *Re the Trevor Smallwood Trust; Smallwood and another v HMRC* [2008] STC (SCD) 629.

⁷⁴⁹ Para 99 (emphasis added).

4.5 Article 3(2): the general *renvoi* clause

The OECD MTC defines only a few terms and deals with the interpretation of undefined terms (which is somewhat unusual in a treaty context)⁷⁵⁰ in terms of the so-called general *renvoi* clause – Article 3(2). All South African DTAs include a version of this clause. Article 3(2) currently reads as follows:

“As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.”

Article 3(2) takes precedence over the Vienna rules,⁷⁵¹ but that does not mean that these rules are no longer relevant when such a clause is applicable. Apart from the fact that Article 3(2) itself must be interpreted in accordance with the Vienna rules,⁷⁵² if no domestic meaning can be determined, Article 3(2) cannot apply and the Vienna rules will apply.⁷⁵³ Also, if a domestic meaning does exist, but the context requires that it not be used, the Vienna rules will govern the interpretation of the term.⁷⁵⁴

⁷⁵⁰ Baker *Double Taxation Conventions* para E.19; E van der Bruggen “Good Faith in the Application and Interpretation of Double Taxation Conventions” (2003) *BTR* 25 n 10.

⁷⁵¹ This seems to be the prevalent view, as expressed by Wattel & Marres (2003) *Euro Tax* 69; Engelen *Interpretation of Tax Treaties* 477-478; A Rust “Article 3(2) OECD and UN MC” in E Reimer & A Rust (eds) *Klaus Vogel on Double Taxation Conventions Volume I* (2015) 206 207 m.nr. 110; Pötgens *Income from International Private Employment* 70; Kandev (2007) *Can Tax J* 39; RT Castro “When Does ‘the Context Otherwise Require’ in Article 3 of the OECD Model Convention?” (2014) 42 *Intertax* 709 715. It has recently also been confirmed in *Martin Frederick Fowler v The Commissioners* [2016] UKFTT 0234 (TC) para 100, a judgment by the UK First-Tier Tribunal Tax Chamber that dealt with the 2002 South Africa/UK DTA. But see Van der Bruggen (2003) *Euro Tax* 143.

⁷⁵² Avery Jones (1986) *BFIT* 77 (opinion expressed by Sinclair); Pijl (1997) *BFIT* 542-543; Wattel & Marres (2003) *Euro Tax* 69; De Broe *International Tax Planning* 236; Kandev (2007) *Can Tax J* 55.

⁷⁵³ Kandev (2007) *Can Tax J* 55. Rust “Article 3(2)” in *Klaus Vogel* (2015) 213 m.nr. 126 argues that the “general rules of interpretation” should apply. Presumably, this refers to the Vienna rules.

⁷⁵⁴ Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 8.2.2.4. The fact that Du Toit *Beneficial Ownership of Royalties* 185 also turns to the Vienna rules to determine the meaning of the term “beneficial owner” (if Art 3(2) cannot apply), supports this view. Baker *Double Taxation Conventions* E-20 suggests as alternative that the term is given its “ordinary and natural meaning in the language concerned”. In a domestic context, when a court holds that the context requires that a definition in domestic legislation not be applied to give meaning to the defined term in that legislation, it will usually give that term its ordinary meaning, as explained by Du Plessis *Interpretation of Statutes* 112. However, what that meaning may be should be subject to the usual interpretation process followed by the domestic court in the interpretation of undefined terms in legislation. By way of analogy one would thus expect that, if a term in a DTA is not given its meaning in domestic law since the context otherwise requires, the interpretation process that is to be followed to find an alternative meaning is the one prescribed in the Vienna rules.

Article 3(2) seems to go against the goal of common interpretation as discussed in part 4.2 since the contracting states may have different meanings in their domestic laws for the same term. The contracting states thus agree to the possibility of diverse outcomes in the interpretation of the same term.⁷⁵⁵ As to why the contracting countries would agree to the possibility that different meanings be given, the answer seems to be the need for flexibility. Firstly, there is a need for DTAs to link with the contracting states' domestic laws under which the taxes that are restricted under the DTA are levied.⁷⁵⁶ In this respect, it has also been noted that treaty negotiators probably have these domestic meanings in mind when they are negotiating the treaty.⁷⁵⁷ Secondly, if these domestic laws change (which frequently happens),⁷⁵⁸ there is a need for DTAs to be able to adapt to these changes in the domestic laws, without requiring in each instance a renegotiation of the treaty.

This flexibility may come at a cost, though. As has been explained, one of the reasons for pursuing the goal of common interpretation is to increase the probability that the objects of the treaty will be met, including the avoidance of double-taxation. Divergent interpretations of the same terms may thus lead to double-taxation.⁷⁵⁹ However, it should be noted that this will not always be the case. To the extent that there is nevertheless the possibility of double-taxation, this problem may be addressed by the qualification built into Article 3(2), that is that the context may require that the domestic meaning not be used⁷⁶⁰ (provided of course that the international meaning avoids such double taxation).⁷⁶¹

For the same reasons given above Article 3(2) seems to go against the goal of uniform interpretation. It was explained in part 4.2 that Becerra justifies this goal by arguing that the meaning given to a term internationally may be an indication of the meaning that was intended when the term was included in the DTA. However, one should weigh this justification against the fact that parties may instead have meant for the term to have the meaning that would link the DTA to their domestic law and so meet the need for flexibility.

⁷⁵⁵ Van der Bruggen (2003) *Euro Tax* 150; Orow (2005) *Adelaide Law Review* 97; Vogel & Rust "Introduction" in *Klaus Vogel* (2015) 44 m.nr. 96; Rust "Article 3(2)" in *Klaus Vogel* (2015) 206 m.nr. 109; Avery Jones "Treaty Interpretation" in *Global Tax Treaty Commentaries* (2015) para 7.1.

⁷⁵⁶ Avery Jones et al (1984) *BTR* 17; AJM Timmermans "Interpretation of Double Taxation Conventions - Netherlands" in *IFA Cahiers De Droit Fiscal International Vol. 78a* (1993) 439 81; De Broe *International Tax Planning* 263; Kandev (2007) *Can Tax J* 38; Rust "Article 3(2)" in *Klaus Vogel* (2015) 206 m.nr. 109.

⁷⁵⁷ Rust "Article 3(2)" in *Klaus Vogel* (2015) 206 m.nr. 109.

⁷⁵⁸ Avery Jones et al (1984) *BTR* 16.

⁷⁵⁹ Or double-nontaxation.

⁷⁶⁰ Rust "Article 3(2)" in *Klaus Vogel* (2015) 213 m.nr. 124.

⁷⁶¹ 213 m.nr. 124.

As noted earlier, there is some debate on whether the domestic meaning under the country of source or the country in which the direct recipient is resident, should prevail.⁷⁶² The stronger argument seems to be that Article 3(2) favours the domestic meaning under the country of source in the case of non-resident withholding taxes. This country is the country contemplated in the phrase “the meaning ... under the law of that State [who ‘applied’ the Convention]”.⁷⁶³

Since 1995, Article 3(2) clearly ascribes to the ambulatory approach. This means that the domestic meaning that should be given to the undefined treaty term is the domestic meaning that exists when the DTA is applied. A static approach, in terms of which the domestic meaning that should be given to the undefined treaty term is the meaning that existed when the DTA was concluded, is thus not supported. The position before 1995 is, however, less clear and there are arguments in favour of both approaches. This issue is further explored in part 8.2 and is relevant in respect of DTAs that contain a general *renvoi* clause based on the pre-1995 version of Article 3(2).

A number of other issues regarding the interpretation of Article 3(2) that are relevant to this study remain. These are addressed in chapter 8 in building up to the discussion in chapter 9 as to whether there are any domestic meanings that may apply to give meaning to the treaty term “beneficial owner” in South African DTAs. These issues are: which domestic meaning should be used if more than one meaning exists; whether the meanings for different, but comparable terms in domestic law may be used; and what the classification “unless the context otherwise require” means. In that chapter a South African perspective on the interpretation of the general *renvoi* clause is also given.

4.6 Conclusion

DTAs, despite becoming part of domestic law, remain international agreements. A contracting country is thus encouraged to strive for an interpretation of a term in a DTA that accords with the interpretation of the other contracting country to the DTA. Furthermore, a country is also encouraged to interpret its DTAs in accordance with the interpretation adopted more generally by other countries that model their DTAs on the same model convention

⁷⁶² See ns 38, 184 and 185 above.

⁷⁶³ Duff “Beneficial Ownership: Recent Trends” in *Beneficial Ownership* (2013) 16; Kemmeren “Preface to Articles 10 to 12” in *Klaus Vogel* (2015) 718 m.nr. 25. But see the issues with this view mentioned by Baker *Double Taxation Conventions* E.21. See also para 32.1-32.7 of the Commentary to Art 23A and B.

(such as the OECD MTC) than that country. In summary, it can thus be said that the goals of common and uniform interpretation play a role when interpreting DTAs.

South African courts are subject to the rules of interpretation set out in the VCLT when interpreting DTAs. The courts of Canada, the UK and the Netherlands are similarly bound by the VCLT when interpreting DTAs to which these countries are party to.

Article 31(1) of the VCLT requires a court to interpret a treaty in good faith in accordance with the “ordinary” meaning to be given to a treaty term. The recognition of special meanings are separately provided for in Article 31(4). However, Linderfalk’s analysis of case law shows that courts often regard these special meanings to be the “ordinary” meanings of the terms when used in a specific discipline or field. Arguably, the meaning given to the term “beneficial owner” in international tax law will thus be an “ordinary” meaning as contemplated by Article 31(1).

The VCLT also requires that the meaning of treaty terms be determined according to their context and in light of the object of the treaty. The MLC now more clearly states that, although it is a purpose of a DTA to eliminate double taxation, it should not create opportunities for reduced taxation through treaty shopping. The OECD MTC will also make this clearer if the proposed amendments are adopted.

Supplementary aids may also be considered under Article 32 of the VCLT. These aids may only be used to confirm a meaning reached under Article 31. Alternatively, if this rule leads to an absurd result, the supplementary aid may be used to determine the meaning. Despite the apparent supplementary nature of these aids, the use of these aids will in practice often be easy to justify.

There is uncertainty amongst scholars whether certain material falls to be taken into account under Article 31 or rather Article 32 of the VCLT. This material includes case law, scholarly writings and the Commentaries.

With regard to the Commentaries, there is also uncertainty whether amendments to the Commentaries that were made after conclusion of a DTA can be taken into account when interpreting a DTA. One of the most convincing reasons for allowing access to the Commentaries under the VCLT is that they reflect the intention of the parties when concluding the DTA. For this reason, it is problematic to accept Commentaries amended after that date as an interpretational tool. There is nevertheless support for the argument that amendments to the Commentaries that are merely clarifying the position under the previous

version should be acceptable. Amendments that are designed to amend, or fill gaps in, previous versions are, however, not. An alternative argument for allowing revised Commentaries is if the Commentaries can be regarded as a source for the “ordinary meaning” of a treaty term and the intention of the parties when signing a DTA was that the meaning of that term should change as international tax practice evolves, provided that such tax practice is set out in the Commentaries. That brings one to the question in which category the 2003 and 2014 amendments to the Commentaries, discussed in chapter 2, fall. This question is addressed in chapter 7, when a South African perspective on the use of the Commentaries is given.

A last important aspect of the interpretation of DTAs, which is somewhat unusual, is that they usually include a general *renvoi* clause. Such clauses are typically based on Article 3(2) of the OECD MTC and provide that undefined terms in a DTA should have the meaning that the term has in the domestic laws of a treaty party, unless the context otherwise requires. An approach of giving domestic meanings to terms in a treaty seems to go against the goals of common and uniform interpretation. Such an approach is justified by arguing that it is necessary to ensure that the DTA links with the domestic laws under which the taxes that are restricted under the DTA are levied. It may thus also be the meanings that the treaty negotiators have in mind when negotiating the treaty.

CHAPTER 5

BENEFICIAL OWNERSHIP AS AN ANTI-AVOIDANCE MEASURE

Chapter overview

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5.1 Introduction

As discussed in part 2.2, the measures employed to combat conduit company treaty shopping may be broadly divided between anti-avoidance rules and the interpretation of the DTA. This study focuses on an aspect of the latter, being the interpretation of the beneficial ownership requirement.

However, anti-avoidance rules often affect the manner in which the beneficial owner requirement is interpreted and one thus cannot study the latter without an appreciation of the former. Duff observes:

“If judicial anti-avoidance doctrines are occasionally employed as an alternative to beneficial ownership, *the concept of beneficial ownership itself is often informed by anti-avoidance or anti-abuse considerations.*”⁷⁶⁴

One of this chapter’s goals is to consider some of these anti-avoidance rules with a view to identify the factors that are typically taken into account under these rules. This will enable one to recognise these factors should they be employed when interpreting the beneficial ownership requirement and to appreciate why such a practice may be problematic. It will also assist one to determine, when considering the case law in the next chapter, whether a court has reached its conclusion based on the interpretation of the term “beneficial owner”, or on the application of a domestic anti-avoidance measure. This is not always immediately apparent.⁷⁶⁵

Another goal of this chapter is to consider how the fact that (one of) the purposes of the beneficial ownership requirement is to combat tax avoidance may influence the meaning given to the term. This issue, which is key to an understanding of beneficial ownership in a treaty context, centres on whether the term will be given a legal or an economic meaning.

A third goal is to show how domestic anti-avoidance measures may be introduced under the general *renvoi* clause to apply in a treaty context. This will inform the discussion of the application of the general *renvoi* clause in the South African context in chapter 9.

In order to meet these goals, the chapter commences with a discussion of the application of domestic anti-avoidance rules in a treaty context. This includes both interpretational approaches and judicial anti-avoidance measures. The discussion of the application of these domestic anti-avoidance rules will also show how domestic anti-avoidance measures may be introduced under the general *renvoi* clause.

⁷⁶⁴ Duff “Beneficial Ownership: Recent Trends” in *Beneficial Ownership* (2013) 12 (emphasis added).

⁷⁶⁵ S van Weeghel “Tax Treaties and Tax Avoidance: Application of Anti-Avoidance Provisions - General Report” in *IFA Cahiers de Droit Fiscal International Vol. 95a* (2010) 17 42. Judicial domestic anti-avoidance measures are often used in combination with the beneficial ownership requirement. For example, the application of the simulation principle may lead to a court deciding that the transaction before it was not the real one intended by the parties and the court will then apply the beneficial ownership requirement to the real transaction intended by the parties.

The next part of the chapter considers judicial domestic anti-avoidance rules and interpretational approaches. It should be noted, firstly, that only rules and interpretational approaches followed by courts from Canada, the Netherlands and the UK are considered in this study. The reason for the selection of these jurisdictions is that the meanings given to the beneficial ownership requirement by courts from these countries are considered in some detail in the next chapter. With regard to the position in South Africa, the judicial anti-avoidance measures employed by South African courts are also considered in this chapter whereas the interpretative approach followed by these courts is considered in part 7.4.

Secondly, it should be noted that the study restricts itself to a consideration of *judicial* anti-avoidance measures. That is because it is impossible within the scope of this study to consider all statutory anti-avoidance measures in South African, Canadian, UK and Dutch law. (A brief reference is nevertheless made in this chapter to the South African GAAR.⁷⁶⁶) This focus on judicial approaches is based on the consideration that comments made by scholars on the interaction between domestic anti-avoidance measures and the interpretation of the treaty term “beneficial owner”⁷⁶⁷ are often restricted to judicial anti-avoidance measures. The following judicial domestic anti-avoidance measures are considered in this chapter:⁷⁶⁸ simulated transactions (shams),⁷⁶⁹ the Dutch *fraus legis* rule, the Dutch *fiscale kwalificatie* principle and piercing the corporate veil.

⁷⁶⁶ See the main text corresponding to ns 795 and 796 below. For a detailed discussion of the GAARs in South African, Canadian and UK law, see BT Kujinga *A Comparative Analysis of the Efficacy of the General Anti-Avoidance Rule as a Measure against Impermissible Income Tax Avoidance in South Africa* LLD thesis University of Pretoria (2013) chs 5, 7 and 9. With regard to the Dutch GAAR, RLH IJzerman “Form and Substance in Tax Law - Netherlands” in *IFA Cahiers de Droit Fiscal International Vol. 87a* (2002) 451 453 explains that it has fallen into disuse and that the *fraus legis* rule is instead exclusively used. The *fraus legis* rule, being a judicial anti-avoidance measure, is discussed in part 5.5 below. A Dutch SAAR relating to beneficial ownership in dividend stripping scenarios is mentioned in part 9.6.

⁷⁶⁷ See, e.g. n 1243 below.

⁷⁶⁸ There is some doubt as to whether the *Ramsay* approach is purely an interpretational approach or a stand-alone anti-avoidance measure, as discussed in part 5.3.3. It is considered in this chapter as the former.

⁷⁶⁹ Whether the “simulation principle” can be regarded as a (stand-alone) anti-avoidance measure is not clear. On the one hand it has been referred to as a “fundamental doctrine” by Innes HR in *Dadoo Ltd and others v Krugersdorp Municipal Council* 1920 AD 530 547 in the statement quoted at n 880 below. On the other hand, J Waincymmer *Australian Income Tax: Principles and Policy* 2 ed (1993) 484 claims that it is “not even a separate doctrine, but merely a description of the way judges must approach the facts before them. Judges must always look at the facts. If something is not what it seems, they must discern what it really is and apply the law to the reality, not fiction.” The question whether sham is regarded as an independent legal doctrine in the UK and Canada is addressed by G Loutzenhiser “Sham in the Canadian Courts” in E Simpson & M Stewart (eds) *Sham Transactions* (2013) 243 para 14.04. In this study, the principle of simulation is discussed as a stand-alone anti-avoidance measure, without thereby meaning to provide a view on this debate.

5.2 Anti-avoidance measures

5.2.1 The application of domestic anti-avoidance measures in a treaty context

The application of domestic anti-avoidance measures can be problematic in a treaty context.⁷⁷⁰ The problem is that it may allow countries to refuse to grant the tax relief that they have apparently agreed to in terms of the DTA. This issue usually centres on whether the DTA or the domestic law (not including the DTA) takes preference in the particular jurisdiction in the case of conflict.⁷⁷¹ Although this vast and complex topic, known as “treaty override”, is not addressed in this study, a few general comments are made to provide context.

Domestic judicial anti-avoidance measures are typically seen in one of two ways.⁷⁷² The factual approach concerns measures aimed at establishing the facts to which the tax law provisions are applied.⁷⁷³ Under this approach, a court may for example find that the facts presented to it are not the real facts and it will then apply the tax rules to the real facts. The second approach is the interpretive approach, which concerns the interpretation of the tax law provisions. Under the interpretive approach, tax legislation may for example be interpreted to apply only to transactions with economic substance, or with a *bona fide* business purpose. In these cases the facts are not re-characterised and the tax legislation merely does not apply to the relevant transactions.

⁷⁷⁰ This topic is addressed *inter alia* in paras 9 and 22 of the Commentary (2003) to Art 1. These paragraphs are discussed and criticised by Arnold & Van Weeghel “Tax Treaties and Domestic Anti-Abuse Measures” in *Tax Treaties and Domestic Law* (2006) paras 5.4.2 and 5.4.3 and C Cilliers “Anti-Avoidance” in A P de Koker & E Brincker (eds) *Silke on International Tax* (2010) para 46.32. For a discussion of the position before the 2003 amendments, see Arnold (2004) *BFIT* 245-246 and Arnold & Van Weeghel “Tax Treaties and Domestic Anti-Abuse Measures” in *Tax Treaties and Domestic Law* (2006) para 5.2.

⁷⁷¹ Arnold (2004) *BFIT* 249.

⁷⁷² Sub-paras 1-3 of paragraph 9 of the Commentary (2003) to Art 1, discussed by Arnold (2004) *BFIT* 249 251. Baker “Improper Use of Tax Treaties, Tax Avoidance and Tax Evasion” in *UN Handbook on Selected Issues in Administration of Double Tax Treaties for Developing Countries* (2013) 389, however, makes no such distinction when he discusses judicial anti-avoidance doctrines. He refers to these, in general, as “doctrines relating to interpretation of tax legislation.” F Zimmer “Domestic Anti-Avoidance Rules and Tax Treaties - Comment on Brian Arnold's Article” (2005) 59 *BFIT* 25 25-26 questions whether this distinction is possible, but see in reply JJZ Pérez & A Báez “The 2003 Revisions to the Commentary to the OECD Model on Tax Treaties and GAARs: A Mistaken Starting Point” in M Lang, P Pistone, J Schuch, C Staringer, A Storck & M Zagler (eds) *Tax Treaties: Building Bridges between Law and Economics* (2010) 129 134.

⁷⁷³ But see the sources mentioned by Pérez & Báez “The 2003 Revisions to the Commentary” in *Tax Treaties: Building Bridge* (2010) 132, which support a different interpretation of the factual approach as an approach that establishes the *taxable event*.

Before 2003, the Commentary on Article 1 said very little about the application of domestic anti-avoidance measures in a treaty context, and what it did say, was confusing.⁷⁷⁴ Several amendments were made in 2003 and the Commentary to Article 1 currently includes the following statements:

- a) It records that countries do not have to grant the benefits of a DTA in the case of abusive transactions,⁷⁷⁵ although it should not be “lightly assumed” that transactions are abusive.⁷⁷⁶
- b) The “guiding principle” is that “the benefits of a double taxation convention should not be available where a main purpose for entering into transactions was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions.”⁷⁷⁷
- c) Domestic anti-avoidance doctrines (and here the Commentaries mention “substance-over-form”, “economic substance” and GAARs) are not problematic in a treaty context since they form “part of the basic domestic rules set by domestic tax laws for determining which facts give rise to a tax liability” and “are not addressed in tax treaties”.⁷⁷⁸
- d) This is subject, firstly, to the guiding principle and, secondly, to the rider that “member countries should carefully observe the specific obligations enshrined in tax treaties to relieve double taxation as long as there is no clear evidence that the treaties are being abused”.⁷⁷⁹

If one applies these principles to the anti-avoidance measures discussed in this chapter, the simulation principle (in the sense discussed in part 5.4 below) can apply in a treaty context.⁷⁸⁰

⁷⁷⁴ See Arnold (2004) *BFIT* 246 for a summary of the confusing aspects of that Commentary.

⁷⁷⁵ Para 9.4 of the Commentary (2003) to Art 1. See also *Draft 2017 Update* Part C para 24, which renumbers this para 9.4 as para 60 of the Commentary to Art 1.

⁷⁷⁶ Para 9.5 of the Commentary (2003) to Art 1. See also *Draft 2017 Update* Part C para 24, which renumbers this para 9.5 as para 61 of the Commentary to Art 1 and adds a sentence, as discussed at n 158 above.

⁷⁷⁷ Para 9.5 of the Commentary to Art 1 (2003). This provision is discussed by Arnold & Van Weeghel “Tax Treaties and Domestic Anti-Abuse Measures” in *Tax Treaties and Domestic Law* (2006) paras 5.3 and 5.4.3.

⁷⁷⁸ Paras 9.2, 22 and 22.1 of the Commentary to Art 1 (2003). It should be noted that the Netherlands had entered an observation to the statement in the Commentary that there is no conflict between domestic anti-avoidance rules and DTAs, as discussed by Arnold & Van Weeghel “Tax Treaties and Domestic Anti-Abuse Measures” in *Tax Treaties and Domestic Law* (2006) paras 5.3 and 5.3.3.

⁷⁷⁹ Sub-para 1 and 2 of para 22 of the Commentary (2003) to Art 1.

⁷⁸⁰ Cilliers “Anti-Avoidance” in *Silke on International Tax* (2010) para 46.33; Van Weeghel “Tax Treaties and Tax Avoidance - General Report” in *Cahiers Vol. 95a* (2010).

There is also support for the application of the Dutch *fiscale kwalificatie* principle.⁷⁸¹ Other measures that go further than merely “establishing the facts” and that entail a re-characterisation of the facts have been accepted less readily.⁷⁸² These include the Dutch *fraus legis* rule (although it is argued to apply in limited circumstances)⁷⁸³ and piercing of the corporate veil.⁷⁸⁴ Whether there is a conflict between a domestic interpretive approach and a DTA will depend on whether a similar interpretive approach can be followed when the DTA is interpreted.⁷⁸⁵

A number of changes to the interaction between domestic anti-avoidance measures and DTAs were recommended under the BEPS project and are included in the 2017 draft update to the Commentaries.⁷⁸⁶ These amendments include the following statement:

“In the process of interpreting tax legislation in cases dealing with tax avoidance, the courts of many countries have developed a number of judicial doctrines or principles of interpretation. These include doctrines such as substance over form, economic substance, sham, business purpose, step-transaction, abuse of law and *fraus legis*. These doctrines and principles of interpretation, which vary from country to country and evolve over time based on refinements or changes resulting from subsequent court decisions, are essentially views expressed by courts as to how tax legislation should be interpreted.”⁷⁸⁷

⁷⁸¹ Van Weeghel “Tax Treaties and Tax Avoidance - General Report” in *Cahiers Vol. 95a* (2010) 22; Smit “Beneficial Ownership in Netherlands Case law” in *Beneficial Ownership* (2013) 73. This view, however, is controversial since the dividing line between this rule and the Dutch *fraus legis* rule is problematic, as discussed in part 5.6.

⁷⁸² Arnold & Van Weeghel “Tax Treaties and Domestic Anti-Abuse Measures” in *Tax Treaties and Domestic Law* (2006) para 5.4.2. See also part 5.3.3 regarding the application of the *Ramsay* approach in a treaty context.

⁷⁸³ Ijzerman “Form and Substance - Netherlands” in *Cahiers Vol. 87a* (2002) 468; Arnold & Van Weeghel “Tax Treaties and Domestic Anti-Abuse Measures” in *Tax Treaties and Domestic Law* (2006) para 5.5.3; FGF Peters & A Roelofsen “Tax Treaties and Tax Avoidance: Application of Anti-Avoidance Provisions - Netherlands” in *IFA Cahiers de Droit Fiscal International Vol. 95a* (2010) 551 561; Van Weeghel “Tax Treaties and Tax Avoidance - General Report” in *Cahiers Vol. 95a* (2010) 22; Cilliers “Anti-Avoidance” in *Silke on International Tax* (2010) para 46.33; Smit “Beneficial Ownership in Netherlands Case law” in *Beneficial Ownership* (2013) 69-70. The Dutch constitutional system is also argued to limit the application of the *fraus legis* rule in a treaty context. See in this regard Arnold & Van Weeghel “Tax Treaties and Domestic Anti-Abuse Measures” in *Tax Treaties and Domestic Law* (2006) para 5.5.3; Peters & Roelofsen “Tax Avoidance - Netherlands” in *Cahiers Vol. 95a* (2010) 551-552. Under the proposed amendments mentioned in the main text corresponding to n 787 below, the argument for allowing the application of, especially, *fraus legis* strengthens, given the direct reference to this rule. It is, however, debatable whether this rule in Dutch law is merely a view “expressed by courts as to how tax legislation should be interpreted”. See in this regard AG Derksen *n Benadering tot die Uitleg van Wette, met Besondere Verwysing na die Inkomstebelastingwet 58 van 1962 en Vermydingskemas* LLD thesis University of South Africa (1989) 69.

⁷⁸⁴ Cilliers “Anti-Avoidance” in *Silke on International Tax* (2010) paras 46.9 and 46.33.

⁷⁸⁵ Arnold (2004) *BFIT* 251.

⁷⁸⁶ 2015 BEPS Report on Action Point 6 para 59 and Draft 2017 Update Part C para 24.

⁷⁸⁷ Draft 2017 Update Part C para 24, setting out the proposed para 78 of the Commentary to Art 1.

It is also proposed that the Commentaries be amended to state that these judicial doctrines and principles of interpretation “as a general rule” do not conflict with DTAs.⁷⁸⁸ This is subject to the guiding principle (which is retained)⁷⁸⁹ and, secondly, the existing rider that “member countries should carefully observe the specific obligations enshrined in tax treaties to relieve double taxation as long as there is no clear evidence that the treaties are being abused.”⁷⁹⁰

It is furthermore stated that the VCLT does not prevent the application of judicial doctrines to the interpretation of DTAs. Therefore, if a country’s domestic courts interpret a domestic tax provision to apply based on the economic substance of a transaction, a similar approach may apply when interpreting provisions of a DTA to a “similar transaction”.⁷⁹¹ This confirms that countries may, generally speaking, interpret provisions in DTAs in the same manner they interpret domestic legislation where tax avoidance is suspected, provided that the Vienna rules are adhered to. The analysis in part 5.3 shows that this is a practice that one already detects when it comes to the case law on beneficial ownership.

It is also noteworthy that domestic anti-avoidance measures may apparently be applied even though a country’s treaty partner may not regard the particular transaction as abusive and may not apply the same domestic anti-avoidance measures. This is also illustrated by the fact that the Commentaries accept that treaty partners may not arrive at the same interpretation of treaty terms in cases where tax avoidance is argued.⁷⁹²

⁷⁸⁸ *Draft 2017 Update* Part C para 24, setting out the amendments to para 9.2 (now para 58) of the Commentary to Art 1, as well as a new para 79 of the Commentary to Art 1.

⁷⁸⁹ See *Draft 2017 Update* Part C para 24, which renumbers para 9.5 as para 61 of the Commentary to Art 1 and which adds the sentence quoted at n 158 above.

⁷⁹⁰ *Draft 2017 Update* Part C para 24, setting out the proposed para 80 of the Commentary to Art 1.

⁷⁹¹ *Draft 2017 Update* Part C para 24, setting out the proposed para 78 of the Commentary to Art 1. An example is given of a “sham transaction doctrine” being used to prevent abuse of a provision in domestic law. The conclusion is that “to the extent that the sham transaction doctrine developed by the courts of [the country] does not conflict with the rules of interpretation of treaties, it will be possible to apply that doctrine when interpreting [a provision in a DTA]”. The highlighted phrase implies that domestic anti-avoidance doctrines will not necessarily be allowed under the VCLT.

⁷⁹² Arnold (2004) *BFIT* 259 argues:

“The 2003 revisions [to the Commentary to Article 1] envisage each treaty partner applying its own domestic anti-avoidance rules despite the fact that such rules usually differ. In other words, a country is entitled to apply its domestic anti-avoidance rules to strike down a tax avoidance transaction even though the transaction would not be considered to be abusive under the laws of the other country (as long as the guiding principle of Para. 9.5 of the Commentary on Art. 1 is complied with).”

5.2.2 The interaction between interpretative principles and anti-avoidance measures

Courts may often be tempted to take into account factors that typically form part of (stand-alone) anti-avoidance measures under the guise of interpretation. These can be either judicially developed anti-avoidance measures or those contained in legislation. Such an approach obviates the need to comply with all the requirements set by these rules.⁷⁹³ As Wardzynski puts it, “purposive interpretation ... makes the troubling issue of treaty override less apparent ... [and] creates a comfortable pretext to circumvent the procedural safeguards ... germane to domestic anti-avoidance provisions.”⁷⁹⁴

Therefore, should a South African court take into account factors that usually form part of statutory or judicial anti-avoidance measures when interpreting the beneficial ownership requirement, the court should be clear on why the interpretational approach adopted by it justifies that such factors be taken into account. These factors would, for example, include those that have to be considered under the GAAR,⁷⁹⁵ such as whether the sole or main purpose of the conduit company treaty shopping structure (or a part thereof) was to obtain a tax benefit; whether it was entered into in a manner that would not normally be employed for *bona fide* business purposes; or whether it lacks commercial substance since it does not have a significant effect upon the business risks or net cash flows of the direct recipient.⁷⁹⁶ A second example would be factors usually taken into account in piercing of the corporate veil cases, such as whether the direct recipient is under the control of the ultimate recipient.

5.2.3 The introduction of domestic anti-avoidance measures by way of the general *renvoi* clause

General *renvoi* clauses based on Article 3(2) of the OECD MTC can also play a role in introducing domestic anti-avoidance measures in a treaty context. Article 3(2) prescribes the use of domestic meanings when giving meaning to undefined treaty terms, unless the context provides otherwise.⁷⁹⁷ The important question in this regard is whether countries may include anti-avoidance provisions in their domestic laws that could, by virtue of the general *renvoi* clause, be used to combat treaty shopping.

⁷⁹³ Jiménez (2010) *World Tax J* 53 n 79.

⁷⁹⁴ Wardzynski (2015) *Intertax* 186.

⁷⁹⁵ Contained in s 80A-80L of the ITA.

⁷⁹⁶ S 80A and 80C of the ITA.

⁷⁹⁷ See parts 4.5 and 8.

A proposed paragraph in the Commentary to Article 1 recognises this possibility:

“[P]aragraph 2 of Article 3 makes domestic rules relevant for the purposes of determining the meaning of terms that are not defined in the Convention. *In many cases, therefore, the application of specific anti-abuse rules found in domestic law will have an impact on how the treaty provisions are applied rather than produce conflicting results.*”⁷⁹⁸

In the context of the treaty term “beneficial owner” it is possible that countries may use Article 3(2) to introduce domestic anti-avoidance measures in a treaty context by including definitions of “beneficial owner” in the domestic law. Such definition may, for example, give an economic meaning to the term or may include specific tests aimed at combatting treaty shopping.

As indicated elsewhere,⁷⁹⁹ not all scholars support the use of Article 3(2) in the context of beneficial ownership. One argument against allowing a domestic meaning is that the treaty term was (arguably) introduced to combat treaty shopping, which is made possible by the very existence of the treaty.⁸⁰⁰ According to this argument, provisions in treaties aimed at combatting treaty abuse should be addressed through common interpretation of the term by the contracting parties and uniform interpretation amongst all countries that adopt the same wording in their treaties.⁸⁰¹ De Broe argues that the beneficial ownership requirement is “*lex specialis*”, constituting an expression of the contracting parties’ intention of what constitutes treaty abuse, and should prevail over provisions in domestic law.⁸⁰² This argument is arguably is not supported by the new proposed statement in the Commentaries quoted above.

De Broe also argues that, should a definition of beneficial ownership be included in domestic law, the rider to Article 3(2), “unless the context otherwise requires”, will apply. He provides a number of reasons for his view.⁸⁰³ Firstly, domestic anti-avoidance provisions may go substantially beyond the “ordinary meaning” of the undefined treaty term. He argues that this is not supported by Article 31(1) of the VCLT, which provides that treaty terms should be given their “ordinary” meanings and which also applies to the interpretation of Article

⁷⁹⁸ *Draft 2017 Update Part C para 24*, setting out the proposed para 73 of the Commentary to Art 1 (emphasis added).

⁷⁹⁹ Parts 2.4 and 9.6.

⁸⁰⁰ As explained in part 2.2. De Broe *International Tax Planning* 670; Kemmeren “Preface to Articles 10 to 12” in *Klaus Vogel* (2015) 721 m.nr. 32.

⁸⁰¹ De Broe *International Tax Planning* 288 and 670.

⁸⁰² 288.

⁸⁰³ 288-290 and 671.

3(2).⁸⁰⁴ Secondly, the domestic meaning should not apply where it may lead to double taxation (an important purpose of DTAs). He does not, however, explain how double taxation may arise in the context of beneficial ownership. Thirdly, when the beneficial ownership requirement was added in 1977, the OECD was still of the view that domestic anti-avoidance measures had to be expressly provided for in the DTA in order to be applicable.⁸⁰⁵ He regards this as a further indication that a domestic meaning (which may reflect domestic anti-avoidance measures) should not be used. Fourthly, if these anti-avoidance rules are introduced after conclusion of the DTA (and the ambulatory approach is followed)⁸⁰⁶ they may extend the country's taxing rights beyond what the treaty partner could reasonably have foreseen when the treaty was concluded.⁸⁰⁷ In the context of the undefined treaty term "beneficial owner", De Boer thus notes:

"If one leaves it to each State to define the term '*beneficial owner*' through recourse to its domestic law, there may be a significant risk that the meaning emerging from domestic law goes well beyond the ordinary meaning of the term used in the treaty, especially if the meaning under domestic law is established under anti-avoidance provisions giving wide discretionary powers to tax authorities to disregard entities; redetermine the taxpayer who receives the income, etc. with a view to curtail tax avoidance in general. In other words, the door to treaty override is wide open."⁸⁰⁸

Here it may be noted that Avery Jones argues that changing the meaning of an undefined treaty term in domestic law for application under Article 3(2) does not constitute treaty override.⁸⁰⁹ However, if the change was not made in good faith (for example to extend the country's taxing rights), the context may require that the amended domestic meaning does not apply.⁸¹⁰

It is not clear that any of De Broe's arguments justify an outright rejection of all domestic meanings of "beneficial owner". Even if a treaty provision is aimed at combating abuse of the

⁸⁰⁴ Parts 4.3.1 and 4.5.

⁸⁰⁵ As pointed out in part 5.2.1, the pre-2003 Commentary was unclear in this regard.

⁸⁰⁶ See part 8.2.

⁸⁰⁷ He notes at De Broe *International Tax Planning* 289-290 that an exception may be if the treaty partner has anti-avoidance measures that would render the same result.

⁸⁰⁸ De Broe *International Tax Planning* 670. See also JL Walser "The Concept of Beneficial Ownership in Tax Treaties" in *Proceedings of a Seminar held in London, in 1998 during the 52nd Congress of the International Fiscal Association Vol 23a* (1998) 17.

⁸⁰⁹ It is nevertheless very common to refer to "treaty override" in this context, as evidenced by the contribution of C de Pietro "Tax Treaty Override and the Need for Coordination between Legal Systems: Safeguarding the Effectiveness of International Law" (2015) 7 *World Tax J* 73.

⁸¹⁰ Avery Jones "Treaty Interpretation" in *Global Tax Treaty Commentaries* (2015) paras 2.2.1.3 and 4.6.

DTA, it does not follow that an international meaning should be given. With regard to the other arguments, domestic meanings cannot simply be discarded and each such meaning should be considered on its own merits. Furthermore, as pointed out in part 8.6.2, courts have been prepared, for example, to adopt meanings for the undefined treaty term “alienation” (or an equivalent term) in domestic laws that are far removed from the dictionary meaning of the term.

5.3 The interpretation of tax legislation and the characterisation of transactions

As discussed in part 4.3.2, words in legislation and treaties may have different meanings depending on the context in which they are used. A question that often arises when interpreting tax legislation is whether terms should bear the meaning that they have in other areas of law, such as in the law of contract and property, or another meaning, such as the meaning given by economists or accountants.

Determining which one of these possibilities is the appropriate one, can be difficult. That is because tax legislation represents an uneasy compromise between legal and economic concepts. As Friedman explains:

“[T]he tax system is often not based on *economic* reality, and this would make it difficult to apply any kind of economic substance test in such cases. Some taxes... are based on legal concepts of property or contract and are of their essence a matter of legal form rather than economic substance. Other areas of taxation are based on business or accounting concepts, but these may be modified for tax purposes... Legal substance has its own reality, but economics is not its basis. It is where these legal concepts clash with economic substance that problems often arise.”⁸¹¹

This difficulty is also present when the meaning of “beneficial owner” in Article 10 of the OECD MTC is considered. As explained earlier,⁸¹² if one views a conduit company treaty shopping structure from an economic perspective, the direct recipient may have very little economic substance and may simply pay all, or most of, the income received on to the

⁸¹¹ J Freedman “Interpreting Tax Statutes: Tax Avoidance and the Intention of Parliament” (2007) 123 *LQR* 53 73 (emphasis in the original). See also Z Prebble & J Prebble “Comparing the General Anti-Avoidance Rule of Income Tax Law with the Civil Law Doctrine of Abuse of Law” (2008) 62 *BFIT* 151 168:

“An income tax law necessarily levies tax on the results of legal transactions rather than their underlying economic effect. It is not legally possible to tax economic profits, the target of the income tax, directly. Instead, a legal description of the economic profits is the subject of the tax, but the legal description is never anything more than a simulacrum of the profits.”

⁸¹² See especially the statement quoted in the main text corresponding to n 68 above.

ultimate recipient. However, for the structure to result in the planned-for tax benefit, one has to rely on the legal construct that the direct recipient, as a person recognised as law, is legally entitled to the income. Under such a construct one has to pay close attention to the meaning of “beneficial owner” and the other expressions used in the text of the Commentaries (if it is considered as part of the interpretation process) in areas such as company, contract, trust and property law. An important question to consider in this study is thus whether a South African court is likely to adopt a legal view of a conduit company structure. As pointed out in part 2.2, from a policy point of view both legal and economic approaches have their advantages and disadvantages. This is especially true if, under an economic approach, beneficial ownership is regarded as a broad anti-avoidance measure. A legal approach ensures greater certainty, but may not be able to combat the wide variety of forms that treaty shopping may take. An economic approach serves the latter purpose better, but the resultant uncertainty is undesirable both from a legal and international trade perspective.

As will be seen from the discussion below and in part 7.4, courts in South Africa, Canada, the Netherlands and the UK are inclined to give undefined terms in income tax legislation a legal meaning. This may change if they are concerned that taxpayers deliberately create (or pretend to create) legal rights that are at odds with the “economic realities” of their transaction in order to get a tax benefit.⁸¹³ These transactions may violate a court’s “subconscious sense of justice”⁸¹⁴ or at least cause “judicial irritation”,⁸¹⁵ as is made clear in the following statement by O’Keefe:

⁸¹³ According to J Li “Economic Substance: Drawing the Line Between Legitimate Tax Minimization and Abusive Tax Avoidance” (2006) 54 *Can Tax J* 23 45 the disapproval is often aimed at transactions that lack economic substance in that the taxpayer’s economic position was not meaningfully altered by the transaction, or transaction where no economic reason exists for entering into the transaction apart from obtaining the tax benefit. She argues at 45-50 that this will be the case if the taxpayer was not exposed to economic risk, or if the transaction did not offer the taxpayer the opportunity for a profit.

⁸¹⁴ NL Joubert “Asset-Based Financing, Contracts of Purchase and Sale, and Simulated Transactions” (1992) 109 *SALJ* 707 712, said in the context of transactions entered into for the purpose of avoiding the provisions of legislation in general, not only tax legislation.

⁸¹⁵ Examples of “judicial irritation” with tax avoidance include the statement by the House of Lords in *Ensign Tankers (Leasing) Ltd v Stokes* [1992] 1 AC 655 681 that these transactions are “raids on the public funds at the expense of the general body of taxpayers, and as such are unacceptable”; and in the statement by MacDonald, JP in *Commissioner of Taxes v Ferera* 1976 (2) SA 653 (RAD):

“I endorse the opinion expressed that the avoidance of tax is an evil. Not only does it mean that a taxpayer escapes the obligation of making his proper contribution to the *fiscus*, but the effect must necessarily be to cast an additional burden on taxpayers who, imbued with a greater sense of civic responsibility, make no attempt to escape or, lacking the financial means to obtain the advice and set up the necessary tax-avoidance machinery, fail to do so. Moreover, the nefarious practice of tax avoidance arms opponents of our capitalistic society with potent arguments that it is only the rich, the astute and the ingenious who prosper in it and that ‘good citizens’ will always fare badly.”

“There is a negative judicial reaction or feeling of repugnance towards blatant tax avoidance schemes which causes the courts to strive mightily to strike down such schemes ... if there is no valid business purpose to the transaction. If any trend is discernible it is a shift away from a blind obedience to the rule in the Duke of Westminster case...⁸¹⁶ How hard they (the judges) will try to find a flaw in the scheme depends in part on the degree of judicial irritation, which of course is directly related to the degree of gimmickry employed by the taxpayer and his advisers. The more blatant the scheme, the greater amount of judicial ingenuity employed in locating the fatal flaw.”⁸¹⁷

If these circumstances are present, it becomes perhaps more likely that courts will have regard to the economic consequences of transactions, either by way of the application of anti-avoidance rules such as those discussed in this chapter, or by the manner in which the relevant legislative instrument is interpreted. Whether this latter possibility will eventuate, depends largely on the role given to “purpose” in the interpretation of the legislative instrument.⁸¹⁸ The following questions are particularly relevant: How will the court determine the purpose of a particular provision? Will the court consider purpose in all scenarios, or only in the case of ambiguity? What weight is to be given to purpose in comparison with the “literal” meaning of the word?

It also depends on the manner in which the court views the transaction.⁸¹⁹ Will it consider the legal or the economic substance of the transaction? One would expect this to depend on the

For a discussion of some of the material pertaining to the disapproval aimed at tax avoidance in general, see Kujinga *A Comparative Analysis of the Efficacy of the General Anti-Avoidance Rule* ch 2.

⁸¹⁶ This refers to the following statement famously made by Lord Tomlin in *Inland Revenue Commissioners v Duke of Westminster* [1936] AC 1 19: “Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be.” This statement has been quoted with approval by courts in South Africa (e.g. *Erf 3183/1 Ladysmith (Pty) Ltd and another v Commissioner for Inland Revenue* 1996 (3) SA 942 (A) 949), the UK (e.g. *WT Ramsay Ltd v Inland Revenue Commissioners* [1982] AC 300 323) and Canada (e.g. *Stuart Investments Ltd v the Queen* [1984] 1 SCR 536 540 and 552).

⁸¹⁷ MJ O’Keefe “The Business Purpose Test: Who Needs it?” (1977) 25 *Can Tax J* 139 139.

⁸¹⁸ It is thus important to note that it is impossible to decide in the abstract (outside the context of the particular legislative provision) whether terms have either a legal or commercial meaning. To the extent that the statement by Lord Hoffman in *MacNiven (HM Inspector of Taxes) v Westmoreland Investments Ltd* [2001] UKHL 6 para [32] meant to convey this, it was rejected in *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* [2005] 1 AC 684 para 38. See also J Freedman “Converging Tracks? Recent Developments in Canadian and UK Approaches to Tax Avoidance” (2005) 53 *Can Tax J* 1038 1041.

⁸¹⁹ The AD in *Commissioner of Customs and Excise v Randles Brothers and Hudson Ltd* 1941 AD 369 394 explained:

“When a statute forbids or taxes a certain transaction, defined by name or description, and the question arises whether a particular transaction falls within or without the prohibition or tax, two problems of interpretation or construction always arise. Firstly, the law has to be construed to ascertain what kind of transaction is forbidden or taxed, and secondly the transaction has to be interpreted to ascertain whether it is a transaction of the kind which is forbidden or taxed”.

The following statement by the House of Lords in *Barclays Mercantile Business Finance Ltd v Mawson* [2005] 1 AC 684 para 32 is along the same lines:

answers to the above-mentioned set of questions. For example, a court may decide after considering those questions that a term has a “legal meaning”. When applying that meaning to the transaction, the court is likely to look at the legal rights created under the transaction. On the other hand, if the term is to have an economic meaning, the court will look at the transaction in a manner that considers economic realities.⁸²⁰

The following statement by De Broe neatly summarises these considerations when it comes to the question to which extent the anti-avoidance purpose of the term “beneficial owner” can inform the meaning given to it:

“A broad economic interpretation of the term permits the source State to deny treaty relief each time a significant part of the income sourced there is economically (ultimately) received by a resident of a third State. ... Arguably, such interpretation turns more on who is the ultimate recipient of the income than who is the beneficial owner thereof as the latter requires an analysis in law, not purely in fact. *Whether such a broad economic interpretation amounts to a teleological interpretation of the term to give optimal effect to its purpose of the prevention of treaty shopping* depends on how one reads the Conduit Companies Report and the Commentary.”⁸²¹

It is impossible to analyse thoroughly the manner in which Canada, the Netherlands and the UK address all these considerations, both domestically and with regard to DTAs. A few general remarks will have to suffice.⁸²² A similar analysis is carried out with regard to South Africa in part 7.4.

“The essence of the new approach was ... to determine the nature of the transaction to which [the statutory provision] was intended to apply and then to decide whether the actual transaction ... answered to the statutory description.”

⁸²⁰ Li (2006) *Can Tax J* 37; Cilliers “Anti-Avoidance” in *Silke on International Tax* (2010) para 46.6; J Vella “Sham, Tax Avoidance, and ‘a Realistic View of Facts’ in the UK” in E Simpson & M Stewart (eds) *Sham Transactions* (2013) 259 para 15.14.

⁸²¹ De Broe *International Tax Planning* 690 (emphasis added).

⁸²² It should be pointed out that the analysis conducted in the main text is done in order to evaluate the manner in which the term “beneficial owner” may be interpreted. As pointed out in part 2.2, it is also sometimes argued that treaty shopping may be addressed by the manner in which the DTA *as a whole* is interpreted. In terms of this argument there is an inherent anti-abuse principle in DTAs which can be applied to combat treaty shopping. Here reference is often made to para 9.3 of the Commentary (2003) to Art 1. According to Ault & Arnold “Protecting the Tax Base of Developing Countries” in *UN Handbook on Selected Issues in Protecting the Tax Base of Developing Countries* (2015) 30, the effectiveness of this approach will depend on the way in which courts of a treaty country generally approach domestic and treaty interpretation. Baker “Improper Use of Tax Treaties, Tax Avoidance and Tax Evasion” in *UN Handbook on Selected Issues in Administration of Double Tax Treaties for Developing Countries* (2013) 391 states that support for this argument is “not overwhelming”. See also De Broe et al (2011) *BFIT* 386-387. This alternative way of combatting treaty shopping is outside the scope of this study since it does not concern the meaning of the term “beneficial owner” as such.

5.3.1 Canada

In Canada the SCC stated the following in its 1984 decision in *Stuart Investments Ltd v the Queen* (“*Stuart*”)⁸²³ regarding the approach to be followed when interpreting tax legislation:

“Courts today apply to this [tax] statute the plain meaning rule, but in a substantive sense so that if a taxpayer is within the spirit of the charge, he may be held liable...[T]he learned author of *Construction of Statutes* (2nd ed. 1983), at p. 87, E.A. Dreidger, put the modern rule succinctly:

Today there is only one principle or approach, namely, the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.”⁸²⁴

Although the approach in *Stuart* has been recognised in subsequent case law,⁸²⁵ various scholars have expressed their scepticism as to whether Canadian courts place much emphasis on purpose in the interpretation of tax legislation.⁸²⁶ Recent case law, such as the 2005 decision by the SCC in *The Queen v Canada Trustco Mortgage Company*,⁸²⁷ has not put an end to this scepticism.⁸²⁸

⁸²³ *Stuart Investments Ltd v the Queen* [1984] 1 SCR 536.

⁸²⁴ 578.

⁸²⁵ See the cases mentioned by BJ Arnold “Reflections on the Relationship Between Statutory Interpretation and Tax Avoidance” (2001) 49 *Can Tax J* 1 7-9; G Masson & SD Porter “Form and Substance in Tax Law - Canada” in *IFA Cahiers de Droit Fiscal International Vol. 87a* (2002) 187 189.

⁸²⁶ Before the decision in *The Queen v Canada Trustco Mortgage Co.* [2005] 2 SCR 601 (a case dealing with the Canadian GAAR), Arnold (2001) *Can Tax J* 8 argued that case law had shown that the role of purpose is likely to be limited if the purpose is “unexpressed” and the “meaning of the words is clear and unambiguous”. See also his view at 12. J Tiley “Tax Avoidance Jurisprudence as Normal Law” (2004) 4 *BTR* 329 (also written before the decision in *The Queen v Canada Trustco Mortgage Co.* [2005] 2 SCR 601) similarly argues that reference to purpose has become an “afterthought”, following cases such as *Shell Canada Ltd. v Canada* [1999] 3 SCR 622. See also B Alarie & DG Duff “The Legacy of UK Tax Concepts in Canadian Income Tax Law” (2008) *BTR* 228 248 and Freedman (2005) *Can Tax J* 1044.

⁸²⁷ *The Queen v Canada Trustco Mortgage Co.* [2005] 2 SCR 601. Although the case dealt with the application of the Canadian GAAR, it has also raised questions regarding statutory interpretation outside the GAAR.

⁸²⁸ Brown, in B Alarie, S Bhatia & DG Duff “Symposium on Tax Avoidance After Canada Trustco and Mathew: Summary of Proceedings” (2005) 53 *Can Tax J* 1010 1021, but see Duff at 1013. See also the discussion by Freedman (2005) *Can Tax J* 1044-1046.

When it comes to characterisation of transactions,⁸²⁹ the SCC in *Stuart* recognised the possibility that the “formal validity of the transaction may also be insufficient where:

“... (b) the provisions of the Act necessarily relate to an identified business function. This idea has been expressed in articles on the subject in the United States:

The business purpose doctrine is an appropriate tool for testing the tax effectiveness of a transaction, where the language, nature and purposes of the provision of the tax law under construction indicate a function, pattern and design characteristic solely of business transactions...

(c) ‘the object and spirit’ of the allowance or benefit provision is defeated by the procedures blatantly adopted by the taxpayer to synthesize a loss, delay or other tax saving device.... This may be illustrated where the taxpayer, in order to qualify for an ‘allowance’ or a ‘benefit’, takes steps which the terms of the allowance provisions of the Act may, when taken in isolation and read narrowly, be stretched to support. However, when the allowance provision is read in the context of the whole statute, and with the ‘object and spirit’ and purpose of the allowance provision in mind, the accounting result produced by the taxpayer’s actions would not, by itself, avail him of the benefit of the allowance.”⁸³⁰

In *Bronfman Trust v the Queen*⁸³¹ the SCC further indicated support for the consideration of transactions “with an eye to commercial and economic realities, rather than juristic classification of form” in the context of transactions aimed at tax avoidance.⁸³²

However, in *Shell Canada Ltd. v Canada*⁸³³ the SCC stated that it “has never held that the economic realities of a situation can be used to re-characterise a taxpayer’s *bona fide* legal relationships”, absent a finding of sham or mislabelling.⁸³⁴

In light of this it has been proposed that the guidelines laid down in *Stuart* have been “largely ignored” and are today “primarily of historical interest”.⁸³⁵ Canadian courts thus

⁸²⁹ See also the discussion by Freedman (2005) *Can Tax J* 1044-1046.

⁸³⁰ *Stuart Investments Ltd v the Queen* [1984] 1 SCR 536 579-580.

⁸³¹ *Bronfman Trust v the Queen* [1987] 1 SCR 32.

⁸³² Para 48, where the court noted that such an approach “may help to avoid the inequity of tax liability being dependent upon the taxpayer’s sophistication at manipulating a sequence of events to achieve a patina of compliance with the apparent prerequisites for a tax deduction”. See also other cases in which a similar argument was made, mentioned by DG Duff “Justice Iacobucci and the ‘Golden and Straight Metwand’” (2007) 57 *University of Toronto Law Journal* 525 536-541.

⁸³³ *Shell Canada Ltd. v Canada* [1999] 3 SCR 622.

⁸³⁴ Para 39.

⁸³⁵ Arnold (2001) *Can Tax J* 16 and 17.

nowadays pay close regard to the legal rights created by the parties and little attention to the economic realities of a transaction.⁸³⁶

With regard to the interpretation of DTAs in Canada, Baker refers to case law which states that the approach is more liberal than when it comes to the interpretation of domestic tax legislation,⁸³⁷ but he argues that, following the decision in *Stuart*, there is more of a convergence between the two.⁸³⁸ This view, however, appears contrary to the one mentioned above. It should also be noted that Van Weeghel is of the opinion that Canadian case law shows a high “threshold for abuse” with regard to DTAs.⁸³⁹

Finally, if regard is had to the decisions in *Prévost*⁸⁴⁰ and *Velcro*,⁸⁴¹ discussed in the next chapter, the tendencies to give legal meanings to terms in tax rules and to consider the legal substance of a transaction are born out in these cases.⁸⁴²

5.3.2 The Netherlands

When it comes to the interpretation of tax legislation in the Netherlands, Dutch courts also often used legal concepts to give content to the terms used in tax legislation.⁸⁴³ They also tend to accept the legal rights created by the parties and do not determine the tax consequences of transactions based on their economic substance. However, there are exceptions to this general position, including the *fiscale kwalificatie* measure and *fraus legis* rule, discussed later in this chapter.⁸⁴⁴

⁸³⁶ See the cases discussed by Duff (2007) *University of Toronto Law Journal* 541-566 and his conclusion at 568 that these judgments “emphasized the ‘legal and practical effect’ of the transactions”. Arnold (2001) *Can Tax J* 18-22, after an analysis of decisions by the Supreme Court of Canada (the “SCC”) from 1997 to 1999, comes to a similar conclusion. See also BJ Arnold “The Long, Slow, Steady Demise of the General Anti-Avoidance Rule” (2004) 52 *Can Tax J* 488 504-505; Li (2006) *Can Tax J* 32-33; N Goyette & PD Halvorson “Tax Treaties and Tax Avoidance: Application of Anti-Avoidance Provisions - Canada” in *IFA Cahiers de Droit Fiscal International Vol. 95a* (2010) 171 173.

⁸³⁷ Baker *Double Taxation Conventions* para E.04. See also Kandeve (2007) *Can Tax J* 35-36; G Watson & S Baum “Beneficial Ownership as a Treaty Anti-Avoidance Tool?” (2012) 60 *Can Tax J* 149 153-154. See also *Prévost Car Inc. v The Queen* 2008 TCC 231 paras [36]-[37], discussed in part 6.5.2.

⁸³⁸ Baker *Double Taxation Conventions* para E.04 n 1.

⁸³⁹ Van Weeghel “Tax Treaties and Tax Avoidance - General Report” in *Cahiers Vol. 95a* (2010).

⁸⁴⁰ *Prévost Car Inc. v The Queen* 2008 TCC 231 and *Prévost Car Inc. v Canada* 2009 FCA 57 (CanLII), discussed in part 6.5.

⁸⁴¹ *Velcro Canada Inc. v the Queen* 2012 TCC 57 (CanLII), discussed in part 6.6.

⁸⁴² See also Ward *Access to Tax Treaty Benefits* 9; Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.6.3.

⁸⁴³ Ijzerman “Form and Substance - Netherlands” in *Cahiers Vol. 87a* (2002) 451-452; Smit “Beneficial Ownership in Netherlands Case law” in *Beneficial Ownership* (2013) 72.

⁸⁴⁴ Ijzerman “Form and Substance - Netherlands” in *Cahiers Vol. 87a* (2002) 451-452.

With regard to the interpretation of DTAs, Van Weeghel notes that, like Canadian case law, Dutch case law on the interpretation of DTAs shows a high “threshold for abuse”.⁸⁴⁵ In the Dutch case discussed in the next chapter, the *Market Maker* case,⁸⁴⁶ the *Hoge Raad* gave a legal meaning to the term, as is often the case in the Netherlands. In that case, however, the Dutch authority had not argued that anti-avoidance measures such as *fraus legis* and *zelfstandige fiscale kwalificatie* applied.

5.3.3 The UK and the *Ramsay* approach

The discussion when it comes to the UK has been left for last since it is the most problematic. As with the other jurisdictions discussed above, UK courts tend to give terms in tax legislation their legal meaning and to characterise transactions according to their legal substance.⁸⁴⁷

However, the so-called *Ramsay* approach should be noted. It derives its name from the 1982 decision of the House of Lords in *W T Ramsay Ltd v Inland Revenue Commissioners* (“*Ramsay*”). This decision was subsequently followed in a number of cases,⁸⁴⁸ including *IRC v Burmah Oil Co. Ltd*⁸⁴⁹ and *Furniss v Dawson*.⁸⁵⁰ The approach has been described over the years as a “step doctrine”,⁸⁵¹ a “business purpose doctrine”,⁸⁵² a “doctrine of economic equivalence”,⁸⁵³ a “doctrine of fiscal nullity”,⁸⁵⁴ and, less technically, “a broad spectrum antibiotic which killed off all tax avoidance schemes”.⁸⁵⁵

⁸⁴⁵ Van Weeghel “Tax Treaties and Tax Avoidance - General Report” in *Cahiers Vol. 95a* (2010).

⁸⁴⁶ *Decision by the Hoge Raad* (6 April 1994) 28638 BNB 1994/217, discussed in part 6.2.

⁸⁴⁷ RM Ballard & PEM Davison “Form and Substance in Tax Law - United Kingdom” in *IFA Cahiers de Droit Fiscal International Vol. 87a* (2002) 569 569, 573 and 587. See also the case law referred to by Vella “Sham in the UK” in *Sham Transactions* (2013) para 15.08.

⁸⁴⁸ For a list of decisions of the House of Lords with which the *Ramsay* approach is associated, see E Simpson “Sham and Purposive Statutory Construction” in E Simpson & M Stewart (eds) *Sham Transactions* (2013) 86 para 5.03 n 10.

⁸⁴⁹ *Inland Revenue Commissioners v Burmah Oil Co. Ltd.* [1982] STC 30.

⁸⁵⁰ *Furniss (Inspector of Taxes) v Dawson (D.E.R)* [1984] AC 474.

⁸⁵¹ Alarie & Duff (2008) *BTR* n 95. Ballard & Davison “Form and Substance - UK” in *Cahiers Vol. 87a* (2002) 583 also refer to this designation, but argue that this element was never “really dominant”.

⁸⁵² Ballard & Davison “Form and Substance - UK” in *Cahiers Vol. 87a* (2002) 583, who, however, argue that this element was never “really dominant”. See also Freedman (2007) *LQR* 58-59, who argues that it was neither a business-purpose doctrine in the manner understood in US law, nor a doctrine which enabled courts to look at the economic consequences of a transaction by “bypassing” the text of the legal rule.

⁸⁵³ *Re Oakey Abattoir Pty Ltd v the Commissioner of Taxation* [1985] FCA 373.

⁸⁵⁴ See the sources mentioned by J Cassidy “Tainted Elements or Nugatory Directive? The Role of the General Anti-Avoidance Provisions (‘GAAR’) in Fiscal Interpretation” (2012) 23 *Stell LR* 319 341.

⁸⁵⁵ *MacNiven (HM Inspector of Taxes) v Westmoreland Investments Ltd* [2001] UKHL 6 332.

Furniss v Dawson, which concerned a linear scheme,⁸⁵⁶ is used here to illustrate the *Ramsay* approach. It concerned the Dawsons, who owned shares that they wanted to sell to Wood Bastow Holdings Ltd. Since this would have constituted a “disposal” under UK legislation, it would have given rise to capital gains tax (“CGT”). In terms of this legislation capital gains were, however, deferred in the case of reorganisations. In order to fall within this provision, the Dawsons incorporated a new company, Greenjacket Ltd, to which they transferred their shares. Greenjacket in turn sold these shares to Wood Bastow.

The court found that, in light of the earlier decision in *Ramsay*, the step that was inserted with the sole purpose of avoiding tax (the role of Greenjacket) should be ignored and the transaction regarded as a disposal by the Dawsons directly to Wood Bastow. The court explained the circumstances under which the so-called *Ramsay* approach would apply by stating that there must, firstly, be “a pre-ordained series of transactions; or, if one likes, one single composite transaction”. Secondly, included in this pre-ordained series of transactions must be “steps inserted which have no commercial (business) *purpose* apart from the avoidance of a liability to tax”. If these are present, the result is that the inserted steps are “disregarded” for tax purposes and the court considers the “end result”, depending on the provisions of the tax legislation.⁸⁵⁷

Considerable debating ensued as to the basis for the so-called *Ramsay* approach. It is important to note that sham, in the sense understood in part 5.4, was not regarded as the basis.⁸⁵⁸ Initially, it was argued that the House of Lords had developed a new legal rule. In terms of this rule the actual set of facts would be replaced by a new set of facts in the circumstances set out in *Furniss v Dawson*.⁸⁵⁹

⁸⁵⁶ See the description of a linear scheme in *MacNiven (HM Inspector of Taxes) v Westmoreland Investments Ltd* [2001] UKHL 6 para [45]. Conduit company treaty shopping structures, as described in part 1.3, are usually linear.

⁸⁵⁷ *Furniss v Dawson* [1984] AC 474 527(emphasis in the original).

⁸⁵⁸ Ballard & Davison “Form and Substance - UK” in *Cahiers Vol. 87a* (2002) 576; Tiley (2004) *BTR* 327; K Burt “The Approach in *WT Ramsay Ltd v IRC*: Elucidation Long Overdue” (2004) 121 *SALJ* 745 n 4; Freedman (2007) *LQR* 56; M Gammie “Tracing the Boundaries of Sham and *Ramsay*” in E Simpson & M Stewart (eds) *Sham Transactions* (2013) 211 para 12.14. It is not clear whether T Legwaila “The Substance over Form Doctrine in Taxation: The Application of the Doctrine after the Judgment in *Commissioner for the South African Revenue Service v NWK Ltd* 2011 (2) SA 67 (SCA)” (2016) 28 *SA Merc LJ* 112 112 disagrees since he refers to *WT Ramsay Ltd v IRC* [1982] AC 300 when explaining the concept of simulated transactions.

⁸⁵⁹ Derksen *Uitleg van Wette* 11; AG Derksen “Should the South African Courts Adopt the English Anti-Tax-Avoidance Rule in *Furniss v Dawson*” (1990) 107 *SALJ* 416 419-420. His argument was made without the benefit of the decisions delivered in the 1990’s and 2000’s, referred to at ns 860 and 861 below. See also Ballard & Davison “Form and Substance - UK” in *Cahiers Vol. 87a* (2002) 569-570 and Vella “Sham in the UK” in *Sham Transactions* (2013) para 15.16, where this view is mentioned.

However, in more recent decisions, such as *MacNiven (HM Inspector of Taxes) v Westmoreland Investments Ltd*⁸⁶⁰ and *Barclays Mercantile Business Finance Ltd v Mawson*,⁸⁶¹ the House of Lords has held that the *Ramsay* approach is not a legal rule, but merely an example of statutory (purposive) interpretation.⁸⁶² In *Barclays Mercantile Business Finance Ltd v Mawson* that court explained:

“The essence of the new approach was to give the statutory *provision a purposive construction in order to determine the nature of the transaction to which it was intended to apply* and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answered to the statutory description... But however one approaches the matter, the question is always whether the relevant provision of statute, upon its true construction, applies to the facts as found.”⁸⁶³

The court also stated:

“Cases such as these gave rise to a view that, in the application of *any* taxing statute, transactions or elements of transactions which had no commercial purpose were to be disregarded. But that is going too far. It elides the two steps which are necessary in the application of any statutory provision: first, to decide, on a purposive construction, exactly what transaction will answer to the statutory description and secondly, to decide whether the transaction in question does so. As Ribeiro PJ said in *Collector of Stamp Revenue v Arrowsmith Ltd* (2004) 6 ITLR 454 at 468:

‘[T]he driving principle in the *Ramsay* line of cases continues to involve a general rule of statutory construction and an unblinkered approach to the analysis of the facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to *the transaction, viewed realistically*.’”⁸⁶⁴

Following these more recent cases some scholars are satisfied that the *Ramsay* approach does not make provision for a re-characterisation of the legal substance of a transaction. Vella and Gammie argue that the *Ramsay* approach merely entails that, if the particular tax provision,

⁸⁶⁰ *MacNiven (HM Inspector of Taxes) v Westmoreland Investments Ltd* [2001] UKHL 6.

⁸⁶¹ *Barclays Mercantile Business Finance Ltd v Mawson* [2005] 1 AC 684. See also *McGuckian v Commissioners of Inland Revenue* [1997] 1 WLR 991. The earlier case of *Craven v White* [1989] AC 398 is also noteworthy.

⁸⁶² See also Burt (2004) *SALJ* 747; M Gammie “Sham and Reality: the Taxation of Composite Transactions” (2006) 3 *BTR* 294-297-299.

⁸⁶³ *Barclays Mercantile Business Finance Ltd v Mawson* [2005] 1 AC 684 para [32] (emphasis added).

⁸⁶⁴ Para [36] (emphasis added). Vella “Sham in the UK” in *Sham Transactions* (2013) para 15.19 warns that this statement creates the impression (in his view, incorrect) that transactions should always be read “realistically” (that is with reference to their economic substance), irrespective of the manner in which the legislative provision has been interpreted.

purposely interpreted, requires a court to look at the economic rather than the legal substance of a transaction, the court will do so. It may then be necessary for the court to regard steps in a transaction as forming part of a composite transaction.⁸⁶⁵

Not all scholars, however, accept this explanation of the *Ramsay* approach.⁸⁶⁶ Freedman's view is particularly important, given the fact that in recent times she formed part of the advisory committee who advised on whether a GAAR should be introduced in the UK. Her views on judicial approaches to tax avoidance are thus particularly informative. She maintains that, apart from the interpretation of the statutory provision, the courts also consider, as a question of law, whether a composite transaction exists.⁸⁶⁷ This enquiry includes paying attention to policy considerations.⁸⁶⁸ If such a composite transaction is found to exist, it allows courts to consider the economic substance of the transactions.⁸⁶⁹ Their conclusion on this legal question (whether a composite transaction exists) may be decisive to the outcome of the case.⁸⁷⁰

The application of the *Ramsay* approach in the context of conduit company treaty shopping is returned to in part 7.4.

⁸⁶⁵ Vella "Sham in the UK" in *Sham Transactions* (2013) paras 15.14 -15.17. Gammie (2006) *BTR* 306 argues that "the *Ramsay* approach does not permit re-characterisation. Because the legal nature of the taxpayer's actual transactions are unaffected (but are placed in their commercial context), it must be possible to construe the legislation in question in a non-technical or non-legal manner, i.e. in a commercial sense, to ensure that it does not apply to the taxpayer's actual transaction."

⁸⁶⁶ Freedman (2005) *Can Tax J* 1042 and Freedman (2007) *LQR* 69. See also Vella "Sham in the UK" in *Sham Transactions* (2013) paras 15.05 and 15.24-15.32. Vella argues that the legislative provisions considered by the UK Supreme Court in the case of *Tower MCashback LLP 1 and another v Revenue and Customs Commissioners* [2011] 2 AC 457 were comparable with those in *Barclays Mercantile Business Finance Ltd v Mawson* [2005] 1 AC 684. Yet, the Supreme Court in the later case considered the transaction with regard to its economic substance, but did not do so in the earlier case. He is concerned that this may be an indication that the *Ramsay* approach goes further than mere statutory interpretation.

⁸⁶⁷ Freedman (2007) *LQR* 69. At 68 she also argues with reference to the House of Lords' decision in *Scottish Provident Institution v Revenue Commissioners* [2004] UKHL 52, which handed down just after the decision in *Barclays Mercantile Business Finance Ltd v Mawson* [2005] 1 AC 684 and comprising the same bench, as follows:

"This looks very little like a decision about construction of a document and rather more like a principle about the nature of a composite transaction ... It has nothing to do with the particular wording of the statute before the court and looks very like a judicial ruling about the factors to be taken into account in cases where there are transactions that in fact cancel each other out as a matter of substance. This finding of law clearly sets a precedent about the characteristics of a composite transaction, which would apply where the statute in question was worded completely differently from that in this case."

⁸⁶⁸ Freedman (2007) *LQR* 65-67.

⁸⁶⁹ 67 and 69.

⁸⁷⁰ See her argument at Freedman (2007) *LQR* 67:

"This goes further than pure statutory construction, even of a purposive nature since the outcome of the application of the statutory words depends upon this special style of transaction analysis and not just a reading of the wording in the statute. Whatever they might have said about the need for a closer analysis of what the *statute* actually requires, it was a close analysis of the *transaction* that gave them the result they reached" (emphasis in the original).

With regard to the interpretation of DTAs by UK courts, Lord Diplock remarked in *Fothergill v Monarch Airlines Ltd*⁸⁷¹ (which concerned the interpretation of the Warsaw Convention):⁸⁷²

“The language of an international convention has not been chosen by an English parliamentary draftsman. It is neither couched in the conventional English legislative idiom nor designed to be construed exclusively by English judges. It is addressed to a much wider and more varied judicial audience than is an Act of Parliament that deals with purely domestic law. It should be interpreted, as Lord Wilberforce put it in *James Buchanan & Co. Ltd. v. Babco Forwarding & Shipping (U.K.) Ltd.* [1978] A.C. 141, 152, ‘unconstrained by technical rules of English law, or by English legal precedent, but on broad principles of general acceptance.’”⁸⁷³

UK scholars are somewhat divided on whether the *Ramsay* approach can be applied to interpret DTAs. Ballard and Davison argue on the strength of the above statement in *Fothergill v Monarch Airlines* that the *Ramsay* approach, being a “domestic principle of statutory construction”, should not be applied when interpreting a DTA.⁸⁷⁴ Morton and Sykes are likewise against the application of the *Ramsay* approach in a treaty context,⁸⁷⁵ but Schwarz adopts a different view.⁸⁷⁶ Given the proposed amendments to the Commentary to Article 1 mentioned in part 5.2, the argument that the *Ramsay* approach may be applied in a treaty context may be stronger in future. If the view of Ballard and Davison regarding the impact of the decision in *Fothergill v Monarch Airlines* is correct, though, it remains to be seen whether UK courts will be willing to depart from that decision.

It is noteworthy that in the next chapter one will detect in the UK case of *Indofood (CA)*⁸⁷⁷ traces of the *Ramsay* approach. It is, however, unlikely that the CA in *Indofood (CA)* deliberately applied that approach.⁸⁷⁸ It is also argued by some authors that the approach to

⁸⁷¹ *Fothergill v Monarch Airlines Ltd* [1981] AC 251.

⁸⁷² Unification of Certain Rules Relating to International Carriage by Air

⁸⁷³ 281-282. See also Baker *Double Taxation Conventions* para E.06; Olivier & Honiball *International Tax* 310-311; Du Plessis *Critical Issues Regarding the OECD Model Tax Convention* 109-110.

⁸⁷⁴ Ballard & Davison “Form and Substance - UK” in *Cahiers Vol. 87a* (2002) 586.

⁸⁷⁵ P Morton & L Sykes “Tax Treaties and Tax Avoidance: Application of Anti-Avoidance Provisions - United Kingdom” in *IFA Cahiers de Droit Fiscal International Vol. 95a* (2010) 805 816.

⁸⁷⁶ Having discussed a recent treaty case in the UK involving a trust, J Schwarz “United Kingdom - Avoidance and Tax Treaties: Current UK Experience” (2011) 65 *BFIT* 453 457 states:

“If the mischief was the bringing of the trust within the provisions of the tax treaty ...solely to come within the provisions of the tax treaty, ... it is surprising that rather more established principles such as those set out by the House of Lords in *Ramsay v. IRC* (1979-1983) and the following cases were not invoked.... Such an approach may have produced a more satisfactory analysis”.

⁸⁷⁷ *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] STC 1195.

⁸⁷⁸ See n 1119 below and the main text corresponding to that footnote.

beneficial ownership of the UK tax authority, Her Majesty's Revenue & Customs (UK) ("HMRC"), reflects the *Ramsay* approach.⁸⁷⁹

The question whether the *Ramsay* approach may find application in South African courts in the context of beneficial ownership in DTAs is discussed in part 7.4.

5.4 Simulated transactions, shams and the "wrong label"

Common to most legal systems⁸⁸⁰ is the principle that when a court decides whether or not a legislative provision applies to a set of facts, it will take into account only the true facts and will not give effect to an appearance or simulation created by the parties.⁸⁸¹ If the set of facts concerns a transaction, the court will apply the legislative provision to the rights that the parties truly intended to create under the transaction,⁸⁸² rather than the apparent rights presented by the written terms of the documents (the "simulated agreements"),⁸⁸³ if these are not the same.

This principle applies in South Africa, Canada, the Netherlands and the UK. It is known by various expressions.⁸⁸⁴ In South Africa the expressions "simulated transactions" (or "simulations") and "shams" are especially prevalent,⁸⁸⁵ "shams" is the expression most commonly used in the UK and Canada; and the Netherlands favours "simulations".⁸⁸⁶

⁸⁷⁹ See n 1138 below.

⁸⁸⁰ In *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 530 547 Innes HR remarked: "[T]he fundamental doctrine that the law regards the substance rather than the form of things [is] a *doctrine common, one would think, to every system of jurisprudence*" (emphasis added). Van Weeghel "Tax Treaties and Tax Avoidance - General Report" in *Cahiers Vol. 95a* (2010) 22 also notes that this principle was common to all the countries who submitted branch reports for that edition.

⁸⁸¹ Derksen *Uitleg van Wette* 20.

⁸⁸² Another possibility is that the parties in truth intended for no agreement to have been entered into. Zimmer "Form and Substance - General Report" in *Cahiers Vol. 87a* (2002) 29; L Swanepoel 'n *Gestruktureerde Regsgefundeerde Metodologie vir die Inkomste-Kapitaal Riglyne en Verwante Subjektiewiteitsvraagstukke in die Suid-Afrikaanse Inkomstebelastingreg* PhD thesis University of Stellenbosch (2002) 127; Van Weeghel "Tax Treaties and Tax Avoidance - General Report" in *Cahiers Vol. 95a* (2010) 22.

⁸⁸³ The question whether simulation can only be found in the case of written agreements is not considered here.

⁸⁸⁴ Examples include "the *plus valet* rule", a "transaction in *fraudem legis*" and "substance over form".

⁸⁸⁵ See, e.g. *Commissioner of Customs and Excise v Randles Brothers and Hudson Ltd* 1941 AD 369 and *Hicklin v Secretary for Inland Revenue* 1980 (1) SA 481 (A). AG Derksen "Skynverwekking en Belastingvermyding" (1990) DR 211 212 notes that the word "sham" is also sometimes used to refer to the manner of purposive statutory interpretation discussed in part 5.3. "Sham" is furthermore sometimes used in the context of piercing of the corporate veil, as discussed in part 5.7.

⁸⁸⁶ According to Zimmer "Form and Substance - General Report" in *Cahiers Vol. 87a* (2002) 29, "sham" is typically used in common-law jurisdictions and "simulation" in civil-law jurisdictions. See also M Macnair "Sham: Early Uses and Related and Unrelated Doctrines" in E Simpson & M Stewart (eds) *Sham Transactions* (2013) 29 para 2.40 for a short explanation of how the word "simulation", which derives from civil law, came to be used in UK law.

In South African law the principle was famously explained in *Zandberg v Van Zyl*⁸⁸⁷ in the following statement:

“Now, as a general rule, the parties to a contract express themselves in language calculated without subterfuge or concealment to embody the agreement at which they have arrived. They intend the contract to be exactly what it purports; and the shape which it assumes is what they meant it should have. Not infrequently, however (either to secure some advantage which otherwise the law would not give, or to escape some disability which otherwise the law would impose), the parties to a transaction endeavour to conceal its real character. They call it by a name, or give it a shape, intended not to express but to disguise its true nature. And when a Court is asked to decide any rights under such an agreement, it can only do so by giving effect to what the transaction really is; not what in form it purports to be. The maxim then applies *plus valet quod agitur quam quod simulate concipitur*. But the words of the rule indicate its limitations. The Court must be satisfied that there is *a real intention, definitely ascertainable, which differs from the simulated intention. For if the parties in fact mean that a contract shall have effect in accordance with its tenor, the circumstances that the same object might have been attained in another way will not necessarily make the arrangement other than it purports to be. The inquiry, therefore, is in each case one of fact, for the right solution of which no general rule can be laid down.*”⁸⁸⁸

The classic statement in English law on what constitutes a sham was made in *Snook v London and West Riding Investments Ltd*,⁸⁸⁹ where the House of Lords explained:

“[I]t means acts done or documents executed by the parties to the ‘sham’ which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create.... But one thing, I think, is clear ... that for acts or documents to be a ‘sham’, ... all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating.”⁸⁹⁰

⁸⁸⁷ *Zandberg v Van Zyl* 1910 AD 302.

⁸⁸⁸ 309 (emphasis added).

⁸⁸⁹ *Snook v London and West Riding Investments Ltd*. [1967] 2 QB 786.

⁸⁹⁰ 802. For a short discussion of the use of “sham” in UK case law on tax avoidance, see Ballard & Davison “Form and Substance - UK” in *Cahiers Vol. 87a* (2002) 571-573.

In Canada the definition in *Snook* has been accepted in a number of decisions.⁸⁹¹ Loutzenhiser argues that, for the most part, Canadian courts have followed this notion of a sham.⁸⁹²

With regard to simulation under Dutch law, IJzerman explains the concept in the following statement:

“In Netherlands law generally, the substantive relationships between parties must be examined on the basis of what they have actually agreed, and not on the basis of a different perception thereof that they may attempt to present to third parties [such as the tax authorities].”⁸⁹³

The situation where there is a deliberate attempt to disguise the true transaction (called a “sham”) is often distinguished from one where no such deliberate attempt has been made,⁸⁹⁴ but the parties have inadvertently attached the wrong “label” to their transaction. They may, for example, call their transaction a sale because they believe this to be the case. However, when the legal characteristics of the transaction are considered, it is found to be a lease. Upon having decided on the correct “label”, the court will apply the legal rule in question based on the correct label (a lease in the example).⁸⁹⁵ Loutzenhiser states that, in Canada, “mislabelling” falls under the “legally ineffective” doctrine.⁸⁹⁶ This doctrine has been described as one under which “acts or documents appear to give rise to certain legal rights different from the true legal rights the parties actually established, but there was no intention to deceive”.⁸⁹⁷

⁸⁹¹ Most notably by the SCC in *Minister of National Revenue v Cameron* [1974] SCR 1062. See also the cases referred to by DG Duff “Interpreting the Income Tax Act - Part 1: Interpretive Doctrines” (1999) 47 *Can Tax J* 464 493 n 144.

⁸⁹² Loutzenhiser “Sham in the Canadian Courts” in *Sham Transactions* (2013) para 14.09. However, see also his discussion of the explanation of a sham given by the majority in *Stubart Investments Ltd v the Queen* [1984] 1 SCR 536 545-546, which he discusses at para 14.20.

⁸⁹³ IJzerman “Form and Substance - Netherlands” in *Cahiers Vol. 87a* (2002) 452.

⁸⁹⁴ A Hutchison & D Hutchison “Simulated Transactions and the Fraus Legis Doctrine” (2014) *SALJ* 69 71 argue in the following manner: “For a simulated transaction there must be a deliberate element of disguise, which would of necessity entail dolus.” In a footnote (n 10) to this statement, they further argue: “This dolus may exist simply in the fact that the parties did not intend their transaction to have inter partes the legal effect which it tends to convey to the outside world.” See also the Canadian case law quoted by Loutzenhiser “Sham in the Canadian Courts” in *Sham Transactions* (2013) para 14.43 in this context. A further question that is sometimes considered, is whether both parties must have attempted to create the deception in order for it to qualify as a “sham”, but it is not necessary for purposes of this study to consider this question.

⁸⁹⁵ TS Emslie, DM Davis, SJ Hutton & L Olivier *Income Tax Cases and Materials* 3 ed (2001) 897; Gammie (2006) *BTR* n 64; M Conaglen “Sham Trusts” (2008) 67 *Cambridge LJ* 176 180; Hutchison & Hutchison (2014) *SALJ* 70, but see Cilliers “Anti-Avoidance” in *Silke on International Tax* (2010) para 46.7.

⁸⁹⁶ Also called the “legally ineffectual” or “incomplete transaction” doctrine.

⁸⁹⁷ Loutzenhiser “Sham in the Canadian Courts” in *Sham Transactions* (2013) para 14.06, who also points out that not all cases that resort under the “legally ineffective” doctrine are examples of mislabelling. Another example would include where the parties failed to implement the acts described in the agreements properly. For

So how does a court determine whether the parties “honestly intended” to enter into the transaction before the court;⁸⁹⁸ or, put differently, whether there is an unexpressed agreement contrary to the one apparently entered into?⁸⁹⁹ The discussion will focus here on the application in South African law,⁹⁰⁰ where it is a question of fact, rather than law.⁹⁰¹ In the case of an agreement forming part of a number of interdependent agreements,⁹⁰² these agreements can be considered as a whole in order to determine whether there is a simulation.⁹⁰³

The aim of the factual enquiry is to determine whether the parties subjectively intended to create the legal rights presented in the documents and that the agreement “would *inter partes* have effect according to its tenor”.⁹⁰⁴ Since it is difficult to determine subjective intention, objective *indicia* play an important role.⁹⁰⁵ Courts have in the past taken the following into

another brief mention of this doctrine, see Goyette & Halvorson “Tax Avoidance - Canada” in *Cahiers Vol. 95a* (2010) 173.

⁸⁹⁸ To quote Watermeyer JA in *Commissioner of Customs and Excise v Randles Brothers and Hudson Ltd* 1941 AD 369 395:

“A transaction is not necessarily a disguised one because it is devised for the purpose of evading the prohibition in the Act or avoiding liability for the tax imposed by it. A transaction devised for that purpose, if the parties *honestly intend* it to have effect according to its tenor, is interpreted by the Courts according to its tenor, and then the only question is whether, so interpreted, it falls within or without the prohibition or tax” (emphasis added).

⁸⁹⁹ In *Commissioner of Customs and Excise v Randles Brothers and Hudson Ltd* 1941 AD 369 396 Watermeyer JA noted that there must be “some unexpressed agreement or tacit understanding” for a simulation to exist. This was quoted with approval in *Erf 3183/1 Ladysmith (Pty) Ltd v CIR* 1996 (3) SA 942 (A) 952, where the court concluded at 954 that anomalies in various interdependent agreements, all concluded on the same day, “are consistent with a *wider, unexpressed agreement or tacit understanding*, the terms of which have not been divulged” (emphasis added).

⁹⁰⁰ As Simpson “Sham and Purposive Statutory Construction” in *Sham Transactions* (2013) para 5.01 explains, the scope of sham transactions differs from jurisdiction to jurisdiction. It is not the purpose of this study to explore those differences.

⁹⁰¹ Derksen (1990) *DR* 213; Swanepoel *Subjektiviteitsvraagstukke* 134-135; Hutchison & Hutchison (2014) *SALJ* 76. Cilliers “Anti-Avoidance” in *Silke on International Tax* (2010) para 46.8 agrees and reconciles this view with the one expressed in some case law that the question is a legal one.

⁹⁰² Explained in *Erf 3183/1 Ladysmith (Pty) Ltd v CIR* 1996 (3) SA 942 (A) 954 to be agreements that would not have been concluded, unless all the others were also concluded.

⁹⁰³ In *Commissioner for Inland Revenue v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)* 1999 (4) SA 1149 (SCA) 1158 the court held that sale and lease agreements had to be regarded as a “composite transaction”. And in *Erf 3183/1 Ladysmith (Pty) Ltd v CIR* 1996 (3) SA 942 (A) 954 the various leases, sub-leases and variation agreements were regarded “in the context of all the others in order to discover their total effect.” See also Hutchison & Hutchison (2014) *SALJ* 77; Swanepoel *Subjektiviteitsvraagstukke* 128 n 18.

⁹⁰⁴ *Erf 3183/1 Ladysmith (Pty) Ltd v CIR* 1996 (3) SA 942 (A) 953. Hutchison & Hutchison (2014) *SALJ* 82 conclude, after considering various decisions by the AD, that “the subjective intention of the parties to an alleged simulated transaction [is] paramount, with the subjective intention being inferred from objective factors.” For the position in the UK and Canada, see *Roger Stone (HM Inspector of Taxes) v Richard Henry Hitch, Thomas Henry Hitch, Ian Geoffry Handy* [2001] EWCA Civ 63 para 66; Conaglen (2008) *Cambridge LJ* 186 and Masson & Porter “Form and Substance - Canada” in *Cahiers Vol. 87a* (2002) 192.

⁹⁰⁵ In *Zandberg v Van Zyl* 1910 AD 302 309 the court referred to “Perezuis (*Ad Cod*, 4.22.2)” which remarked that “simulations may be detected by considering the facts leading up to the contract, and by taking account of any unusual provision embodied in it”. See also *Michau v Maize Board* 2003 (6) SA 459 (SCA) para [4]; *Maize*

account: events leading up to the conclusion of the agreements;⁹⁰⁶ unusual aspects of the agreements;⁹⁰⁷ the fact that a number of interconnected agreements were concluded on the same day;⁹⁰⁸ the fact that the agreements were not implemented according to their terms⁹⁰⁹ and the manner in which a party has explained the agreement to a third party.⁹¹⁰

Another indication taken into account by courts is whether or not the transaction makes business sense.⁹¹¹ Economic realities are thus also a relevant consideration.⁹¹² An important question is whether, if the only purpose in entering into a transaction in a specific manner was to reduce tax, the transaction is rendered a simulation. Most academics argue against this.⁹¹³ Hutchison et al, for example, point out that purpose relates to the “lawfulness” of a transaction⁹¹⁴ rather than the “genuineness” of the parties’ intention.⁹¹⁵ Courts have traditionally taken a similar approach.⁹¹⁶ This is evidenced by the statement from *Randles*

Board v Jackson 2005 (6) SA 592 (SCA) para [8]; Joubert (1992) *SALJ* 713-716; Swanepoel *Subjektiviteitsvraagstukke* 135-136.

⁹⁰⁶ *Erf 3183/1 Ladysmith (Pty) Ltd v CIR* 1996 (3) SA 942 (A) 955.

⁹⁰⁷ 954; *Relier (Pty) Ltd v Commissioner for Inland Revenue* [1998] 1 All SA 183 (A) 187-188; *Roshcon (Pty) Ltd v Anchor Auto Body Builders CC and others* 2014 (4) SA 319 (SCA) para [37].

⁹⁰⁸ *Erf 3183/1 Ladysmith (Pty) Ltd v CIR* 1996 (3) SA 942 (A) 954; *Roshcon (Pty) Ltd v Anchor Auto Body Builders CC* 2014 (4) SA 319 (SCA) para [37].

⁹⁰⁹ *Michau v Maize Board* 2003 (6) SA 459 (SCA) para [8]; *Maize Board v Jackson* 2005 (6) SA 592 (SCA) para [12].

⁹¹⁰ *Maize Board v Jackson* 2005 (6) SA 592 (SCA) paras [13]-[14].

⁹¹¹ See the discussion of *CIR v Conhage (Pty) Ltd* 1999 (4) SA 1149 (SCA) by Hutchison & Hutchison (2014) *SALJ* 82.

⁹¹² Swanepoel *Subjektiviteitsvraagstukke* 137-138; Cilliers “Anti-Avoidance” in *Silke on International Tax* (2010) para 46.8.

⁹¹³ Derksen (1990) *DR* 212; Cilliers “Anti-Avoidance” in *Silke on International Tax* (2010) para 46.6.

⁹¹⁴ Contracts entered into for an unlawful purpose may be void or unenforceable.

⁹¹⁵ Hutchison & Hutchison (2014) *SALJ* 70 (emphasis added).

⁹¹⁶ Examples in South African case law (not all dealing with matters of taxation) include *Western Bank v Registrar of Financial Institutions* 1975 (4) SA 37 (T) 45; *Michau v Maize Board* 2003 (6) SA 459 (SCA) para [4]; *Maize Board v Jackson* 2005 (6) SA 592 (SCA) para [8]; *Ex Parte Millman and others NNO: In Re Multi-Bou (Pty) Ltd and others* 1987 (4) SA 405 (C) 416. This was also accepted in UK case law, including *Miles v Bull* [1969] 1 QB 258 264; *W T Ramsay Ltd v IRC* [1982] AC 300 323; *Roger Stone (HM Inspector of Taxes) v Richard Henry Hitch, Thomas Henry Hitch, Ian Geoffry Handy* [2001] EWCA Civ 63 para 67 and see also Ballard & Davison “Form and Substance - UK” in *Cahiers Vol. 87a* (2002) 572. In Canada the court in *Minister of National Revenue v Leon* [1977] 1 FC 249 256 stated that “[i]f the agreement or transaction lacks a bona fide purpose, it is a sham”. Subsequently, however, the SCC in *Stubart Investments Ltd v the Queen* [1984] 1 SCR 536 took a different view. Wilson J, who delivered a separate judgment in which he agreed with the majority, stated at 540: “A transaction may be effectual and not in any sense a sham (as in this case) but may have no business purpose other than the tax purpose.” Moreover, the majority held at 567-570 as follows:

“The Federal Court of Appeal ... appears to have drawn back from the *Leon* proposition when Urie J. wrote (*Massey-Ferguson Ltd. v. The Queen*, [1977] 1 F.C. 760, at p. 772):

I am not at all sure that I would have agreed with the broad principles relating to a finding of sham as enunciated in that case [*Leon*], and, I think, that the principle so stated should perhaps be confined to the facts of that case. ... *Leon, supra*, at its highest, is a modification of the sham test, but it seems to have been isolated on its factual base by *Massey-Ferguson, supra*.”

In *2529-1915 Québec Inc. v Canada* 2008 FCA 398 the FCA noted at para [54] that sham does not mean that transactions could be ignored or disregarded “on the sole ground that they give rise to an abuse”. See also Masson

Brothers that “[a] transaction is not necessarily a disguised one because it is devised for the purpose of evading the prohibition in the Act or avoiding liability for the tax imposed by it.”⁹¹⁷

In 2011 some doubt arose whether this position still holds true in the wake of statements made by the SCA in *C:SARS v NWK Ltd*.⁹¹⁸ The following statement was considered the most controversial:

“In my view the test to determine simulation cannot simply be whether there is an intention to give effect to a contract in accordance with its terms. Invariably where parties structure a transaction to achieve an objective other than the one ostensibly achieved they will intend to give effect to the transaction on the terms agreed. The test should thus go further, and require an examination of the commercial sense of the transaction: of its real substance and purpose. If the purpose of the transaction is only to achieve an object that allows the evasion⁹¹⁹ of tax, or of a peremptory law, then it will be regarded as simulated.”⁹²⁰

The worry amongst scholars and tax practitioners was that the SCA had formulated “one simple objective test” in terms of which the question was no longer whether the transaction was genuine.⁹²¹ In two subsequent cases, *Roshcon (Pty) Ltd v Anchor Auto Body Builders CC* (“*Roshcon*”)⁹²² (a non-tax case) and *CSARS v Bosch* (“*Bosch*”),⁹²³ the SCA, however, sought to quell some of these concerns. It argued that *NWK* did not establish a new test in terms of which, if the only purpose of a transaction is to avoid tax, it would automatically be regarded as a simulation.⁹²⁴

& Porter “Form and Substance - Canada” in *Cahiers Vol. 87a* (2002) 191-192; Goyette & Halvorson “Tax Avoidance - Canada” in *Cahiers Vol. 95a* (2010) 173; Loutzenhiser “Sham in the Canadian Courts” in *Sham Transactions* (2013) paras 14.13-14.20.

⁹¹⁷ *Commissioner of Customs and Excise v Randles Brothers and Hudson Ltd* 1941 AD 369 394.

⁹¹⁸ *Commissioner for the South African Revenue Service v NWK Ltd* 2011 (2) SA 67 (SCA).

⁹¹⁹ The appropriateness of using the word “evasion” rather than “avoidance” by the court has been questioned, as briefly pointed out by EB Broomberg “*NWK and Founders Hill*” (2011) *The Taxpayer* 187 198, who argues that by “evasion” the court likely meant “avoidance”.

⁹²⁰ Para 55 (emphasis added). See also the following statement at para 81: “But as I have said, *there must be some substance - commercial reason - in the arrangement, not just an intention to achieve a tax benefit or to avoid the application of a law*” (emphasis added).

⁹²¹ Hutchison & Hutchison (2014) *SALJ* 85. However, in the next paragraph of this contribution they noted that another argument, which was that the court in *CSARS v NWK Ltd* 2011 (2) SA 67 (SCA) had deducted that the parties were subjectively dishonest, “makes (with respect) the best sense”.

⁹²² *Roshcon (Pty) Ltd v Anchor Auto Body Builders CC* 2014 (4) SA 319 (SCA).

⁹²³ *CSARS v Bosch* 2015 (2) SA 174 (SCA).

⁹²⁴ See the argument by Legwaila (2016) *SA Merc LJ* 127 that, given the complex nature of the facts in *CSARS v NWK Ltd* 2011 (2) SA 67 (SCA), the judge in this case would not have sought to lay down a precedence for general use.

Bosch is especially relevant since it concerned a scheme that the Commissioner argued had resulted in tax avoidance. *Bosch* concerned so-called “deferred delivery schemes” aimed at incentivising employees. In terms of these schemes employees were given options to purchase shares in a company,⁹²⁵ which were exercisable within 21 days. When they exercised the options, the employees became entitled to delivery of the shares, although delivery was postponed for a number of years. If an employee left the service of the employer before the delivery date had arrived, he was obliged to resell the shares at the price at which he had originally acquired them.⁹²⁶ On their interpretation of the ITA the employees argued that they were not liable for normal tax on the increase in the value of the shares that took place after exercising the option and before delivery of the shares. For this tax benefit to materialise, the employees had to become unconditionally entitled to delivery of the shares on exercise of the options. The Commissioner, however, argued that employees had no such unconditional entitlement.⁹²⁷ One of the Commissioner’s arguments was based on simulation.⁹²⁸ Wallis JA disagreed, providing the following explanation:

“That submission involved a misunderstanding of the judgment in *NWK*, as was pointed out in *Roshcon*.⁹²⁹ There I stressed that *simulation is a question of the genuineness of the transaction under consideration*. If it is genuine then it is not simulated, and if it is simulated then it is a dishonest transaction, *whatever the motives of those who concluded the transaction*. The true position is that ‘the court examines the transaction as a whole...’ Among those features will be the income tax consequences of the transaction. ... But there is nothing impermissible about arranging one’s affairs so as to minimise one’s tax liability If the revenue authorities regard any particular form of tax avoidance as undesirable they are free to amend the Act, as occurs annually, to close anything they regard as a loophole.”⁹³⁰

On the facts, he held:

“For [the argument based on simulation] to succeed, it required all the participants in the scheme to have intended, when exercising their options to enter into agreements of purchase and sale of shares, to do so on terms other than those set out in the scheme. That is manifestly

⁹²⁵ The company belonged to the same group of companies than the employer.

⁹²⁶ In fact, set-off would occur.

⁹²⁷ The discussion in the main text concerns the court’s view on the meaning of a “condition”. This view was expressed in answer to the argument that, if the purchase of the shares was subject to a “suspensive condition”, the tax benefit described in the main text would not follow.

⁹²⁸ *CSARS v Bosch* 2015 (2) SA 174 (SCA) para [39]. It was argued that there was a suspensive condition that the employees remain employed until delivery of the shares.

⁹²⁹ In *Roshcon (Pty) Ltd v Anchor Auto Body Builders CC* 2014 (4) SA 319 (SCA) Wallis JA gave a separate judgment in which he agreed with the majority.

⁹³⁰ *CSARS v Bosch* 2015 (2) SA 174 (SCA) para [40] (emphasis added, footnotes omitted).

implausible and was not suggested ... As Watermeyer JA said in *Randles Bros & Hudson* in regard to a contention that certain agreements of purchase and sale were not genuine – ‘there was no material advantage to be gained by pretending to enter into a contract of sale which could not be gained by entering into a real contract of sale’. *Similarly in this case there was no advantage to the parties in entering into a conditional contract of purchase and sale when they were free to enter into an unconditional contract and postpone performance of the obligation to pay the purchase price and deliver the shares.*”⁹³¹

To summarise: it seems that the question when it comes to determining whether an agreement is a sham, is still whether the parties subjectively intended to enter into that particular agreement and to give effect to the agreement according to their terms. Objective factors continue to play a key role in the enquiry. If there is a tax avoidance motive, that may cause the court to look at the transactions “with a quizzical eye”,⁹³² but does not cause the transactions to be a sham.

If one turns to the role of the principle of simulated transactions in the context of conduit company treaty shopping, one can observe from the afore-going discussion that South African courts are familiar with the use of the principle in scenarios involving tax avoidance.⁹³³ They have developed a strong jurisprudence in scenarios considering domestic taxation, perhaps more so than in some of the other jurisdictions discussed in this chapter.

With regard to the application in the context of DTAs, it was pointed out in part 5.2.1 that there is no reason for disallowing the application of the principle as understood in South African law. If faced with a conduit company treaty shopping structure South African courts will thus be prepared to consider whether the various transactions that comprise the structure, constitute shams. In making this determination the fact that the parties entered into the structure to get the treaty benefit of a reduced withholding tax will not on its own result in the structure being regarded a sham. However, the court will take into account the following considerations, if present: unusual aspects of the transactions, such as the direct recipient not making a profit, the fact that multiple agreements were signed on the same day and the fact that the agreements were not executed according to their written terms.

⁹³¹ Para [41] (emphasis added, footnotes omitted).

⁹³² *EBN Trading (Pty) Ltd v Commissioner of Customs and Excise and another* 2001 (2) SA 1210 (SCA) para [22]. If there is no such motive, the court looks at the transaction “acceptively” and although “[t]his does not mean that the true nature of the transactions does not have to be determined ... it does mean that a wary interpretation is inappropriate”.

⁹³³ Or, possibly, even tax evasion. See n 919 above.

This enquiry is likely to be the starting point of the court's enquiry and only once it has reached its decision will it turn to the interpretation of the treaty term "beneficial owner". For example, if the real intention was that the direct recipient would merely receive the dividends as agent for the ultimate recipient, the court will assess whether that ultimate recipient is the "beneficial owner" based on this fact.

It is, however, proposed that an argument based on simulation will only rarely succeed in a conduit company treaty shopping structure given the fact that the relevant parties will appreciate that the tax benefit is only available if the direct recipient in the above example acts as a principal and will thus not intend for the direct recipient to be an agent, as explained in *Bosch*.⁹³⁴

5.5 The Dutch *fraus legis* rule

Before considering two Dutch anti-avoidance measures, it is useful to mention judicial anti-avoidance measures that are typically adopted by civil-law countries briefly. These measures are summarised by Alvarrenga as follows:⁹³⁵

- a) Abuse of form, which she describes as "the use of an atypical, abnormal or unnecessary legal form by the taxpayer to perform a juridical act, which, if carried out through a 'normal' form, would have a more burdensome tax treatment. The doctrine of abuse of form could be compared to the 'step transaction' doctrine, as it is usually used by tax authorities to disregard unnecessary transactions adopted by the taxpayer with the only purpose of avoiding taxation."⁹³⁶
- b) Abuse of law, which she describes as "the improper exercise of a right ... [I]ndividuals are prohibited from invoking their right to structure their activities with the objective of reducing the tax burden on their acts and businesses if such a structure is clearly abuse."⁹³⁷
- c) *Fraus legis*, which is discussed below.

⁹³⁴ See the statement quoted in the main text corresponding to n 931.

⁹³⁵ CA Alvarrenga "Preventing Tax Avoidance: Is There Convergence in the Way Countries Counter Tax Avoidance" (2013) 67 *BFIT* 348 354-355. For a summary of the judicial anti-avoidance measures commonly adopted in common-law countries such as the US, see J Tiley "Judicial Anti-Avoidance Doctrines: the US Alternatives - Part 2" (1987) *BTR* 220 and Alvarrenga (2013) *BFIT* 359-352.

⁹³⁶ Alvarrenga (2013) *BFIT* 354 (footnotes omitted).

⁹³⁷ 355.

Turning to Dutch law, the first measure described here is the Dutch *fraus legis* rule. If this rule applies, a new set of facts replaces the actual set of facts before the court. The court thus constructs a new set of facts that accords with the object and spirit of the legislative provision. The legislative provision is then applied to this re-characterised transaction. Alternatively, the transaction is disregarded.⁹³⁸

The rule has been described as an “*ultimum remedium*”, which means that it can only be considered after the legislation has been interpreted according to the normal approaches.⁹³⁹ In the context of tax avoidance⁹⁴⁰ Smit set out the following conditions which all have to be met for the rule to apply:⁹⁴¹

- a) the taxpayer obtains a tax benefit as a result of one or more transactions;
- b) tax avoidance is the principal purpose for adopting the particular way of structuring the transactions;
- c) the transactions serve no business purpose apart from avoiding tax;⁹⁴² and
- d) the transactions are against the object and spirit of the law.

Where steps are inserted into a transaction that serve no business purpose other than the reduction of tax, *fraus legis* can apply even though the purpose of the transaction, regarded as a whole, is not primarily to obtain a tax benefit.⁹⁴³ Ijzerman argues that these steps go against the object and spirit of the law since

“the legislator cannot as a rule be considered to have sought to reward purely tax-motivated detours with tax benefits. The taxpayer at very least has entered into a risky area. Other factors,

⁹³⁸ Smit “Beneficial Ownership in Netherlands Case law” in *Beneficial Ownership* (2013) 69. See also the explanation provided by V Uckmar “Tax Avoidance/Tax Evasion - General Report” in *IFA Cahiers De Droit Fiscal International Vol. 68a* (1983) 15 27 that, when *fraus legis* is found, the courts “replace the ‘non-taxable’ transaction with a ‘taxable’ transaction”.

⁹³⁹ Ijzerman “Form and Substance - Netherlands” in *Cahiers Vol. 87a* (2002) 455 and 458.

⁹⁴⁰ The rule is not limited to this area of the law, though.

⁹⁴¹ Smit “Beneficial Ownership in Netherlands Case law” in *Beneficial Ownership* (2013) 69. However, see also AG Derksen “Die Nederlandse Fraus Legis-Reël en Belastingvermyding in Suid-Afrika” (1989) 1 *SA Merc LJ* 299 302; Ijzerman “Form and Substance - Netherlands” in *Cahiers Vol. 87a* (2002) 454 and Arnold & Van Weeghel “Tax Treaties and Domestic Anti-Abuse Measures” in *Tax Treaties and Domestic Law* (2006) para 5.5.3 for different views of the requirements.

⁹⁴² In a number of discussions on *fraus legis* this requirement is seen as a correlative of the previous requirement, rather than a separate one. Under the formulation of the rule by Ijzerman “Form and Substance - Netherlands” in *Cahiers Vol. 87a* (2002) 454 and 457, a business or commercial purpose of only “secondary importance” will not suffice to take the transaction outside the rule.

⁹⁴³ Ijzerman “Form and Substance - Netherlands” in *Cahiers Vol. 87a* (2002) 457 and 458.

such as whether such detours were considered acceptable during the parliamentary debates, will then determine whether it is possible to avoid the application of *fraus legis*.⁹⁴⁴

Smit argues that the rule is unlikely to apply in the case of conduit company treaty shopping. Apart from the problem of applying the rule in a treaty context,⁹⁴⁵ he argues that the beneficial ownership requirement is a *lex specialis*, which leaves no room for the application of *fraus legis*.⁹⁴⁶

5.6 The Dutch substance-over-form rule (“(zelfstandige) fiscale kwalificatie”)

Apart from the Dutch *fraus legis* rule, some scholars argue that Dutch law also recognises another rule that may result in a re-characterisation of facts.⁹⁴⁷ In a 1999 decision the *Hoge Raad*⁹⁴⁸ explained that this principle (known as “*zelfstandige fiscale kwalificatie*” or simply “*fiscale kwalificatie*”) applies “if the fiscal result of the legal form is unacceptable because of its economic outcome and the purpose of the tax law”.⁹⁴⁹

In Wattel’s *conclusio* to another decision of the *Hoge Raad*⁹⁵⁰ he states that the application of the principle does not rest on the purpose (“*bedoelingen*”) to avoid tax.⁹⁵¹ It is based on objective facts and the objective economic result in light of the wording, purpose and scope (“*tekst, doel en strekking*”) of the legislation.

The dividing line between this and the *fraus legis* rule is not clear.⁹⁵² Peters and Roelofsen argue that the distinction “seems to be wafer thin”,⁹⁵³ bearing in mind that both rules allow for re-characterisation of facts.⁹⁵⁴ Arnold and Van Weeghel note that case law suggests that the rule “is a subset of *the proper determination of the facts* and upon such determination the treaty can be applied in accordance with its terms, whereas in the application of *fraus*

⁹⁴⁴ 462.

⁹⁴⁵ See part 5.2.1.

⁹⁴⁶ Smit “Beneficial Ownership in Netherlands Case law” in *Beneficial Ownership* (2013) 69-70.

⁹⁴⁷ 72.

⁹⁴⁸ *Decision by the Hoge Raad* (15 December 1999) 33830 BNB 2000/126.

⁹⁴⁹ Para 3.4. Translation provided by H Pijl “Conflicts in the Attribution of Income to a Person - Netherlands” in *IFA Cahiers de Droit Fiscal International Vol. 92b* (2007) 447-448.

⁹⁵⁰ *Decision by the Hoge Raad* (30 November 2007) 37646 BNB 2007/250 para 5.7.

⁹⁵¹ However, Ijzerman “Form and Substance - Netherlands” in *Cahiers Vol. 87a* (2002) 458 n 16 argues that the requirements for *fraus legis* will have to be met (which, of course, begs the question what the difference between the two rules is). As discussed in part 5.5, this includes a tax avoidance purpose.

⁹⁵² See also n 951 above.

⁹⁵³ Peters & Roelofsen “Tax Avoidance - Netherlands” in *Cahiers Vol. 95a* (2010) 562.

⁹⁵⁴ Smit “Beneficial Ownership in Netherlands Case law” in *Beneficial Ownership* (2013) 72-73 also argues that *fiscale kwalificatie* is not based on interpretation of the tax legislation, but on the manner in which the facts are construed.

legis/fraus conventionis a further inquiry as to the shared expectations of the contracting states is necessary.”⁹⁵⁵ This does not clearly explain where the two rules differ. Dutch case law in a treaty context is also not particularly instructive. In the decision most often referred to as an example of the application of the *fiscale kwalificatie* rule,⁹⁵⁶ the court does not discuss the application of the rule. It is rather deduced by scholars.⁹⁵⁷

Lastly, Smit indicates that Dutch courts rarely apply this rule and that the changes are slim that a conduit company with “no or little substance solely for tax reasons” will fall under this rule.⁹⁵⁸

5.7 Piercing the corporate veil

The expression “piercing the corporate veil” is often mentioned in connection with beneficial ownership and conduit companies and thus deserves attention in this study.⁹⁵⁹ A company, as a separate legal person, can perform legal acts and is the owner of the company assets.⁹⁶⁰ This also applies to companies that form part of a group of companies, despite the fact that such a group is often regarded and managed as an economic unity.⁹⁶¹ As commented by the CA in the UK:

“Mr. Hoffmann suggested beguilingly that it would be technical for us to distinguish between parent and subsidiary companies in this context; economically, he said, they were one. But we

⁹⁵⁵ Arnold & Van Weeghel “Tax Treaties and Domestic Anti-Abuse Measures” in *Tax Treaties and Domestic Law* (2006) 5.5.3.

⁹⁵⁶ *Decision by the Hoge Raad* (18 May 1994) 28293 BNB 1994/252. The case did not concern a DTA, but the Tax Arrangement for the Kingdom of the Netherlands. Arnold & Van Weeghel “Tax Treaties and Domestic Anti-Abuse Measures” in *Tax Treaties and Domestic Law* (2006) para 5.5.3 describe this as “not a treaty but a set of rules that are part of the law of the Kingdom of the Netherlands”.

⁹⁵⁷ Arnold & Van Weeghel “Tax Treaties and Domestic Anti-Abuse Measures” in *Tax Treaties and Domestic Law* (2006) para 5.5.3 refer to this view, but it is not clear whether they agree. S van Weeghel & R de Boer “Anti-Abuse Measures and the Application of Tax Treaties in the Netherlands” (2006) 60 *BFIT* 358 361 also refer to this view and seem to agree with it. See also the other contributions mentioned by Smit “Beneficial Ownership in Netherlands Case law” in *Beneficial Ownership* (2013) 87 n 90.

⁹⁵⁸ Smit “Beneficial Ownership in Netherlands Case law” in *Beneficial Ownership* (2013) 72-73 and 89.

⁹⁵⁹ For example, in *Prévost Car Inc. v The Queen* 2008 TCC 231 para 100, discussed in part 6.5.2, the court made the following statement in reply to the argument that a company was not the “beneficial owner” of dividends under a DTA: “When corporate entities are concerned, one *does not pierce the corporate veil* unless the corporation is a conduit for another person...” (emphasis added). Examples in South African case law of the use of the expression “piercing of the corporate veil” (and “piercing of the veneer of a trust”) in combination with the expression “beneficial owner” are referred to in part 3.5.2.2.

⁹⁶⁰ Part 3.4.

⁹⁶¹ Blackman et al *Commentary on the Companies Act* 4-142-1 [Revision Service 3, 2006]; Cassim et al *Contemporary Company Law* 53; N Locke “The Approach of the Supreme Court of Appeal to the Enterprise Reality in Company Groups [Discussion of *Consolidated News Agencies (Pty) Ltd (in liquidation) v Mobile Telephone Networks (Pty) Ltd* 2010 (3) SA 382 (SCA)]” (2012) 23 *Stell LR* 476 476.

are concerned not with economics but with law. The distinction between the two is, in law, fundamental and cannot here be bridged.”⁹⁶²

A number of legal principles may, however, result in the company’s shareholders⁹⁶³ either being held accountable for legal acts (ostensibly) performed by the company, or being regarded as the owners of the company assets.⁹⁶⁴ Although all of these principles are commonly described as “piercing the corporate veil”,⁹⁶⁵ not all of them are used exclusively in situations where companies and shareholders are involved.⁹⁶⁶ These include the principles of statutory interpretation, sham and agency,⁹⁶⁷ which have all already been discussed in this study. A few comments are nevertheless made below with regard to these too.

5.7.1 Statutory (purposive) interpretation

Statutory interpretation can result in courts regarding holding and subsidiary companies as one entity.⁹⁶⁸ For example, in *Dimbleby & Sons Ltd. v National Union of Journalists*⁹⁶⁹ the argument was raised that UK legislation should be interpreted to allow for employees of a company to be regarded as employees of another company belonging to the same group of companies. The House of Lords acknowledged that this possibility is in theory possible:

“I do not wholly exclude the possibility that even in the absence of express words stating that in specified circumstances one company, although separately incorporated, is to be treated as sharing the same legal personality of another, a purposive construction of the statute may

⁹⁶² *Bank of Tokyo Ltd. v Karoon and another* [1987] AC 45 64.

⁹⁶³ Another possibility is that its directors may be held liable, but this is not discussed further.

⁹⁶⁴ Not all principles that may play a role to hold a company’s shareholders liable for the acts of the company are addressed in this study. Others may include liability based on a duty of care, as pointed out by R Miles & E Holland “Piercing the Corporate Veil” in E Simpson & M Stewart (eds) *Sham Transactions* (2013) 192 para 11.14. Another possibility is the *actio pauliana*, which is referred to in cases such as *CSARS v Metlika Trading Ltd* (2003) 66 SATC 345, discussed in part 3.5.2.2, and *ITC 1611* (1995) 59 SATC 126, from which is quoted at n 979 below.

⁹⁶⁵ The uncertainty that remains in this area of the law is emphasised by the fact that the authors of one of the most prominent textbooks on South African company law state that this area of the law has “resisted clarity and coherence” and that their views are “therefore tentative”. Blackman et al *Commentary on the Companies Act 4-133* [Revision Service 5, 2008].

⁹⁶⁶ To these are sometimes referred as “quasi-piercing” or “indirect piercing”, although the latter is also used in a different sense, as explained by K Vandekerckhove *Piercing the Corporate Veil: A Transnational Approach* Doctoraatsproefschrift: graad van doctor in de rechten thesis Katholieke Universiteit Leuven (2001) para 29 and see also para 22.

⁹⁶⁷ As discussed in part 5.7.3, when it comes to the use of the expression “agency” in this context, one has to distinguish between it being used to describe the situation where a company acts as an agent in the usual way (see part 3.6) and it being used to convey a basis for disregarding the separate legal existence of a company.

⁹⁶⁸ Cassim et al *Contemporary Company Law* 55.

⁹⁶⁹ *Dimbleby & Sons Ltd. v National Union of Journalists* [1984] 1 W.L.R. 427.

nevertheless lead inexorably to the conclusion that such must have been the intention of Parliament.”⁹⁷⁰

The South African scholar Locke argues that purposive interpretation along the line of the *Ramsay* approach may result in company groups being considered as a unity also outside scenarios concerning tax avoidance. As a result of the application of this approach, acts done by one company in the group may be taken into account when considering the legal position of another company in the group.⁹⁷¹

Although other authors have also recognised the *Ramsay* approach in a number of South African tax cases,⁹⁷² the analysis in part 7.4 shows that there is no strong indication of its existence in South African jurisprudence.

5.7.2 Sham

Another possibility is the existence of a simulation or sham. The distinction between a sham and piercing in the sense mentioned in part 5.7.3 below is not always clear.⁹⁷³ Certainly the terminology is not particularly helpful in this regard. An example of this is *The Shipping Corporation of India Ltd v Evdomon Corporation* case.⁹⁷⁴ In this case, when explaining the basis under which a court will pierce the corporate veil, the court referred to the existence of “an element of fraud or other improper conduct in the establishment or use of the company or the conduct of its affairs” and indicated that “in this connection the words ‘device’, ‘stratagem’, ‘cloak’ and ‘sham’ have been used”.⁹⁷⁵

⁹⁷⁰ 435. In this case the statutory provision was not interpreted in this manner.

⁹⁷¹ Locke (2012) *Stell LR*. She proposes that this is the explanation for the SCA’s finding in *Consolidated News Agencies (Pty) Ltd (in liquidation) v Mobile Telephone Networks (Pty) Ltd* 2010 (3) SA 382 (SCA), where a provision in insolvency legislation was considered. She explains her view with reference to the *Ramsay* approach as follows at 486:

“In my opinion, the court in *CNA* interpreted the [legislative provision] commercially or factually, rather than looking at the legal effects of each of the separate contracts that made up the whole of the arrangements between the parties. Note that the legislation itself must indicate that the concept or result is commercial, which will then warrant the broadening of the consideration to non-legal effects” (footnotes omitted).

Cassim et al *Contemporary Company Law* 52 n 151, on the other hand, regards this case as an example of agency, discussed in the main text in part 5.7.3.

⁹⁷² See n 1325 below.

⁹⁷³ See Cilliers “Anti-Avoidance” in *Silke on International Tax* (2010) para 46.9: “The distinction [between the *plus valet* rule and piercing], assuming there is one...” (emphasis added).

⁹⁷⁴ *The Shipping Corporation of India Ltd v Evdomon Corporation* 1994 (1) SA 550 (A).

⁹⁷⁵ 566. Another word that is often used is that of “façade”. See in this regard Miles & Holland “Piercing the Corporate Veil” in *Sham Transactions* (2013) paras 11.20 and 11.55 and *Faiza Ben Hashem v Abdulhadi Ali Shayif* 2008 WL 5504532 paras [151]-[156].

One has to make the following distinction between shams and piercing: in the case of an argument that the involvement of a company in a transaction is a sham,⁹⁷⁶ the court has to consider as a *question of fact*⁹⁷⁷ whether the parties' real intention was that the company would be involved in the transaction. If a sham is found, it is the apparent transaction rather than the separate legal existence of the company that is disregarded.⁹⁷⁸ On the other hand, if an argument for piercing is made, the court as a *question of law* considers whether the separate existence of the company may be disregarded.

5.7.3 Piercing the corporate veil

When "piercing of the corporate veil" takes place,⁹⁷⁹ the separate existence of the company is disregarded. As a result, the company's assets, activities and liabilities may be regarded as those of its shareholders. It is possible for a company's separate existence to be disregarded in relation to particular transactions, but recognised in the case of others.⁹⁸⁰

Although piercing may be sanctioned by statute,⁹⁸¹ it is also recognised judicially in all the jurisdictions discussed here.⁹⁸² It is beyond the scope of this study to consider the

⁹⁷⁶ It is unlikely that a properly incorporated company can be a "sham". From a South African perspective, s 14(4)(b) of the 2008 Companies Act provides that a registration certificate is "conclusive evidence" that a company is incorporated. See also the following statement by L Linklater, quoted in Blackman et al *Commentary on the Companies Act* 4-137 n 2 [Revision Service 6, 2009]: "These companies are 'not shams in the true sense. They would have passed the blunt test set by Lord Halsbury in *Salomon* – 'either the limited company was a legal entity or it was not'". See also Miles & Holland "Piercing the Corporate Veil" in *Sham Transactions* (2013) paras 11.53 and 11.55. In the UK case of *Faiza Ben Hashem v Abdulhadi Ali Shayif* 2008 WL 5504532 para [157] it was held: "I have some difficulty with the very suggestion that a company, so long as it remains on the register of companies, could ever properly be described as a sham in the Snook sense." The description of a sham in *Snook v London and West Riding Investments Ltd.* [1967] 2 QB 786 is quoted in part 5.4.

⁹⁷⁷ See part 5.4.

⁹⁷⁸ Miles & Holland "Piercing the Corporate Veil" in *Sham Transactions* (2013) para 11.55.

⁹⁷⁹ It is not universally accepted that "piercing of the corporate veil" is a rule in its own right, as explained by Miles & Holland "Piercing the Corporate Veil" in *Sham Transactions* (2013) para 11.03. See also *ITC 1611* (1995) 59 SATC 126 140:

"In our judgment a court can lift the veil only if that is legitimate by the application of established doctrines, such as the *plus valet* rule or the *fraus legis* rule (or in other cases of fraud or dishonesty) or, possibly, the *actio pauliana*, that is if the requirements for such application are present, or a finding of a true relationship of principal and agent. *There is, we consider, no self-standing doctrine of piercing the veil*" (emphasis added).

For purposes of this study it is assumed that piercing is a distinct legal rule. The distinction made between "piercing" and "lifting" of the corporate veil, mentioned by Miles & Holland "Piercing the Corporate Veil" in *Sham Transactions* (2013) para 11.11, is not explored here.

⁹⁸⁰ *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd and others* 1995 (4) SA 790 (A) 804. See also *Faiza Ben Hashem v Abdulhadi Ali Shayif* 2008 WL 5504532 para [164]; Blackman et al *Commentary on the Companies Act* 4-136 [Revision Service 5, 2008]; Cassim et al *Contemporary Company Law* 45.

⁹⁸¹ Examples in South African law include s 65 of the Close Corporation Act 69 of 1984 and s 20(9) of the 2008 Companies Act. It was recently indicated in *Ex Parte Gore* 2013 (3) SA 382 (WCC) that the latter provision does not replace the common-law remedy. The requirements set by this provision are not addressed here.

circumstances in each jurisdiction in which piercing of the corporate veil is allowed.⁹⁸³ Two general observations can, however, be made: piercing is only allowed in rare cases;⁹⁸⁴ and it is a prerequisite that the finances, policies and business practices of a company are dominated by its shareholders (although that will not suffice in itself).⁹⁸⁵

Blackman et al argue that there are two main bases for piercing the corporate veil. The first is the existence of fraud or other improper conduct.⁹⁸⁶ The second basis is that of an “agency” relationship. A company, as a juristic person, can be an agent for its shareholder in the usual way⁹⁸⁷ to receive assets, or act otherwise on behalf of its shareholder.⁹⁸⁸ However, “agency” may also be used in a different sense, to describe another basis for disregarding the separate

⁹⁸² For a somewhat outdated list of some of the scholarly writing in this regard, which includes reference to Canadian and UK law, see Blackman et al *Commentary on the Companies Act* 4-133 n 7 [Revision Service 5, 2008]. The position under Canadian law is also discussed by A Keuler *in Regsvergelykende Studie Aangaande die Leerstuk van Lig van die Korporatiewe Sluier* LLD thesis University of the Free State (2013) ch 6. In respect of the Netherlands Vandekerckhove *Piercing the Corporate Veil: A Transnational Approach* para 19 mentions “identification” (“*vereenzelvinging*”) and “*doorbraak van (de beperkte) aansprakelijkheid*” (but see also her discussion at paras 24-28). See also the description of *vereenzelvinging*” given in *AIC/Rijnmond c.s.* (11 februari 2013) LJN: BZ2307 2013 para 4.7, as well as the discussion of the terminology in this context by Vandekerckhove *Piercing the Corporate Veil: A Transnational Approach* para 73 note 103. L Bergkamp & W Pak “Piercing the Corporate Veil: Shareholder Liability for Corporate Torts” (2001) 8 *Maastricht Journal of European & Comparative Law* 167 175 note 40 regard *vereenzelvinging* as a form of the *alter ego* basis of piercing the corporate veil discussed later in the main text.

⁹⁸³ The nuances are bound to differ from jurisdiction to jurisdiction, as highlighted in the comparison made in *Ex Parte Gore* 2013 (3) SA 382 (WCC) para [27] between the willingness of courts from South Africa and the UK to employ piercing of the corporate veil.

⁹⁸⁴ With regard to the position in South Africa, see Cassim et al *Contemporary Company Law* 50 and Blackman et al *Commentary on the Companies Act* 4-134 [Revision Service 5, 2008]. With reference to the UK, Miles & Holland “Piercing the Corporate Veil” in *Sham Transactions* (2013), after having considered the decision by the UK Supreme Court in *Prest v Petrodel Resources Ltd and others* [2013] 2 A.C. 415, conclude at paras 11.56 and 11.57 that the rule has been “defined out of existence” and that “it is an extremely rare specimen [which] has arguably never been seen in the wild, and, given that it has recently been confined ... it possibly never will be.” With regard to the Netherlands, see Vandekerckhove *Piercing the Corporate Veil: A Transnational Approach* para 75; as well as *AIC/Rijnmond c.s.* (11 februari 2013) LJN: BZ2307 2013 para 4.7 where the court remarked that, with regard to the rule, “*de Hoge Raad is zeer terughoudend in de toepassing*”.

⁹⁸⁵ Blackman et al *Commentary on the Companies Act* 4-134 [Revision Service 5, 2008]. See also *Faiza Ben Hashem v Abdulhadi Ali Shayif* 2008 WL 5504532 para [159], where the court agreed that control was a requirement, but did not suffice on its own.

⁹⁸⁶ For more on the case law on this part of the enquiry, see Blackman et al *Commentary on the Companies Act* 4-139 [Revision Service 6, 2009] - 4-140-2 [Revision Service 6, 2009]. A good example of this in South African law is the decision in *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 (4) SA 790 (A). In that case, the AD found that if fraud, dishonesty or other improper conduct is found to exist, one has to balance the need to preserve a company’s separate corporate identity against policy considerations which arise in favour of piercing the corporate veil. Compare this with the view expressed by Miles & Holland “Piercing the Corporate Veil” in *Sham Transactions* (2013) para 11.56 regarding the state of the rule in UK law following the decision by the Supreme Court in *Prest v Petrodel Resources Ltd* [2013] 2 A.C. 415. They argue that the rule will only apply if the company was interposed deliberately to evade or frustrate an *existing* legal obligation or restriction.

⁹⁸⁷ See the discussion in part 3.6.

⁹⁸⁸ Miles & Holland “Piercing the Corporate Veil” in *Sham Transactions* (2013) para 11.13.

existence of a company.⁹⁸⁹ In a group of companies, a subsidiary may be regarded as the implied “agent” of its holding company,⁹⁹⁰ in the following circumstances:

“This may occur for instance where a director or controlling shareholders do not treat the company as a separate entity, but treat it as if it were merely a means of furthering their own private business affairs. In this instance the company may be regarded as the ‘agent’ or the ‘alter ego’ or ‘instrumentality’ of its directors or controlling shareholders. Since the directors of shareholders manage the company in such a way as not to separate their personal affairs from those of the company, the company does not carry on its own business or affairs, but acts merely to further the business or affairs of its directors or controlling shareholders.”⁹⁹¹

Blackman et al argue that agency in this sense always entails an abuse of the company’s separate existence by attempting to get the advantages of such separate existence without treating the company as having such an existence.⁹⁹² Cassim et al propose that the following factors may be taken into account for this enquiry: the fact that the company is substantially undercapitalised, that formalities regarding the corporate form have not been followed, that substantial salaries or other payments are made to the controlling shareholder but no dividends are paid, that the company profits are treated as profits of the controlling shareholder or director, that the controlling shareholder has siphoned off the company’s funds and that the directors or officers of the company do not function properly.⁹⁹³

If piercing of the corporate veil as understood here is considered in the context of conduit company treaty shopping, the first basis is unlikely to be successful. As Cilliers explains, piercing on this basis is not “commonly or easily applied in a tax avoidance context. This is

⁹⁸⁹ Blackman et al *Commentary on the Companies Act* 4-140-2 [Revision Service 6, 2009]. A similar argument is made by A Hargovan & J Harris “Piercing the Corporate Veil in Canada: A Comparative Analysis” (2007) 28 *Company Lawyer* 58. See the criticism against the use of the term in *Banco de Mocambique v Inter-Science Research and Development Services (Pty) Ltd* 1982 (3) SA 330 (T) 344-345, quoted at n 527 above. It is conceptually problematic to refer to agency as a form of piercing, if by the latter is meant that the company’s legal existence is disregarded: if it is disregarded, it would not be able to act as an “agent”. See also Du Toit *Beneficial Ownership of Royalties* 233; Miles & Holland “Piercing the Corporate Veil” in *Sham Transactions* (2013) para 11.13; Wallis *The Associated Ship* 101 n 89; Cassim et al *Contemporary Company Law* 52 and the case law discussed by Hargovan & Harris (2007) *Company Lawyer* under the heading “Comparative analysis”.

⁹⁹⁰ There is, however, no presumption that a subsidiary is its holding company’s agent. Du Toit *Beneficial Ownership of Royalties* 232; Blackman et al *Commentary on the Companies Act* 4-140-3 [Revision Service 6, 2009].

⁹⁹¹ Cassim et al *Contemporary Company Law* 52 (footnotes omitted).

⁹⁹² Blackman et al *Commentary on the Companies Act* 4-140-2 [Revision Service 6, 2009].

⁹⁹³ Cassim et al *Contemporary Company Law* 52-53. See also the factors proposed by Cilliers et al *Corporate Law* 15.

because the intent to avoid (corporate) taxes *per se* is not only not inherently fraudulent but also cannot broadly be said to defeat public policy.”⁹⁹⁴

The agency basis of piercing of the corporate veil may, however, be more relevant: if a subsidiary is regarded as the *alter ego* of its holding company, the veil may be pierced so that the income of the subsidiary is regarded as the income of the holding company. Under this basis the economic substance of the direct recipient and the extent to which it is under the control of another company or persons (for example, the ultimate recipient) will be considered.

However, piercing of the corporate veil only occurs in rare cases in all the jurisdictions discussed in this chapter and it is not clear whether it can currently be applied in a treaty context, as pointed out in part 5.2.1.

5.8 Conclusion

The answer to the question whether the term “beneficial owner” is to be given a legal or economic meaning is central to this study. This is a question of interpretation and domestic courts are likely to be influenced in their interpretation and application of the beneficial ownership requirement by the manner in which they generally deal with tax avoidance in a domestic context. The proposed amendments to the Commentaries make it clearer that countries may use domestic interpretative approaches aimed at combatting tax avoidance when interpreting DTAs, provided of course that these abide by the Vienna rules.

Courts in Canada, the Netherlands and the UK usually give legal meanings to terms in tax legislation and apply these meanings to the legal substance of the transactions before them. However, in the case of the UK the adoption of the *Ramsay* approach shows that UK courts, when applying domestic tax legislation, are more inclined to give words a non-legal meaning and to consider transactions with regard to their economic substance. Therefore, in the next chapter one will detect in the UK case of *Indofood (CA)*⁹⁹⁵ traces of the *Ramsay* approach. In the Dutch case discussed there, the *Hoge Raad* gave a legal meaning to the term, as is often the case in the Netherlands. Also, if regard is had to the Canadian cases discussed in the next chapter, the tendency to give legal meanings to terms in tax legislation and to consider the legal substance of a transaction, are born out in these cases.

⁹⁹⁴ Cilliers “Anti-Avoidance” in *Silke on International Tax* (2010) para 46.9.

⁹⁹⁵ *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] STC 1195.

Moving away from the interpretation of the term “beneficial owner”, other possibilities exist under which the result may be achieved that a holding company is regarded as the “beneficial owner” of income received by its subsidiary. As part of the interpretation process a court has to determine whether a transaction that is presented to the court is a true reflection of the intention of the parties to that transaction. If it is not, it is a simulation and the court will proceed based on the transaction that reflects the real intention of the parties.

South African courts are familiar with the use of the principle of simulated transactions in cases involving tax avoidance and have developed a strong jurisprudence in this regard. There does not seem to be a reason for disallowing the application of this principle in the context of DTAs. For that reason, one can argue that, if faced with a conduit company treaty shopping structure, South African courts will be prepared to consider whether the various transactions, which comprise the structure, constitute shams. This requires an evaluation of whether the parties subjectively intended to enter into those transactions and to give effect to the transactions according to their terms. Objective factors continue to play a key role in the enquiry. However, the mere fact that the parties entered into the structure to get the treaty benefit of a reduced withholding tax will not result in the structure being regarded as a sham. But considerations such as unusual aspects of the transactions (for example, the direct recipient not making a profit), the fact that multiple agreements were signed on the same date and the fact that the agreements were not executed according to the written terms will also play a role.

Another possibility is the Dutch *fraus legis* rule. The application of the rule in a treaty context is, however, problematic. The Dutch *fiscale kwalificatie* might be more generally accepted in a treaty context, but its application is rare. Neither of these is available in South Africa.

A further possibility, which is available in South Africa, is piercing the corporate veil. The so-called “agency” basis of piercing is especially relevant: if a subsidiary is regarded as the *alter ego* of its holding company, the veil may be pierced so that the income of the subsidiary is regarded as the income of the holding company. Here the economic substance of the subsidiary will play a role. Arguably, piercing of the corporate veil may thus be used to counter entity conduit structures. This measure is, however, only applied in rare cases and there is no strong jurisprudence for applying it in tax avoidance cases. It may also be problematic in a treaty context.

There is no legal basis under South African law for considering any of the factors taken into account under the above anti-avoidance measures when interpreting the beneficial ownership requirement; unless the meaning given to the term requires one to take some of these factors into account, as is the case under the *Ramsay* approach.

Lastly, proposed changes to the Commentaries make it clearer that general *renvoi* clauses can be used to introduce domestic anti-avoidance measures in a treaty context. There is no convincing argument why this may not be the case with regard to the beneficial ownership requirement. One will thus have to evaluate domestic definitions of beneficial ownership on an individual basis and reach a conclusion based on that particular definition.

CHAPTER 6
THE VIEWS OF FOREIGN COURTS ON THE MEANING OF THE TERM
“BENEFICIAL OWNER”

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6.1 Introduction

In this chapter the views of foreign courts in the countries used for comparative purposes on the issues identified in part 1.4 are considered. These issues are firstly, whether the beneficial ownership requirement can be regarded an anti-avoidance rule aimed at combatting conduit company treaty shopping; secondly, whether the term “beneficial owner” should have a legal or an economic meaning; and thirdly, whether the term “beneficial owner” should have the meaning that it has under the domestic law of a treaty country or instead an “international tax law” meaning.

Various cases have dealt with the meaning of the term “beneficial owner” in a treaty context and the list is growing.⁹⁹⁶ For purposes of this study only a few cases have been selected for

⁹⁹⁶ Collier (2011) *BTR* 693. The following contributions each mention a number of the cases dealing with beneficial ownership in DTAs: B Gibert & Y Ouamrane “Beneficial ownership - A French Perspective” (2008) 48 *Euro Tax* 2; Jiménez (2010) *World Tax J*; L Verdoner, R Offermanns & S Huijbregtse “A Cross-Country Perspective on Beneficial Ownership – Part 1” (2010) 50 *Euro Tax* 419; L Verdoner, R Offermanns & S Huijbregtse “A Cross-Country Perspective on Beneficial Ownership – Part 2” (2010) 50 *Euro Tax* 465; J Vleggeert *Abuse of Tax Treaties: a Discussion of Recent Court Cases in Various Countries with Opposite Outcomes* (2010) available at <https://openaccess.leidenuniv.nl/bitstream/handle/1887/37150/Vleggeert%20-%20Abuse%20of%20Tax%20Treaties%20-%20a%20Discussion%20of%20Recent%20Court%20Cases%20in%20Various%20Countries%20with%20Opposite%20Outcomes.pdf?sequence=1> (accessed on 23-05-2017); Collier (2011) *BTR*; P Fekar “Czech Supreme Administrative Court on Beneficial Ownership” (2011) 51 *Euro Tax* 418; MR Jung “Switzerland Trends and Developments in Swiss Anti-Treaty Shopping Legislation and Treaty Shopping Case Law” (2011) 51 *Euro Tax* 230; BJ Arnold “Tax Treaty Case Law News - A Trio of Recent Cases on Beneficial Ownership” (2012) 66 *BFIT* 323; F Avella “Using EU Law To Interpret Undefined Tax Treaty Terms: Article 31(3)(c) of the Vienna Convention on the Law of Treaties and Article 3(2) of the OECD Model Convention” (2012) 4 *World Tax J* 96; L Banfi & F Mantegazza “An Update on the Concept of Beneficial Ownership from an Italian Perspective” (2012) 52 *Euro Tax* 57; T Booker “Denmark Beneficial Ownership” (2013) 53 *Euro Tax* 164 165; LF Castro “Concept of Beneficial Owner in Tax Treaties: Separating the Wheat from the Chaff Through Case Law Method Internationally” (2013) 39 *International Tax Journal* 21; HS Hansen, LE Christensen & AE Pedersen “Danish ‘Beneficial Owner’ Cases – A Status Report” (2013) 67 *BFIT* 192 196; Gooijer (2014) *Intertax*; F Avella “Recent Tax Jurisprudence on the Concept of Beneficial Ownership for Tax Treaty Purposes” (2015) *Euro Tax* 56; J Bundgaard “The Notion of Beneficial Ownership in Danish Tax Law: The Creation of a New Legal Order with Uncertainty as Companion” in M Lang, P Pistone, J Schuch, C Staringer & A Storck (eds) *Beneficial ownership: Recent Trends* (2013) 91 97; Kemmeren “Preface to Articles 10 to 12” in Klaus Vogel (2015) 728-758; Poiret (2016) *Euro Tax*; P Reinartz & F Carelli “Switzerland - Court Rulings on Dividend Stripping and Denial of Swiss Tax Treaty Benefits” (2016) 18 *Derivatives & Financial Instruments* 1; C Garbarino *Judicial Interpretation of Tax Treaties* (2016) 54-60.

an in-depth analysis.⁹⁹⁷ Some of the reasons for this selection were given in part 1.7, but some additional reasons are provided here.

The first case was decided by the Dutch *Hoge Raad* and is known as the “*Market Maker* case”.⁹⁹⁸ This case warrants consideration since it was decided by the highest court in the Netherlands on taxation matters.⁹⁹⁹ It also presents a decision by a court of a civil-law tradition and, as a 1994 case, provides an early “benchmark” against which to evaluate later decisions. Lastly, it is a case that is often mentioned by both scholars¹⁰⁰⁰ and courts¹⁰⁰¹ when discussing beneficial ownership in the context of DTAs.

The second case was decided by courts in the UK in the matter of *Indofood*. The judgment by the CA¹⁰⁰² is noteworthy since it represents a different approach to the legal approach adopted by the Dutch and Canadian cases discussed in this chapter. It arguably provided the motivation for the reconsidering of the 2003 Commentaries, which resulted in the 2014 amendments to the Commentaries.¹⁰⁰³

The next case, which is only briefly considered in this chapter, is the judgment by the *Audiencia Nacional* (“AN”)¹⁰⁰⁴ in *Real Madrid F.C. v Oficina Nacional de Inspeccion* (“*Real Madrid*”).¹⁰⁰⁵ For an analysis of this case a contribution written by the Spanish scholar,

⁹⁹⁷ Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.6 also discuss these judgments (with the exception of the latest Canadian judgment, which postdates their contribution, and the Spanish case). They note that these cases “cover arguably the most relevant examples where beneficial ownership disputes arise, namely the cession of income, backto back loans and intermediate holding companies used as a flow through for dividends.”

⁹⁹⁸ *Decision by the Hoge Raad* (6 April 1994) 28638 BNB 1994/217. At para 3.1.1 the *Hoge Raad* remarked that the taxpayer (a stockbroker) “*is geregistreerd als ‘market maker’ voor onder andere aandele Koninklijke Olie*”. The case is also sometimes referred to as the “Royal Dutch” case, named after the Dutch company that paid the dividends.

⁹⁹⁹ Oliver (2001) *BTR* 33.

¹⁰⁰⁰ Du Toit (2010) *BFIT* 503 maintains that this case remains one of the most “authoritative cases” on the topic.

¹⁰⁰¹ E.g. *Prévost Car Inc. v The Queen* 2008 TCC 231 para [93].

¹⁰⁰² *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] STC 1195. The judgment of the High Court in this matter is reported as *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2005] EWHC 2103 (Ch).

¹⁰⁰³ Baker “United Kingdom: Indofood” in *Beneficial Ownership* (2013) 27.

¹⁰⁰⁴ Jiménez (2010) *World Tax J* 37 n 7 describes this as a “real court of justice”. It is not the highest court on taxation matters in Spain.

¹⁰⁰⁵ *Real Madrid F.C. v Oficina Nacional de Inspeccion* Judgments of the AN of 18 July 2006 (JUR\2006\204307, JUR\2007\8915 and JUR\2007\16549), 10 November 2006 (JUR\2006\284679), 20 July 2006 (JUR\2007\16526), 13 November 2006 (JUR\2006\284618), 26 March 2007 (JUR\2007\101877).

Jiménez,¹⁰⁰⁶ is relied on almost exclusively. This case has been included here since it presents another example of a non-legal meaning given to the term “beneficial owner”.¹⁰⁰⁷

The next two cases were decided by Canadian courts. The first is the judgments of the TCC¹⁰⁰⁸ and FCA¹⁰⁰⁹ in the matter of *Prévost* and the latter is the judgment of the TCC in the matter of *Velcro*.¹⁰¹⁰ As pointed out in part 7.6.3.1.1, South African courts prefer to consider judgments from common-law countries and often refer to judgments by Canadian courts. With regard to the judgment by the TCC in *Prévost*, Li points out that the judge who handed down judgment is a “highly respected tax expert in Canada” and that the decision was “unanimously affirmed by a highly respected panel of appellate judges [in the FCA] known for their tax expertise”.¹⁰¹¹ Furthermore, detailed reasons are given in the judgments for the courts’ conclusions, especially in the two judgments given by the TCC.

6.2 The Market Maker case

6.2.1 Facts and the issue

This case came on appeal from the Court of Appeals of Amsterdam to the *Hoge Raad*¹⁰¹² and has been described as an example of dividend stripping.¹⁰¹³ A stockbroker, a resident of the UK, had purchased dividend coupons but not the underlying shares in Koninklijke Olie, a Dutch resident company. The dividend coupons were purchased from a Luxembourgian company at approximately 80 per cent of the face value of the coupons after the dividends had been declared, but a few days before they were payable. Had this sale not taken place, the Luxembourgian seller of the coupons would have been liable for withholding tax at 25 per cent under the Luxembourg/Netherlands DTA.¹⁰¹⁴ However, under the 1980 Netherlands/UK DTA the withholding tax would amount to only 15 per cent. The issue was whether the stockbroker was the “beneficial owner”¹⁰¹⁵ of the dividend.

¹⁰⁰⁶ Jiménez (2010) *World Tax J*. He also discusses the case in Jiménez “Beneficial Ownership as a Broad Anti-Avoidance Provision” in *Beneficial Ownership: Recent Trends* (2013).

¹⁰⁰⁷ See also the list of cases provided by Wardzynski (2015) *Intertax* 184 in support of a non-legal interpretation.

¹⁰⁰⁸ *Prévost Car Inc. v The Queen* 2008 TCC 231.

¹⁰⁰⁹ *Prévost Car Inc. v Canada* 2009 FCA 57 (CanLII).

¹⁰¹⁰ *Velcro Canada Inc. v the Queen* 2012 TCC 57 (CanLII).

¹⁰¹¹ Li *Beneficial Ownership in Tax Treaties* 204.

¹⁰¹² *Decision by the Hoge Raad* (6 April 1994) 28638 BNB 1994/217.

¹⁰¹³ De Broe *International Tax Planning* 694.

¹⁰¹⁴ 694.

¹⁰¹⁵ Or “*uiteindelijk gerechtigde*” in the Dutch version of the Netherlands/UK DTA.

The Dutch tax authority did not rely on any domestic anti-avoidance measures,¹⁰¹⁶ although the transaction may very well have been entered into to obtain the benefit of the lower withholding rate under the Netherlands/UK DTA.¹⁰¹⁷ It canvassed two arguments for denying the stockbroker beneficial ownership. The first was that it was a requirement that the stockbroker be the owner of the underlying shares. The second was that beneficial ownership is determined when dividends are declared, not at the time when the dividends are made available.

The Court of Appeals held that the stockbroker was not the beneficial owner of the dividends. Amongst other reasons it indicated that it was not convinced that the transaction was not aimed at treaty abuse.¹⁰¹⁸ Smit tentatively suggests that this court applied the anti-abuse method of *zelfstandige fiscale kwalificatie*¹⁰¹⁹ in that it effectively held that the stockbroker did not receive a dividend, but only a commission fee.¹⁰²⁰ He criticises the judgment for going beyond the legal dispute since the Dutch tax authority had not relied on domestic anti-avoidance doctrines in disallowing the reduced withholding rate.¹⁰²¹

6.2.2 Judgment of the *Hoge Raad*

On appeal the *Hoge Raad* did not refer to tax avoidance. It held in favour of the stockbroker and stated that

- a) the stockbroker had become the owner of the dividend coupons;
- b) it could freely dispose¹⁰²² of the dividend coupons;
- c) it could also freely dispose of the dividends once the coupons had been cashed;
- d) when cashing the coupons, it had not been acting as a “*zaakwaarnemer*” or “*lasthebber*”. In Dutch law, these are persons who can act in their own names, but for

¹⁰¹⁶ Smit “Beneficial Ownership in Netherlands Case law” in *Beneficial Ownership* (2013) 68, with reference to paras 8.1 and 8.5 of the *conclusio* given by Advocate General Van Soest in this matter.

¹⁰¹⁷ Du Toit *Beneficial Ownership of Royalties* 153; De Broe *International Tax Planning* 696; Smit “Beneficial Ownership in Netherlands Case law” in *Beneficial Ownership* (2013) 68.

¹⁰¹⁸ See the summary of the CA’s judgment at para 5.5 of the judgment of the *Hoge Raad*.

¹⁰¹⁹ See part 5.6 for a discussion of what *zelfstandige fiscale kwalificatie* entails.

¹⁰²⁰ Smit “Beneficial Ownership in Netherlands Case law” in *Beneficial Ownership* (2013) 73.

¹⁰²¹ 68. See also the “*Achtste middel*” and “*Negende middel*” of the taxpayer’s argument, recorded at para 9 of the judgment of the *Hoge Raad* and para 8 of the *conclusio* of Advocate General Van Soest.

¹⁰²² The Dutch is “kon beschikken”.

account of a principal and are obliged to pay income received in their respective capacities as agent and nominee to the principal.¹⁰²³

Advocate General Van Soest in his *conclusio* (which the court generally followed closely)¹⁰²⁴ also remarked that the stockbroker had taken some risk relating to currency and solvency.¹⁰²⁵ As De Broe explains, the stockbroker's obligation to pay the seller of the coupons was not conditional on it receiving the dividends. In that sense, it thus bore risk.¹⁰²⁶

Relating to the first argument raised by the Dutch tax authority, the *Hoge Raad* accepted that being the owner of the underlying shares was not a requirement for beneficial ownership. With regard to the second argument, the court held that it was irrelevant that the stockbroker only acquired the coupons after the dividends had been declared. Instead, the relevant time for considering beneficial ownership is the time when the dividends are made available.

6.2.3 Comments on the decision of the *Hoge Raad*

6.2.3.1 The choice between a domestic and international meaning

The *Hoge Raad* did not refer to the general *renvoi* clause in the Netherlands/UK DTA.¹⁰²⁷ It also did not discuss whether a meaning for the term “beneficial owner” exists in Dutch law (unless one includes here the references to a “*zaakwaarnemer*” and “*lasthebber*”). A number of authors thus argue that the court adopted a non-domestic meaning,¹⁰²⁸ which is a plausible

¹⁰²³ De Broe *International Tax Planning* 695. Van Weeghel translated this, in his capacity as expert witness in *Prévost Car Inc. v The Queen* 2008 TCC 231 para [43], as “voluntary agent” and “for the account of the principal” respectively. Van Weeghel *The Improper Use of Tax Treaties* 77 defines a “*zaakwaarnemer*” as “a person who takes care of the interests of another person without statutory or contractual arrangement, and such person may, but need not, act in the name of the person whose interest are taken care of”. See also Smit “Beneficial Ownership in Netherlands Case law” in *Beneficial Ownership* (2013) 64 n 11. Van Weeghel *The Improper Use of Tax Treaties* 77 defines “*lasthebber*” as “a person who has agreed with a principal to perform legal acts for the account of the principal and ... may, but need not, act in the name of the principal.” See also Smit “Beneficial Ownership in Netherlands Case law” in *Beneficial Ownership* (2013) 64 n 12. Du Toit *Beneficial Ownership of Royalties* 230, however, cautions that a Dutch “*lasthebber*” may not have the same meaning as an “agent” under common law. The legal position of a stockbroker did not enjoy much attention in the judgment of the *Hoge Raad*. Smit “Beneficial Ownership in Netherlands Case law” in *Beneficial Ownership* (2013) 67 notes that the argument that a stockbroker usually “acts as intermediary on behalf of third parties” was put forward too late and could thus not be dealt with by the *Hoge Raad*.

¹⁰²⁴ Smit “Beneficial Ownership in Netherlands Case law” in *Beneficial Ownership* (2013) 66.

¹⁰²⁵ Para 4.27 of the *conclusio* of Advocate General Van Soest.

¹⁰²⁶ De Broe *International Tax Planning* 696 n 1065. He, however, raises the question whether the fact that the court did not refer to this aspect of the *conclusio* is an indication that the court disagreed with it. What is not clear is whether De Broe's question relates to the relevance of considering risk as a factor, or to the conclusion that the stockbroker bore risk.

¹⁰²⁷ Contained in Art 3(2) of the 1980 Netherlands/UK DTA.

¹⁰²⁸ De Broe *International Tax Planning* 696; Smit “Beneficial Ownership in Netherlands Case law” in *Beneficial Ownership* (2013) 65; Kemmeren “Preface to Articles 10 to 12” in *Klaus Vogel* (2015) 721 m.nr. 32.

argument. One should, however, also note that the court did not refer to the Commentaries or to foreign scholars or courts. (Advocate General Van Soest in his *conclusio* did refer to the 1977 Commentary and to foreign scholars.)¹⁰²⁹

6.2.3.2 The meaning given by the *Hoge Raad*

Du Toit and Hattingh state that the judgment should not be seen as an attempt at a “precise definition”, but that the court instead “listed the factors (ownership attributes)” which lead it to arrive at its decision. They note that “the court focused only on the issue to be decided, that is beneficial ownership, and did not apply any other tests, such as whether the sole reason for the scheme was to obtain a tax benefit.” Furthermore, “the court focused on the rights in respect of the coupons and payment to conclude that the taxpayer was the beneficial owner of the dividends because he could freely deal with both the coupons and payment.”¹⁰³⁰

Although they are thus convinced that the court had considered the “rights” of the direct recipient of the dividends, Van Weeghel points out that it is not altogether clear whether the judgment requires that the freedom to dispose of the dividends must exist in law, or in fact, or in both.¹⁰³¹ He prefers the view that it must exist in law¹⁰³² and is supported in his view by various other commentators.¹⁰³³

There is, however, less convergence on whether the case is authority for the view that a direct recipient who is neither an agent, nor a nominee is necessarily a “beneficial owner”.¹⁰³⁴ The implication is that it would leave no room for a conduit company that is neither of these to be denied beneficial ownership. Van Weeghel argues:

“Thus, if there is an obligation as *zaakwaarner* or *lasthebber* – agent or nominee in the language of the Commentary on the OECD Model Convention – to pay the dividend on to the principal, the owner thereof is not the beneficial owner. If there is no such obligation but

¹⁰²⁹ E.g. at paras 4.6, 4.11, 4.12 and 4.16.

¹⁰³⁰ Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.6.1.

¹⁰³¹ Van Weeghel *The Improper Use of Tax Treaties* 76-77.

¹⁰³² 77.

¹⁰³³ Du Toit *Beneficial Ownership of Royalties* 152-153; De Broe *International Tax Planning* 696; Peters & Roelofsen “Tax Avoidance - Netherlands” in *Cahiers Vol. 95a* (2010) 568; Smit “Beneficial Ownership in Netherlands Case law” in *Beneficial Ownership* (2013) 65-66.

¹⁰³⁴ See the discussion of some of the scholarly writings in this regard by Smit “Beneficial Ownership in Netherlands Case law” in *Beneficial Ownership* (2013) 66-67. It is clear from the statement of the Dutch scholar Van Weeghel, quoted next in the main text, that he regards a “*zaakwaarner*” and “*lasthebber*” as agents and nominees.

merely an obligation as debtor in a back-to-back situation, the owner of the dividend is also the beneficial owner thereof.”¹⁰³⁵

However, it is difficult to make deductions from the case with regard to conduit company treaty shopping. This is because the *Hoge Raad* did not address the potential impact of a tax avoidance purpose in this case. In addition, it made no mention of the existence of a pre-existing arrangement in terms of which the dividends received (or a portion thereof) were to be paid to another.¹⁰³⁶ A number of scholars have thus argued that, in the case of back-to-back arrangements, the judgment may not provide good authority for the view that beneficial ownership will only be denied in the case of the direct recipient being an agent or nominee. Pijl is one such author and quotes the following statement from Vleggeert in support of his view:

“It seems that the Supreme Court exclude not only the agent and the nominee from the benefits of the treaty, but also the taxpayer who is not entitled to freely dispose of the dividend coupons *and*, after having cashed them, of the dividends distributed. It seems that, in stating this, the Supreme Court concurs with the Fiscal Committee of the OECD in that situations which resemble agencies or nominees are also to be counteracted through the beneficial ownership test.”¹⁰³⁷

Du Toit also notes:

“The above [*Market Maker*] case is often referred to by commentators when discussing conduit entities. Van Brunschot comments that the decision by the *Hoge Raad* negates the view of the Underminister ... that a person cannot be considered the beneficial owner if he is, for example, contractually obliged to pay the largest part of the income to third parties ... [I]n this case (on the information available) there was no legal obligation on the stockbroker to pay on the distribution received to his creditor. This can therefore not be seen as a decision providing unqualified sanctioning for the use of conduit entities in situations where there is a legal obligation on the conduit entity to pay on the distributions received.”¹⁰³⁸

Smit shares the view that the case leaves open the possibility that a recipient of a dividend may be disqualified from being a beneficial owner despite not being either a

¹⁰³⁵ Van Weeghel *The Improper Use of Tax Treaties* 77.

¹⁰³⁶ Although, as Du Toit *Beneficial Ownership of Royalties* 222 points out, it is probable that the stockbroker used the cashed dividend to pay for the purchase of the coupons.

¹⁰³⁷ Pijl (2000) *BFIT* 258 n 14.

¹⁰³⁸ Du Toit *Beneficial Ownership of Royalties* 153-154 (footnotes omitted).

“zaakwaarnemer” or “lasthebber”. He further argues that this will only be the case if the recipient is legally obliged to pass on “the individual receipts”.¹⁰³⁹

It should be noted that in *Prévost Car Inc. v The Queen* (“*Prévost (TCC)*”),¹⁰⁴⁰ discussed in part 6.5, the TCC also accepted that the implication of the *Hoge Raad* decision is to consider whether a contractual (rather than “factual”) obligation exists. In the Canadian case, however, the TCC seemed to accept the possibility that beneficial ownership will be denied if there is a contractual obligation to pass on only a portion (and not all) of the income received.¹⁰⁴¹

6.3 Indofood

The UK High Court of Justice (Chancery Division)¹⁰⁴² and the CA (Civil Division) heard the case discussed next.¹⁰⁴³ The House of Lords (since restructured as the Supreme Court), the UK’s highest court on tax matters, heard no appeal in this matter.

6.3.1 Facts and issues

The case involved an Indonesian company, PT Indofood Sukses Makmur TBK (“ParentCo”), which wanted to raise capital by issuing loan notes on the international market. Since that would have attracted 20 per cent withholding tax on interest in Indonesia, a Mauritian subsidiary (“the Issuer”) instead issued the notes. The Issuer on-lent the money so raised to ParentCo at substantially the same terms. The benefit of doing this was that the withholding tax was reduced to 10 per cent under the Indonesia/Mauritius DTA. According to the various signed documents, ParentCo was liable to pay interest to the Issuer. The Issuer was then obliged, on the following day, to pay interest to the defendant, as the paying agent of the noteholders. It later transpired, however, that the Issuer was in reality bypassed and that ParentCo made its interest payments directly to the defendant.

A condition of the notes was that they could be redeemed before the agreed date if a change in Indonesian law resulted in the withholding rate increasing above 10 per cent. This was subject to the Issuer not being able to avoid this step, despite having taken “reasonable

¹⁰³⁹ Smit “Beneficial Ownership in Netherlands Case law” in *Beneficial Ownership* (2013) 67-68.

¹⁰⁴⁰ *Prévost Car Inc. v The Queen* 2008 TCC 231.

¹⁰⁴¹ Para [93]. The court is, however, not very clear on this since it refers to the views of the Dutch Underminister and the *Hoge Raad* in the same breath, as if there is no distinction between the two. See Van Burnshot’s contrary view, referred to by Du Toit *Beneficial Ownership of Royalties* 154 and quoted in the main text corresponding to n 1038 above.

¹⁰⁴² *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2005] EWHC 2103 (Ch).

¹⁰⁴³ *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] STC 1195.

measures”. Sometime later, the Indonesia/Mauritius DTA was terminated and the Issuer gave notice to the defendant that the notes would be redeemed early. The defendant, however, refused to accept this, arguing that the Issuer could still take reasonable measures to avoid early redemption. One such measure was that a company (“Newco”) be incorporated in the Netherlands. The Issuer would assign the benefit of the loan agreement between the Issuer and ParentCo to Newco. ParentCo would then pay interest to Newco, which in turn would pay the Issuer. The defendant argued that this would result in the withholding tax being reduced to 10 per cent under the Indonesia/Netherlands DTA.

The applicable provision in the Indonesia/Mauritius DTA, Article 11, contained the beneficial ownership requirement and the Indonesian tax authority was consulted on the question whether Newco would meet this requirement in respect of the interest received from ParentCo. The Indonesian tax authority expressed the view that Newco would not meet the requirement since its insertion would amount to treaty shopping. The Indonesian tax authority argued that this was an abuse of the treaty and thus fell outside the objective of the DTA as evidenced by its title.¹⁰⁴⁴ It also stated as follows:

“In accordance with the principle of Indonesian Income Tax Law which is ‘substance over form’, and also in accordance with OECD and UN Commentary on [the] Model Tax Convention, the term beneficial owner which has been set as one eligibility requirements [sic] for the application of withholding tax rate on interest specified in the treaty is an *anti abusive rule* intended to limit the accession to the benefits provided by the treaty to only those who have the actual rights for such entitlement. Therefore, the term ‘*beneficial owner*’ means the *actual owner of the interest income who truly has the full right to enjoy directly the benefits of that interest income*. Consequently, [a] *conduit company* and *nominee* such as the NewCo will not be regarded as the actual owner of the income.”¹⁰⁴⁵

The Indonesian tax authority subsequently issued a circular, in which it indicated that a “beneficial owner” was the person with the “full privilege to directly benefit from the income”.¹⁰⁴⁶

Having reached a stalemate, the parties took their disagreement to the UK judicial system.¹⁰⁴⁷

In this manner, it transpired that “a common-law non-tax court was asked to interpret, as if it

¹⁰⁴⁴ The title of the Indonesia/Netherlands DTA stated that the purpose of the DTA is “for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income”.

¹⁰⁴⁵ *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2005] EWHC 2103 (Ch) para 26 (emphasis added).

¹⁰⁴⁶ *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] STC 1195 para 19.

were a civil-law tax court, a common-law non-tax concept contained in a tax treaty concluded between two civil-law countries.”¹⁰⁴⁸

6.3.2 Judgment of the High Court

In the High Court Justice Evans-Lombe stated that it was common ground that whether or not the insertion of Newco would constitute a reasonable measure would depend, among other considerations, on whether the Indonesian tax authority and tax court would regard Newco as the “beneficial owner” of the interest.¹⁰⁴⁹ The court also noted that it was accepted by the parties that the Indonesian tax authority would be guided by the Commentary as well as non-official commentaries. The latter included those of Phillip Baker, whose commentary was referred to by both parties before the court.¹⁰⁵⁰ Expert witnesses on both Indonesian and Dutch law were also heard.¹⁰⁵¹

Justice Evans-Lombe, having taken note of Baker’s commentary¹⁰⁵² and the Conduit Report,¹⁰⁵³ noted that “where those words [‘beneficial owner’] are being applied to a set of facts which render their application ambiguous it must follow that a construction should be placed on them which denies the benefit of double taxation relief to an applicant who can be characterised as ‘*treaty shopping*’.”¹⁰⁵⁴ The court also indicated that it was clear that both the original and the proposed transaction amounted to treaty shopping.¹⁰⁵⁵

The court referred to the Conduit Report¹⁰⁵⁶ and also, indirectly, to the 2003 Commentary.¹⁰⁵⁷ It indicated that the Issuer’s expert witness had accepted that the Indonesian tax authority and its tax court would use the “international construction” for beneficial ownership.¹⁰⁵⁸ That expert had also accepted that not all conduit companies would be disqualified from being beneficial owners, a point reinforced by the Commentary.¹⁰⁵⁹ As to the Indonesian tax authority’s explanation that Newco would fail the beneficial ownership requirement because

¹⁰⁴⁷ This is due to the fact that the agreements stated that English law would apply.

¹⁰⁴⁸ Kandeve (2007) *Can Tax J* 50.

¹⁰⁴⁹ *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2005] EWHC 2103 (Ch) para 23.

¹⁰⁵⁰ Paras 16 and 40.

¹⁰⁵¹ Para 30.

¹⁰⁵² According to this contribution, as quoted by the court, the beneficial ownership requirement was added to prevent treaty abuse by way of treaty shopping.

¹⁰⁵³ Paras 40-41. See also paras 45 and 48.

¹⁰⁵⁴ Para 42 (italics in the original).

¹⁰⁵⁵ Para 42.

¹⁰⁵⁶ Para 41.

¹⁰⁵⁷ Para 45, where the court referred to Baker’s discussion of the 2003 Commentary.

¹⁰⁵⁸ Para 43.

¹⁰⁵⁹ Paras 43 and 45.

it would not have “the full right to enjoy directly the benefits of th[e] interest income”, Justice Evans-Lombe stated that he did not understand this explanation.¹⁰⁶⁰

Referencing the wording of the 2003 Commentary, the court held that the Issuer (and Newco) was not a nominee, agent, trustee or fiduciary and, as such, “will have power to dispose of the interest when received as it wishes, although it will be constrained by its contractual obligation to the issuer to apply the proceeds of the interest payments in performance of those obligations.”¹⁰⁶¹

In conclusion, the court held that:

- a) the “beneficial owner of interest received under a loan transaction must be the lender”, which, in this case, would be Newco;¹⁰⁶²
- b) there was no indication that Newco held the interest as nominee or administrator for either the Issuer (since Newco’s only obligation towards the Issuer was that of indemnification) or the noteholders (since they had no claim against Newco);¹⁰⁶³
- c) there was no trust or other fiduciary relationship between Newco and the Issuer, as evidenced by the fact that, should Newco be liquidated, any undistributed interest which it had received from ParentCo would be available for distribution amongst Newco’s creditors;¹⁰⁶⁴
- d) Newco was not the trustee on behalf of ParentCo since the noteholders could also not claim against ParentCo;¹⁰⁶⁵
- e) there had to be a person who would be the “beneficial owner” of the interest, with Newco being the “only candidate”. Newco’s position was stronger than that of the Issuer (which the Indonesian tax authority was prepared to accept as the beneficial owner),¹⁰⁶⁶ since it, Newco, would be entitled to an interest spread.¹⁰⁶⁷ (However, by

¹⁰⁶⁰ Para 43. The court was referring here to the letter written by the Indonesian tax authority, quoted in the main text corresponding to n 1045 above.

¹⁰⁶¹ Para 46.

¹⁰⁶² Para 49.

¹⁰⁶³ Para 49.

¹⁰⁶⁴ Para 49. The court was guided in its approach by Baker’s insolvency test, mentioned in part 3.6.

¹⁰⁶⁵ Para 49.

¹⁰⁶⁶ Para 44. Lord Justice Chadwick in the CA especially criticised this aspect of the High Court’s judgment.

¹⁰⁶⁷ *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2005] EWHC 2103 (Ch) para 49.

the time that the CA considered the transaction, it transpired that Newco would not be entitled to such a spread, but would instead receive a handling charge of sorts.)¹⁰⁶⁸

6.3.3 Judgment of the CA (as delivered by the Chancellor, Sir Andrew Morrit)

On appeal from the High Court, the CA held that the issues before it fell into two categories: firstly, whether the restructuring of the transaction would reduce the withholding tax to 10 per cent or less. This issue related to the interpretation and application of the Indonesia/Netherlands DTA.¹⁰⁶⁹ If the answer to this was positive, the second issue arose, namely whether it would be a “reasonable measure” to adopt. This issue took into account the legal and commercial risks involved in undertaking the proposed transaction.¹⁰⁷⁰

The court noted the following matters that were common ground between the expert witnesses led by the respective parties:¹⁰⁷¹

- a) The Indonesia/Netherlands DTA must be interpreted in accordance with Article 31 of the VCLT.
- a) The DTA has to be interpreted having regard to “substance over form”, as required by the law of Indonesia. What this means, was not elaborated on, except to record that there is “no free-standing principle of Indonesian law which requires an advantage apparently obtained under a tax avoidance scheme to be denied to a participant in that scheme, though the existence of a tax avoidance scheme may be relevant to questions of legislative interpretation.” The question whether this “substance over form” measure can be applied in a treaty context was not addressed (although one has to assume that it can, otherwise it would not have been mentioned).
- b) Indonesian courts would have regard to the Commentaries, non-official commentaries on the OECD model (such as those by Baker) and relevant circulars issued by the Indonesian tax authority (such as the circular referred to earlier).¹⁰⁷²
- c) Indonesian law is based on civil law and there is no decision by an Indonesian court on any of the points that arose in the case.¹⁰⁷³

¹⁰⁶⁸ *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] STC 1195 paras 16 and 40. Jiménez (2010) *World Tax J* 45 argues that such a spread would only have been justifiable if Newco had assumed risk.

¹⁰⁶⁹ *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] STC 1195 para 6.

¹⁰⁷⁰ Paras 6 and 27.

¹⁰⁷¹ Para 24.

¹⁰⁷² See the main text corresponding to n 1046 above.

Regarding the meaning of the term “beneficial owner”, the UK court indicated that the Commentaries make it clear that an “international fiscal meaning” for the term “beneficial owner” must be adopted.¹⁰⁷⁴ The court also noted that receiver of income can be denied beneficial ownership even if it is not a trustee, agent or nominee; and also if someone else does not have an entitlement to security over, or right to call for, the income. The CA indicated that the Commentaries also make it clear that a beneficial owner cannot be “the formal owner who does not have ‘the full privilege to directly benefit from the income’”. Lastly, the court noted that this phrase is quoted directly from the above-mentioned circular distributed by the Indonesian tax authority, which it thought was “entirely consistent” with the Commentaries and the Conduit Report.¹⁰⁷⁵

Applied to the facts the court held that the “legal, commercial and practical structure” pointed towards Newco (and the Issuer, for similar reasons) not being entitled to the full benefit of the interest. The court provided the following reasons:

- a) From a reading of the documents it appears that Newco would not be allowed to source the money payable to the noteholders from any source other than the payments from ParentCo.¹⁰⁷⁶ As a result, it was inevitable that Newco would pay all amounts received from ParentCo to the Issuer.
- b) The meaning of “beneficial owner” is, however, not limited “by so technical and legal an approach” and regard must be had to the “substance” of the matter. In “commercial and practical terms” Newco had to pay onwards to the defendant what it had received from ParentCo. This is evidenced by the fact that in the past ParentCo had directly paid the interest to the defendant. The only “benefit” which Newco could arrive, was to enable it to fulfil its liability to the Issuer and it was thus merely “an administrator” of the income.¹⁰⁷⁷
- c) This conclusion is in line with the purpose and object of the Indonesia/Netherlands DTA, as evidenced by its title, as well as the fact that the DTA has as object the encouragement of long-term foreign loans. This was evidenced by another provision in

¹⁰⁷³ Although Indonesian courts are in any event not subject to *stare decisis*, as noted by the CA.

¹⁰⁷⁴ The court noted that this is also Baker’s view of the Commentaries.

¹⁰⁷⁵ Paras 42 and 49.

¹⁰⁷⁶ Para 43. However, Baker “United Kingdom: Indofood” in *Beneficial Ownership* (2013) 28 n 2 and 31 notes that this reading of the documentation is open for interpretation.

¹⁰⁷⁷ *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] STC 1195 para 44.

the interest article of the DTA. None of these objects would be met by giving tax relief in the specific circumstances.¹⁰⁷⁸

The court concluded on this issue by stating that, if it had “overstated the certainty” of its view, it would in any event not be a “reasonable measure” in the circumstances.¹⁰⁷⁹

6.3.4 Comments on the judgments in *Indofood*

6.3.4.1 The choice between a domestic and international meaning

Both courts indicated that an “international fiscal meaning” should be adopted. In the CA this was based on its reading of the 2003 Commentaries (and Baker’s view of the Commentaries). Although the case is clearly authority for the argument that an “international fiscal meaning” be adopted,¹⁰⁸⁰ the weight of this authority is suspect, for the reasons provided below.

In the High Court it was noted that the Issuer’s expert witness had accepted that the Indonesian tax authorities and its tax court would use an international meaning and the court accepted this without further comment. Neither court attempted to reconcile this view with the general *renvoi* clause in the Indonesia/Netherlands DTA.¹⁰⁸¹ Fraser and Oliver attribute this acceptance of an international meaning, at least to some extent, to the fact that both the Netherlands and Indonesia are civil-law countries (which usually do not have a domestic meaning for the term).¹⁰⁸²

Furthermore, it is argued elsewhere¹⁰⁸³ that possible sources of an international meaning include case law, writings of scholars and the Commentaries. However, both courts referred only to one (highly regarded, but still British) commentator, the Commentaries and the Conduit Report. No foreign case law (such as the *Market Maker* case) was considered.¹⁰⁸⁴ That case would have been especially relevant in light of the goal of common

¹⁰⁷⁸ Para 45.

¹⁰⁷⁹ Para 48.

¹⁰⁸⁰ Baker “‘Beneficial Ownership’ as Applied to Dividends” in *Taxation of Intercompany Dividends* (2012) 96; Baker “United Kingdom: Indofood” in *Beneficial Ownership* (2013) 31.

¹⁰⁸¹ Art 3(2) of the Indonesia/Netherlands DTA and see also Art 3(2) of the Indonesia/Mauritius treaty, the termination of which was the catalyst in this case.

¹⁰⁸² R Fraser & JDB Oliver “Treaty Shopping and Beneficial Ownership: Indofood International Finance Ltd v JP Morgan Chase Bank NA London Branch” (2006) *BTR* 422 427. See also Li *Beneficial Ownership in Tax Treaties* 205.

¹⁰⁸³ Parts 4.2 and 4.3.2.

¹⁰⁸⁴ See also Fraser & Oliver (2006) *BTR* 428 n 21.

interpretation,¹⁰⁸⁵ considering the fact that Netherlands was party to the DTAs considered in both the *Market Maker* and in the *Indofood* cases.¹⁰⁸⁶

With regard to the judgment by the CA, it was at pains to state that the international tax meaning was also in line with the meaning given by the Indonesian tax authority. One can ask why, if an “international fiscal meaning” is to apply, the interpretation given by the Indonesian tax authority is relevant.¹⁰⁸⁷ Perhaps it is explicable in light of the following: firstly, it was common ground between the parties that an Indonesian court would consider the Indonesian circular in which the Indonesian tax authority’s view is expressed; secondly, the CA thought that the interpretation of the Indonesian tax authority was in line with the international meaning, thus obviating the need for the court to choose between the two.¹⁰⁸⁸ Possibly, however, the explanation lies in the fact that, despite the split of issues by the CA,¹⁰⁸⁹ the real issue in this case was not whether Newco would, in fact, be the beneficial owner of the interest. Rather it was whether the insertion of Newco could be considered a “reasonable measure”. In such an enquiry the view of the state institution responsible for the administration of the withholding tax on interest is, indeed, very relevant, bearing in mind the real potential for a drawn-out legal dispute.

6.3.4.2 The role of the Commentaries

Regarding the courts’ reliance on the Commentaries, Kandev points out that Indonesia is not an OECD member country, yet nothing is made of this in the judgments.¹⁰⁹⁰ One should,

¹⁰⁸⁵ Discussed in part 4.2.

¹⁰⁸⁶ De Broe *International Tax Planning* 713 argues that the CA should have referred to the views of the Dutch tax authorities on “beneficial ownership”.

¹⁰⁸⁷ See also Kandev (2007) *Can Tax J* 50. This aspect of the judgment also raises another issue, i.e. whether, under the VCLT, reliance can be placed on unilateral views expressed by the revenue authority of one of the treaty parties. For a discussion of this topic from a South African perspective, refer to Du Plessis (2016) *TSAR* 495-497.

¹⁰⁸⁸ Baker “United Kingdom: Indofood” in *Beneficial Ownership* (2013) 32. However, Vleggeert *Abuse of Tax Treaties* heading 3.3 argues that the meaning given by the court does not appear in the 2003 Commentaries.

¹⁰⁸⁹ By splitting the issues before it into two, as explained in part 6.3.3, it became necessary for the CA to decide whether Newco would be the “beneficial owner” of the interest under Indonesian law (which included the Indonesian/Netherlands DTA). This splitting, however, seems unnecessary. Arguably, it would have sufficed had it simply enquired whether the insertion of Newco could be regarded as a “reasonable measure”. Such an enquiry includes reference to commercial considerations. (For example, a high risk of prolonged legal proceedings would count against a measure being considered “reasonable”.) In this case, the risk was high since the Indonesian tax authority had already been approached on this question and expressed the view that Newco would not be a “beneficial owner”. P Baker *Beneficial ownership: After Indofood* (2007) available at http://taxbar.com/wp-content/uploads/2016/01/Beneficial_Ownership_PB.pdf (accessed on 3-11-2016) 22.

¹⁰⁹⁰ Kandev (2007) *Can Tax J* 50, although this fact was noted at *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2005] EWHC 2103 (Ch) para 15.

however, take into account that it was recorded to be common ground between the parties that an Indonesian court would consider the Commentaries.

It is also noteworthy that the courts referred to the version of the Commentary as amended in 2003, that is *after* the Indonesia/Netherlands DTA had been concluded. Yet this is not mentioned in the judgment.¹⁰⁹¹ Nor is anything said regarding the role of the Commentaries (or the Conduit Report) within the VCLT, although the reference in the CA's judgment to the Vienna rules presumably supposes that the court thought that reference to the Commentaries was permitted under the VCLT.¹⁰⁹²

6.3.4.3 “Substance over form”

A question that has been raised with regard to the judgment by the CA is to what extent the “substance over form” principle in Indonesian law played a role in the decision. The argument is that, if it played a central role, the instructive value of the decision in *Indofood (CA)* will be less in countries that do not subscribe to such an approach. Fraser and Oliver argue:

“[W]hile there was no free-standing principle of Indonesian law which requires an advantage apparently obtained under a tax avoidance scheme to be denied to someone participating in the scheme, the existence of a tax avoidance scheme may be relevant in Indonesia to questions of legislative interpretation and the Indonesia/Netherlands DTA. Moreover, Indonesian law would require the Indonesia/Netherlands DTA to be construed on a substance over form basis. By contrast UK tax law does not apply a substance over form approach and the explicit statements of the UK courts on legislative interpretation do not support the proposition that the [non]-existence of a tax avoidance scheme should alter the interpretation.”¹⁰⁹³

¹⁰⁹¹ See the discussion in part 4.4.2. See also the criticism against this aspect of the judgments by Fraser & Oliver (2006) *BTR* 426 and R Fraser & JDB Oliver “Beneficial Ownership: HMRC’s Draft Guidance on Interpretation of the Indofood Decision” (2007) *BTR* 39 45-46.

¹⁰⁹² The CA only referred to Art 31 of the VCLT and not also to Art 32. It is unlikely that this, without further discussion, is an indication that the court thought that the Commentaries fall within the ambit of Art 31 rather than Art 32. See the debate in part 4.4.1.

¹⁰⁹³ Fraser & Oliver (2006) *BTR* 426; Fraser & Oliver (2007) *BTR* 46 n 32.

However, before considering the role that “substance over form” played, it is important to establish what the expression means here. The expression “substance over form” is commonly used in a number of ways. It may be used to describe the relationship between the text used in tax legislation (“its form”) and its purpose (“substance”). Kandeve explains:

“Systems of interpretation diverge significantly on the fundamental point of what should be the appropriate balance between *form* (language, text) and *substance* (intention, purpose). This results in a multiplicity of systems of interpretation in law and, thus, a variety of possible meanings for the legal text in question.”¹⁰⁹⁴

In the second place, it can also be used to describe the relationship between the legal rights created by parties to a transaction and the “economic substance” thereof. In some jurisdictions a divergence between these two may result in the court applying the tax legislation to the economic substance rather than the legal rights; in other words, an “economic substance over form” approach is followed.¹⁰⁹⁵

In the third place, it can be used to contrast the legal rights that parties have *apparently* created with the legal rights that they have *actually* created, i.e. the “legal substance”.¹⁰⁹⁶ In such a case a “legal substance over form” approach, in the sense of the simulation principle discussed in part 5.4, is followed.

In conclusion it can be said that the expression “substance over form” is commonly used in connection with all of the anti-avoidance measures discussed in the previous chapter:¹⁰⁹⁷ an approach to statutory interpretation that gives a prominent role to the purpose of the legislative provision (including the *Ramsay* approach);¹⁰⁹⁸ simulated transactions;¹⁰⁹⁹ the Dutch *fraus legis* rule,¹¹⁰⁰ the Dutch *fiscale kwalificatie* measure¹¹⁰¹ and piercing of the corporate veil.¹¹⁰²

¹⁰⁹⁴ Kandeve (2007) *Can Tax J* 35 (emphasis added, footnotes omitted).

¹⁰⁹⁵ Arnold (2004) *Can Tax J* 504.

¹⁰⁹⁶ Zimmer “Form and Substance - General Report” in *Cahiers Vol. 87a* (2002) 23.

¹⁰⁹⁷ See, generally, D Clegg “Substance and Form” (1991) *Tax Planning* 33; Ballard & Davison “Form and Substance - UK” in *Cahiers Vol. 87a* (2002) 570; Swanepoel *Subjektiveitsvraagstukke* 138-141; Cilliers “Anti-Avoidance” in *Silke on International Tax* (2010) para 46.6.

¹⁰⁹⁸ Oguttu *Offshore Tax Avoidance* 105 uses the expression in this manner.

¹⁰⁹⁹ Hutchison & Hutchison (2014) *SALJ* 70 confirm this use of the expression and see also Zimmer “Form and Substance - General Report” in *Cahiers Vol. 87a* (2002) 25 and 30.

¹¹⁰⁰ Peters & Roelofsen “Tax Avoidance - Netherlands” in *Cahiers Vol. 95a* (2010) 553.

¹¹⁰¹ Smit “Beneficial Ownership in Netherlands Case law” in *Beneficial Ownership* (2013) 72.

¹¹⁰² See the following explanation of “piercing of the corporate veil” given by Cassim et al *Contemporary Company Law* 41:

Turning to the use of the expression in *Indofood (CA)*, one possibility is that it refers to the legal substance of a transaction not being in accordance with its form; in other words, to a simulation or sham. It will be recalled that the CA made a point of stating that under the original transaction, ParentCo paid the interest directly to the defendant, contrary to the written terms of the agreements. Not executing a contract according to its terms is a consideration that often plays a role in deciding whether a transaction is a sham. In addition, unusual elements (such as Newco not being entitled to an interest spread) is also a relevant consideration in such an enquiry.¹¹⁰³

One may add here that Jiménez argues in respect of this case that “a recharacterization of the legal relations or the analysis inherent to simulation cases is enough to conclude that what the parties are saying (income can be attributed to the ‘intermediary’) is different from what they in fact do (there is an agency-administration relationship rather than a legal entitlement of the intermediary to the income).”¹¹⁰⁴ However, it is unlikely that sham (or the label principle) could have been used in this case. Such an analysis requires one to establish the subjective intention of the parties to the transaction. This cannot be done in the abstract, where no transaction has as yet been entered into, which was what happened in this case with regard to the proposed insertion of Newco.

It is equally clear that sham was not, in fact, applied.¹¹⁰⁵ Therefore, one has to evaluate the *Indofood* decision by accepting that Newco *was* legally the owner of the income and not an

“Metaphorically, once a company is formed, a veil ... is drawn between the company and its shareholders and directors, which separates the company from [them]... When the corporate veil is pierced, the protection afforded to the shareholders and directors is removed and *the substance of the company is examined, rather than the form in which it has been cast*” (emphasis added).

¹¹⁰³ As discussed in part 5.4.

¹¹⁰⁴ Jiménez (2010) *World Tax J* 51. He thus argues at 45, 46 and 51 that the CA could have stuck to such a legal analysis and that there was no need to carry out an economic analysis. It should be noted, however, that the High Court only carried out a legal analysis and nevertheless reached the conclusion that Newco *was* the legal owner of the interest and not merely an agent or nominee. Of course, that could be explained by the High Court interpreting the applicable documentation differently.

¹¹⁰⁵ Clearly, this is also the view of Fraser and Oliver (as expressed in the quote in the main text corresponding to n 1093 above) since sham *does* form part of UK law. See also Jezi (2010) *BFIT* 255 and the reference to the *plus valet* rule by Cilliers “Anti-Avoidance” in *Silke on International Tax* (2010) para 46.39. Note further the latter’s argument that the “consideration that a person has no choice but to use money received from his debtors in order to pay his creditors has, in the absence of extraneous factors pointing to a different conclusion, no bearing on the genuineness of his entitlement to the relevant income flows – even if, it is submitted, ‘entitlement’ is given an economic rather than a strictly legal interpretation.”

agent.¹¹⁰⁶ One thus also has to accept that “substance” in this case does not refer to legal substance.

Another possibility is that the expression “substance over form” refers to an anti-avoidance rule under Indonesian law that would allow it to tax the transaction according to its economic substance. Civil-law jurisdictions commonly use measures such as abuse of form, abuse of law or *fraus legis* to combat tax avoidance.¹¹⁰⁷ However, it seems unlikely that the court had any of these (to the extent that they are stand-alone rules) in mind. After all, the CA indicated that there was no freestanding principle of Indonesian law which requires an advantage apparently obtained under a tax avoidance scheme to be denied to a taxpayer. For this reason, piercing of the corporate veil in the sense discussed in part 5.7 is also an improbable possibility.

The most likely explanation is thus that the UK court referred to the manner in which an Indonesian court would interpret the term. In particular, the CA indicated that, when considering a transaction, an Indonesian court may be more likely to analyse the transaction based on the economic substance of the transaction. Possibly one of the factors, which may lead to the Indonesian court doing such an analysis, is if the transactions do not make business sense (other than tax avoidance).¹¹⁰⁸ In this regard, it thus shows some similarity with the *Ramsay* approach (although insufficient information is provided to compare the two).

The implication of this conclusion is that the instructive value of the decision in *Indofood (CA)* is potentially of wide application, depending on whether courts in a particular jurisdiction may subscribe to a similar interpretation approach. It is also noteworthy that the CA apparently thought that the “substance over form” interpretative approach prescribed under Indonesian law was in line with the Vienna rules.

¹¹⁰⁶ Also note the manner in which the TCC in *Prévost Car Inc. v The Queen* 2008 TCC 231 para [93] understands the CA judgment: “In *Indofood*, the Court of Appeal did not base its reasoning on contractual obligation to forward the interest, but rather whether the recipient enjoyed the ‘full privilege’ of the interest or if it was simply an ‘administrator of income’.”

¹¹⁰⁷ Part 5.5.

¹¹⁰⁸ That is possibly what was meant by the statement that “the existence of a tax avoidance scheme may be relevant to questions of legislative interpretation” in Indonesian law.

6.3.4.4 The meanings given by the High Court and Court of Appeal

The CA held that a beneficial owner must have the “full privilege to directly benefit from the income”. What “full privilege” and “benefit” mean, was not elaborated on. This is unfortunate,¹¹⁰⁹ bearing in mind that the High Court stated that it did not understand the comparable explanation for beneficial ownership given by the Indonesian authority. Furthermore, the CA did not explain what an “administrator” of income is.

Scholarly commentary on this case often focuses on when one can say that a recipient of income has received the “benefit” of that income. The CA in *Indofood* seems to suggest that where the direct recipient’s only “benefit” from receipt of the income is to use that income to settle a liability (that was incurred before receipt of the income), such benefit may not suffice to make him a “beneficial owner”. However, it is a very common element of commercial life that recipients of income have little choice but to use such income to settle their debts.¹¹¹⁰ There is also often a direct link between income received and the payment of a specific debt, such as the case where a sub-licensor uses royalties received to pay the licence fee to the licensor.¹¹¹¹ On a more general note, Baker also points out that all companies eventually distribute their profits.¹¹¹² Neither of these can arguably on their own mean that a recipient of income has not received a “benefit”.¹¹¹³

It has thus been suggested that, looking at the question whether a person has “benefitted” from a payment, does not add much. (One should note here, however, that both the 2003 and 2014 Commentaries refer to a person “simply act[ing] as a conduit for another person who *in fact* receives the *benefit* of the income”).¹¹¹⁴

Consequently, other ways of understanding the judgment have been put forward. De Broe argues that the court gave it the meaning of the “ultimate recipient”, that is “a person who in economic and/or practical terms is the ultimate recipient of income in a chain of related transactions.”¹¹¹⁵ He argues that Newco did not meet this test since it was “practically

¹¹⁰⁹ Baker *After Indofood* 24 argues that the phrase is of little help and see also Jiménez (2010) *World Tax J* 45.

¹¹¹⁰ Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.6.2.

¹¹¹¹ Du Toit *Beneficial Ownership of Royalties* 222.

¹¹¹² Baker *After Indofood* 16. Collier (2011) *BTR* 699 raises a similar argument.

¹¹¹³ See also De Broe *International Tax Planning* 712 and Fraser & Oliver (2006) *BTR* 427-428.

¹¹¹⁴ Para 12.1 of the Commentary (2003) and para 12.3 of the Commentary (2014) to Art 1 (emphasis added).

¹¹¹⁵ De Broe *International Tax Planning* 711.

obliged” to pay on the interest very shortly after receipt and because it was a single purpose vehicle.¹¹¹⁶

Conversely, Avi-Yonah and Panayi argue that the court did not look at the “overall substance of the scheme and effectively the end-result”. According to them the Court focused on the “payment and cash-flow arrangements and how those affected the economic credibility of the intermediate entity”.¹¹¹⁷

Baker argues that the court considered that Newco was both in legal and economic terms obliged to pay the interest on. He is unsure whether the legal and the “facts and circumstances, substance-of-the-matter obligation would, each, by themselves, deprive the recipient of beneficial ownership”.¹¹¹⁸

Jezzi’s view of the judgment concerns the purpose for which Newco would have been inserted. He suggests that the best way of understanding the CA’s judgment is that one has to look at whether, as a question of economic reality, the direct recipient has a function other than the channelling of the income it receives, or whether the direct recipient amounts only to an inserted step. Jezzi argues as follows:

“In light of this, it might be more productive ...to ask if the beneficial ownership concept ... legitimates the interpretation which clearly underpins the decision [of the CA in *Indofood*]. In other words, does the beneficial ownership test amount to an anti-avoidance test, whereby the tax authorities of contracting states may refuse to grant the conventional benefits on the grounds that the company that claims them has been interposed for no other purpose other than that of taking advantage of the benefits?...

As suggested previously, it is not difficult to discern the *Ramsay/Furness* [sic] thinking behind this understanding of the beneficial ownership concept.¹¹¹⁹ The SPV [Newco] appears to epitomize the inserted step devoid of an economic purpose, which, according to this

¹¹¹⁶ 712.

¹¹¹⁷ Avi-Yonah & Panayi “Rethinking Treaty Shopping” in *Tax Treaties: Building Bridges* (2010) 36.

¹¹¹⁸ Baker “United Kingdom: Indofood” in *Beneficial Ownership* (2013) 32.

¹¹¹⁹ See in this regard also the comments made by Fraser & Oliver (2007) *BTR* 49, quoted at n 1138 below. It has not been suggested that the CA relied on the *Ramsay* approach. To the extent that the *Ramsay* approach is a UK measure and the court in *Indofood* was trying to establish the position under *Indonesian* law, it is extremely unlikely that the court would consciously do so without arguing that this manner of interpretation would also apply in Indonesia. One is also reminded of the unique circumstances of this case, namely that it was not argued by tax experts and not heard by judges who regularly decide tax cases (as pointed out by Baker *After Indofood* 22 and Fraser & Oliver (2006) *BTR* 423), whilst the *Ramsay* approach mainly operates within tax law (although, as pointed out in *Barclays Mercantile Business Finance Ltd v Mawson* [2005] 1 AC 684 para [33], as an interpretational approach, it is not limited to tax law). Lastly, as indicated in part 5.3.3, there is some doubt as to whether the *Ramsay* approach can be followed in a treaty context.

jurisprudence, is at the heart of any tax avoidance scheme. In this respect, it should be noted that the criticism incurred by that jurisprudence, on the grounds that it amounts to a recharacterization rule that should be provided by law,¹¹²⁰ cannot be extended to *Indofood*, as, to a certain extent, the beneficial ownership concept is itself a rule of recharacterization”.¹¹²¹

To evaluate Jezzi’s argument, one has to understand the role given to purpose in the interpretation process followed by the CA. The court referred to both the overall purpose of the Indonesia/Netherlands DTA and the purpose of the beneficial ownership requirement itself. If one turns first to the overall purpose, the material considered by the court is the title to the Indonesia/Netherlands treaty (which included the avoidance of double taxation and the prevention of fiscal evasion)¹¹²² and an additional provision found in this DTA, aimed at encouraging long-term foreign loans. Neither of these are controversial sources for establishing purpose.¹¹²³ The court only explicitly refers to this purpose after it has already reached its conclusion that Newco was not the beneficial owner.¹¹²⁴ Cilliers thus describes the reliance placed on this purpose as “secondary”.¹¹²⁵ Although this comment is not unwarranted, one should note that the court was from the outset aware that the Indonesian tax authority was relying on this purpose in denying Newco beneficial ownership.¹¹²⁶

More important, though, was the CA’s view on the purpose of the specific provision itself; in other words, why the beneficial owner requirement was included. The sources that the court took into account to distill this purpose are the 2003 Commentary, the Conduit Report and Baker’s commentary.¹¹²⁷ Although as sources these may be more problematic,¹¹²⁸ the court

¹¹²⁰ By the time that the judgments in *Indofood* were delivered, the House of Lords had already in *MacNiven (HM Inspector of Taxes) v Westmoreland Investments Ltd* [2001] UKHL 6 stated that the *Ramsay* approach amounted to nothing more than purposive interpretation, a fact also recognised by Jezzi (2010) *BFIT* 256 n 22. If this argument is accepted (but see the uncertainty that prevails, as discussed in part 5.3.3) the *Ramsay* approach cannot be seen as a rule of re-characterisation, as argued by Gammie at n 865 above.

¹¹²¹ Jezzi (2010) *BFIT* 255-256 (footnotes omitted).

¹¹²² One can question whether treaty shopping amounts to “tax evasion” rather than “tax avoidance”. As pointed out at n 631 above the question has been raised whether “tax evasion” in this context does not include “tax avoidance”.

¹¹²³ They both form part of the DTA itself and thus fall within any definition of “context”, as discussed in parts 4.3.3 and 4.3.4.

¹¹²⁴ *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] STC 1195 para 45.

¹¹²⁵ Cilliers “Anti-Avoidance” in *Silke on International Tax* (2010) para 46.39.

¹¹²⁶ The CA, early in its judgment at para 18, quoted from a letter written by the Indonesian tax authority in response to the question whether Newco would be the beneficial owner, where this purpose is mentioned. The objects in the title are also recorded as a fact by both the High Court (*Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2005] EWHC 2103 (Ch) para 18) and the CA (*Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] STC 1195 para 14).

¹¹²⁷ *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] STC 1195 paras 34-36. Possibly, one can also add to this the objects of the treaty as a whole.

¹¹²⁸ See parts 4.3.3 and 4.3.4.

seems to accept Baker's explanation that the purpose with including the term in the Indonesia/Netherlands DTA was to combat treaty shopping.

It is interesting to note that the High Court had also accepted that the beneficial owner requirement was inserted to combat treaty shopping and that the structure (both the existing and the new one) amounted to treaty shopping. However, it had applied Baker's "insolvency" test,¹¹²⁹ which considers what happens on the insolvency of the direct recipient. Although Baker himself describes his approach as being "practical", the focus of this "test" is on the *legal rights* of the direct recipient to the income.¹¹³⁰ The High Court thus persisted with a legal meaning.¹¹³¹ Possibly the court had thought that the anti-avoidance purpose could only be taken into account if a particular transaction renders the application of the term "beneficial owner" ambiguous, but that no such ambiguity arose here.¹¹³²

Returning to the decision by the CA, it referred firstly to the "legal structure" and the fact that Newco was only allowed to source the interest payments from the interest received by ParentCo. Only thereafter does the court move on to the "substance" of the matter. As Baker argues, it thus appears that the court applied both a legal and an economic approach. Arguably, its choice to continue with the economic approach was informed by the purpose of the beneficial ownership requirement as measure to combat conduit company treaty shopping. Jezzi's explanation, that the decision in *Indofood* can be explained by looking at the purpose for inserting the intermediate company, is thus plausible. Admittedly, his explanation takes some reading between the lines since the CA did not directly address this issue (of the purpose of inserting Newco). This is understandable given the fact that it was never in doubt that the only purpose was to get the treaty benefit of a lower withholding tax. Also, the fact that CA explicitly stated that under Indonesian law "the existence of a tax avoidance scheme may be relevant to questions of legislative interpretation",¹¹³³ might serve as support for Jezzi's argument.

Finally, one may note here the draft guidance that was issued by the HMRC after this judgment.¹¹³⁴ In that guidance the HMRC proposes that an international meaning only be

¹¹²⁹ Discussed in part 3.6.

¹¹³⁰ Jiménez (2010) *World Tax J* 54; Collier (2011) *BTR* 690 n 21.

¹¹³¹ Li *Beneficial Ownership in Tax Treaties* 200.

¹¹³² See the main text corresponding to n 1054 above.

¹¹³³ *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] STC 1195 para 24.

¹¹³⁴ The draft guidance has since been incorporated into the HMRC *International Manual* available at <https://www.gov.uk/hmrc-internal-manuals/international-manual> (accessed on 20-06-2017) paras INTM32010-INTM332080. Additional guidance has also been added at paras INTM504010-INTM504050.

given to the term “beneficial owner” based on whether or not there is a “treaty shopping intention”.¹¹³⁵

If the decision in *Indofood* can, indeed, be explained in this manner, it should be noted that a number of scholars disagree that the purpose of inserting an intermediate company should play a role on whether it can be recognised as a beneficial owner.¹¹³⁶ There has also been much criticism against the HMRC’s guidance,¹¹³⁷ with Baker finding it doubtful that there will be “legal support” for its approach.¹¹³⁸

6.4 Real Madrid

In 2006-2007, the AN considered a number of similar structures in which the meaning of the term “beneficial owner” (which is undefined in Spanish tax legislation)¹¹³⁹ in DTAs was considered.¹¹⁴⁰ Under these structures, the Real Madrid soccer club paid certain amounts to several Hungarian entities for the use of “image rights” of soccer players with whom the soccer club had work contracts. The Hungarian entities transferred almost the entire income so received to residents of the Netherlands or Cyprus. Under the Hungary/Spain DTA no withholding tax on royalties was levied. The issue was whether the Hungarian entities were the “beneficial owners” of the income for purposes of this DTA.

¹¹³⁵ HMRC *International Manual* para INTM332080 Example 7. The emphasis on a tax avoidance purpose in the context of beneficial ownership is reinforced in the new guidelines. For example, at para INTM504020 it is stated that treaty relief (under the beneficial ownership requirement) should only be denied if the purpose was not “commercial”, but to avoid UK withholding tax. At para INTM504050 the HMRC also states that one of the considerations that should be taken into account in identifying inadmissible conduit structures is whether the direct recipient serves a commercial purpose.

¹¹³⁶ Part 2.4.1.

¹¹³⁷ But there has also been praise. See, e.g. Wardzynski (2015) *Intertax* 187.

¹¹³⁸ Baker *After Indofood* 26-27; Baker “Beneficial Ownership’ as Applied to Dividends” in *Taxation of Intercompany Dividends* (2012) 98. See also Cilliers “Anti-Avoidance” in *Silke on International Tax* (2010) para 46.39. Fraser & Oliver (2007) *BTR* 49 state with regard to example 7 mentioned at n 1135 above:

“The way in which HMRC state the facts is redolent of the *Ramsay/Furniss* line of cases, and on an interpretation of that case law – the ‘inserted step’ interpretation – which may have been rendered substantially obsolete by *MacNiven v Westmoreland Investments*. Thus the fact that [an intermediate company] ‘was set up (or has been maintained in the group) specifically to deal with [an] intra group loan’ and the elements of ‘predetermination’ may be legally less significant than HMRC may perhaps be suggesting; in the writers’ view they are not legally significant at all” (footnotes omitted).

¹¹³⁹ Jiménez (2010) *World Tax J* 36.

¹¹⁴⁰ 36-40. See also Jiménez “Beneficial Ownership as a Broad Anti-Avoidance Provision” in *Beneficial Ownership: Recent Trends* (2013) 127 128-133 for a similar discussion.

Jiménez summarised the AN’s conclusion in holding that the Hungarian entities were not “beneficial owners” as follows:¹¹⁴¹

- a) The main purpose of the beneficial ownership requirement is to combat treaty shopping;
- b) The requirement is comparable to the GAAR in Spanish tax legislation, but with the advantage that the procedures that apply in the case of the GAAR do not have to be complied with;
- c) The term should have an international meaning. To determine this meaning, the court referred to the Conduit Report and the Commentaries. Jiménez describes the court’s view of the 2003 Commentaries as follows:

“[A]n ‘economic interpretation’ can be used to seek the ‘real owner’ of income (and, therefore, disregard the legal owner thereof). In fact, the AN assimilates ‘beneficial ownership’ to a ‘business purpose test’: if there is a business reason to place an entity between the payer and the final recipient of the income beyond reduction of withholding taxes in Spain, the intermediary will be the beneficial owner; however, if the conduit has the only goal of reducing withholding taxes, it will fall outside that concept.”¹¹⁴²

- d) The AN did not explain why the 2003 OECD Commentary (and the Conduit Report) could be used to interpret the 1984 Hungary–Spain DTA;
- e) The AN did not analyse whether the direct recipients (the Hungarian entities) were, legally, the owners of the income and whether they had assumed any risk.

In summary Jiménez states:

“The main conclusion that can be drawn from the judgements is that the Spanish tax administration and courts have aligned (without citing foreign decisions) with the trend to identify beneficial ownership with a broad anti-fraud or avoidance clause. The basis of the reasoning of the AN is an economic/substance-over-form analysis of the kind often found when applying general anti-avoidance clauses or judicially crafted theories on the abuse/avoidance of tax law.”¹¹⁴³

¹¹⁴¹ Jiménez (2010) *World Tax J* 39-40. See also Kemmeren “Preface to Articles 10 to 12” in *Klaus Vogel* (2015) 747-748 m.nr. 106.

¹¹⁴² Jiménez (2010) *World Tax J* 39-40 (footnote omitted).

¹¹⁴³ 40 (footnote omitted).

6.5 *Prévost*

6.5.1 Facts and the issue

This case concerned a Quebec company, Prévost Car Inc (“Prévost Canada”), resident in Canada. The company was a wholly owned subsidiary of a Dutch corporation, Prévost Holding B.V. (“Prévost Holdings”). Two foreign companies owned the latter. A Swedish company, Volvo Bussar A.B. (“Volvo”), held 51 per cent of the issued shares and a UK company, Henlys Group PLC (“Henlys”), held the other 49 per cent.

Regarding the use of Prévost Holdings as a holding company, it was argued by the group that it was intended to be used in a number of North American projects of the group.¹¹⁴⁴ Cilliers notes that it seems that it was accepted by the courts that tax was not the most important consideration in choosing a Dutch holding company.¹¹⁴⁵ However, at the time when the facts described below played out, Prévost Holdings had no employees and no other investments and a third party was appointed to pay its dividends on its behalf.¹¹⁴⁶ Judged on these facts, the company had little substance, which was a cause of concern for the Canadian tax authority.¹¹⁴⁷

Volvo and Henlys had entered into a shareholders’ agreement, in terms of which at least 80 per cent of the profits of Prévost Canada and Prévost Holdings were to be distributed (by dividend or otherwise) to the shareholders, subject to these companies being able to meet their working capital requirements.¹¹⁴⁸ It was also agreed that the board of directors of Prévost Holdings would take reasonable steps to “procure” that the distribution by Prévost Canada takes place or that Prévost Holdings would otherwise be able to make distributions. The boards of directors of Prévost Canada and Prévost Holdings were comprised of the same persons.¹¹⁴⁹

Prévost Canada had declared dividends to Prévost Holdings, which were thereafter distributed by the latter to its shareholders. The issue before the court was whether Prévost Holdings was the “beneficial owner” of these dividends for purposes of the dividends article in the Canada/Netherlands DTA. The argument of the Canadian tax authority was that

¹¹⁴⁴ *Prévost Car Inc. v The Queen* 2008 TCC 231 para [11].

¹¹⁴⁵ Cilliers “Anti-Avoidance” in *Silke on International Tax* (2010) para 46.40.

¹¹⁴⁶ *Prévost Car Inc. v The Queen* 2008 TCC 231 paras [24], [25] and [102].

¹¹⁴⁷ Du Toit (2010) *BFIT* 507; Collier (2011) *BTR* 695.

¹¹⁴⁸ This was subject to the proviso that the shareholders could agree otherwise.

¹¹⁴⁹ *Prévost Car Inc. v The Queen* 2008 TCC 231 paras [12]-[13].

Prévost Holdings was not the beneficial owner since it was merely a conduit for the dividends in favour of Volvo and Henlys.

The matter was first heard by the TCC and Rip ACJ delivered judgment.¹¹⁵⁰ His decision went on appeal to the FCA where, in a single (fairly short) judgment delivered by Décary JA, the finding of the TCC was upheld.¹¹⁵¹ The matter did not go on appeal to the SCC, Canada's highest court on taxation matters.

In the TCC the Canadian tax authority¹¹⁵² argued that there was no meaning for the term “beneficial owner” in either the Canadian income tax act (“Canadian ITA”)¹¹⁵³ (in fact, it was not used in the French version of the Canadian ITA)¹¹⁵⁴ or common law¹¹⁵⁵ that could be used for purpose of the general *renvoi* clause in the Canada/Netherlands DTA.¹¹⁵⁶ The Canadian tax authority thus argued that an international meaning should be given to the term.¹¹⁵⁷ It further argued that a non-legal meaning should be given.¹¹⁵⁸ According to this argument one has to considering the facts, rather than the legal relationships, in order to identify who can “as a matter of fact, ultimately benefit from the dividends”, as supported by the decision in *Indofood*.¹¹⁵⁹

6.5.2 Judgment of the TCC

At the outset of its judgment, the TCC noted the wording of the 1977 Commentary as well as the amendments made to the Commentary in 2003 (after conclusion of the Canada/Netherlands DTA). Rip ACJ also referred to the general *renvoi* clause in the DTA and the Canadian Income Tax Conventions Interpretation Act,¹¹⁶⁰ which states that undefined

¹¹⁵⁰ Reported as *Prévost Car Inc. v The Queen* 2008 TCC 231.

¹¹⁵¹ *Prévost Car Inc. v Canada* 2009 FCA 57 (CanLII).

¹¹⁵² It is noted at *Prévost Car Inc. v The Queen* 2008 TCC 231 para [44] that the Canadian and Dutch tax authorities corresponded on this matter, but disagreed on its outcome.

¹¹⁵³ Income Tax Act R.S.C., 1985, c1 (5th Supp.). The Canadian tax authority argued at para [65] that the words used in the Canadian ITA had “multiple and often irreconcilable meanings” and that it was not used in the withholding tax provisions on Canadian sourced dividends, interest and royalties. See also para [69].

¹¹⁵⁴ Para [68].

¹¹⁵⁵ Paras [66] and [68].

¹¹⁵⁶ Paras [34] and [38].

¹¹⁵⁷ Para [67].

¹¹⁵⁸ The Canadian tax authority argued at para [75] that “from a textual reading” the English version of the term in the DTA applies to “the person who can exercise the normal incidents of ownership (possession, use, risk, control) and as such ultimately benefits from the income.” It pointed out that neither the French, nor the Dutch translation of the term used in the Canada/Netherlands DTA refers to ownership.

¹¹⁵⁹ Paras [77]-[84].

¹¹⁶⁰ Income Tax Conventions Interpretations Act RSC 1985, c I-4.

terms “except to the extent that the context otherwise requires”, shall have the meaning it has for purposes of the Canadian ITA as amended from time to time.¹¹⁶¹

The court then continued by referring to Article 31(1) of the VCLT, before stating that treaties are to be given a “liberal interpretation with a view of complementing the true intentions of the contracting states”.¹¹⁶²

The court referred to the *Market Maker* case, as summarised to the court by Prof Van Weeghel, an expert witness for the appellant. He testified that under that case Prévost Holdings would be the beneficial owner, unless it was legally obligated to pass on the dividends.¹¹⁶³ Another expert witness for the appellant, Mr Lüthi, referred the court to the Conduit Report.¹¹⁶⁴

The court then turned to its analysis of the law. It noted that, according to the Canadian tax authority, the phrase “beneficial owner” (if the words are read together) is not defined in English dictionaries.¹¹⁶⁵ The words are defined separately and the court referred to both English and French dictionaries in respect of these meanings.¹¹⁶⁶

It contrasted the decisions in the *Market Maker* case and *Indofood (CA)*,¹¹⁶⁷ before stating:

“I am being asked to determine what the words ‘beneficial owner’ and ‘bénéficiaire effectif’ (and the Dutch equivalent) mean in Article 10(2) of the Tax Treaty. Article 3(2) of the Tax Treaty requires me to look to a domestic solution in interpreting ‘beneficial owner’. The OECD Commentaries on the 1977 Model Convention with respect to Article 10(2) are also relevant.

The Commentary for Article 10(2) of the Model Convention explains that one should look behind ‘agents and nominees’ to determine who is the beneficial owner. Also, a ‘conduit’ company is not a beneficial owner. In these three examples, the person ... never has any attribute of ownership of the dividend.”¹¹⁶⁸

¹¹⁶¹ *Prévost Car Inc. v The Queen* 2008 TCC 231 paras [31]-[32], [34] and [38]-[39].

¹¹⁶² Paras [36]-[37], referencing *The Estate of the late John N. Gladden v Her Majesty the Queen* 85 DTC 5188.

¹¹⁶³ *Prévost Car Inc. v The Queen* 2008 TCC 231 para [45].

¹¹⁶⁴ Para [58]. There was also an expert witness (Raas) on Dutch corporate law.

¹¹⁶⁵ It is somewhat strange that the court did not consider the dictionary meaning in *Black’s Law Dictionary*, quoted in part 3.6 since the TCC in *Williams v The Queen* 2005 TCC 558 (CanLII) para [38] did quote this dictionary meaning.

¹¹⁶⁶ Paras [72]-[73], [77].

¹¹⁶⁷ *Prévost Car Inc. v The Queen* 2008 TCC 231 para [93].

¹¹⁶⁸ Para [95].

The court then considered the position of a usufruct under the civil law of Quebec and compared this with beneficial ownership under common law.¹¹⁶⁹ After this analysis, it concludes that the term “beneficial owner” refers to

“the person who receives the dividends for his or her own use and enjoyment and assumes the risk and control of the dividend he or she received. The person who is beneficial owner of the dividend is the person who enjoys and assumes all the attributes of ownership. In short the dividend is for the owner’s own benefit and this person is not accountable to any for how he or she deals with the dividend income.”¹¹⁷⁰

Furthermore, in the case of companies

“one does not pierce the corporate veil unless the corporation is a conduit for another person and has absolutely no discretion as to the use or application of funds put through it as conduit, or has agreed to act on someone else’s behalf pursuant to the person’s instructions without any right to do other than what that person instructs it, for example, a stockbroker who is the registered owner of the shares it holds for clients.”¹¹⁷¹

The court paid close attention to the powers of the shareholders of Prévost Holdings and its directors under Dutch company law. It indicated that Prévost Holdings was not party to the shareholders’ agreement and that, should it not declare dividends as per that agreement, the shareholders would have no right in law against it.¹¹⁷² Furthermore, dividends could only be declared by the board and in accordance with Dutch law.¹¹⁷³ In light of this “[t]here was no predetermined or automatic flow of funds to Volvo and Henlys”.¹¹⁷⁴

On the facts, since Prévost Holdings was the owner of the shares, dividends received by it were also its property and it could use the dividends as it deemed fit. It was, therefore, the “beneficial owner” of the dividends.¹¹⁷⁵

6.5.3 Judgment of the FCA

On appeal to the FCA, that court spent some time in assessing whether the use of later Commentaries was acceptable. It lent its support thereto, provided that they “do not conflict

¹¹⁶⁹ This aspect of the judgment is considered in more detail in part 6.6.3.2.

¹¹⁷⁰ *Prévost Car Inc. v The Queen* 2008 TCC 231 para [100].

¹¹⁷¹ Para [100], also quoted in *Prévost Car Inc. v Canada* 2009 FCA 57 (CanLII) para [13].

¹¹⁷² *Prévost Car Inc. v The Queen* 2008 TCC 231 paras [102]-[104].

¹¹⁷³ Paras [104]-[105].

¹¹⁷⁴ Para [102].

¹¹⁷⁵ Para [105].

with” the earlier Commentaries and only “insofar as they are eliciting, rather than contradicting, views previously expressed”.¹¹⁷⁶

The FCA also stated that the TCC’s views accorded with the “general, technical and legal meanings” of the English and French terms, but “[m]ost, importantly, perhaps” it accorded with the Commentaries and Conduit Report.¹¹⁷⁷

The FCA repeated, and accepted as correct, the following findings of the TCC with regard to Prévost Holdings’ legal position: it was not obliged under either Dutch law or the shareholders’ agreement to declare the dividends and as owner of the shares was entitled to the dividends.¹¹⁷⁸

Regarding the Canadian tax authority’s view that “beneficial owner” means the “person who can, in fact, ultimately benefit from the dividend”, it stated that this definition does not appear in OECD material and that “the use of the word ‘can’ opens up a myriad of possibilities which would jeopardize the relative degree of certainty and stability that a tax treaty seeks to achieve.”¹¹⁷⁹

6.5.4 Comments on the judgments in *Prévost*

6.5.4.1 The choice between a domestic and international meaning

Although the TCC refers to both the *Indofood* and *Market Maker* cases, as well as the Commentaries and the Conduit Report, the decision of the TCC is arguably based on a domestic meaning of the term.¹¹⁸⁰ Although not stated expressly, one can possibly see its reference to the relevance of the 1977 Commentary as part of the “context” that could be taken into account to determine whether the “context otherwise provides”. Moreover, although again not stated expressly, one has to deduce that the context here did not provide

¹¹⁷⁶ *Prévost Car Inc. v Canada* 2009 FCA 57 (CanLII) paras [11] and [12].

¹¹⁷⁷ Para [14].

¹¹⁷⁸ Paras [16]-[18].

¹¹⁷⁹ Para [15].

¹¹⁸⁰ P Baker *The United Nations Model Double Taxation Convention between Developed and Developing countries: Possible Extension of the Beneficial Ownership Concept* (2008) available at http://www.un.org/esa/ffd/tax/fourthsession/EC18_2008_CRP2_Add1.pdf (accessed on 25-01-2017) para 25; Jezi (2010) *BFIT* 257; Duff “Responses to Treaty Shopping” in *Tax Treaties: Building Bridges* (2010) 89; Watson & Baum (2012) *Can Tax J* 153; Arnold “Beneficial Ownership under Canadian Tax Treaties” in *Beneficial Ownership* (2013) 42; VT Chew “The Application of Tax Treaties to Collective Investment Vehicles: Beneficial Owner Requirement Explained?” (2015) 17 *Derivatives & Financial Instruments* heading 3.3.5.2.

otherwise.¹¹⁸¹ However, this reading of the judgment as using a domestic meaning is not undisputed.¹¹⁸²

In respect of the decision by the FCA, Li argues that the FCA's statement that the TCC's interpretation was in line with the Commentaries (and thus an international meaning) was made *obiter*. She nevertheless argues that the FCA's view results in it not being "very clear whether *Prévost* steadfastly stands for a domestic solution".¹¹⁸³ Others, however, accept even after the FCA's judgment that *Prévost* does stand for such a domestic solution.¹¹⁸⁴ To some extent this depends on how one regards the role played by the Commentaries and Conduit Report (the only foreign material considered by the FCA) in the judgment of the FCA. This is discussed further under the next heading.

6.5.4.2 Role of the Commentaries

Both the TCC and the FCA referred to the Commentaries and the Conduit Report. With regard to the decision of the FCA, Kandev and Wiener argue that the Commentaries did not play a large part in the decision of the FCA and that the FCA "merely wanted to indicate that the outcome of the case would not have changed even if these OECD materials were used."¹¹⁸⁵ They provide the following reasons for their view:¹¹⁸⁶ Firstly, contrary to what the FCA stated,¹¹⁸⁷ the TCC did not (directly) apply the OECD Commentaries or the Conduit Report, instead adopting a domestic meaning under the general *renvoi* clause.¹¹⁸⁸ Secondly, although the FCA indicated that the TCC's interpretation accorded with the OECD documentation, that interpretation was not based on economic substance (which is, according

¹¹⁸¹ As MN Kandev "Treaty Shopping in Canada: The Door is (Still) Open" (2008) 62 *BFIT* 463 465 explains, the court "seems to have refused to enter the maze of textual interpretation. Instead the judge appears to have adopted a pragmatic approach to interpretation".

¹¹⁸² Jiménez (2010) *World Tax J* 48 n 54 states that the "legal basis of the decision is not very clear", whilst the following scholars all argue that an international meaning was given: Du Toit & Hattingh "Beneficial Ownership" in *Silke on International Tax* (2010) para 9.6.3; SA Rocha "Treaty Shopping and Beneficial Ownership under Brazil's Tax Treaties" (2012) 66 *BFIT* 351 354, Kemmeren "Preface to Articles 10 to 12" in *Klaus Vogel* (2015) 729 m.nr. 56 and Linderfalk & Hilling (2015) *Nordic Tax Journal* 44. De Broe et al (2011) *BFIT* are not sure whether the TCC adopted the domestic law meaning, an international meaning or a combination of both.

¹¹⁸³ Li *Beneficial Ownership in Tax Treaties* 198.

¹¹⁸⁴ Watson & Baum (2012) *Can Tax J* 163.

¹¹⁸⁵ Kandev & Wiener (2009) *Tax Notes International* 671. N Boidman & MN Kandev "Canadian Taxpayer Wins *Prévost* Appeal" (2009) *Tax Notes International* 862 864 raise a similar argument.

¹¹⁸⁶ Kandev & Wiener (2009) *Tax Notes International* 671.

¹¹⁸⁷ *Prévost Car Inc. v Canada* 2009 FCA 57 (CanLII) para [8].

¹¹⁸⁸ Jiménez (2010) *World Tax J* 49 agrees.

to Kandeve and Wiener, what the OECD had proposed).¹¹⁸⁹ But here it should be noted that, as shown in part 2.4.1, this is not a uniform understanding of the 2003 Commentary. This last argument is thus less convincing.¹¹⁹⁰

Contrary to this view, Verdonder et al regard the case (without specifying which judgment) as one in which “great value” was placed on the 2003 Commentary.¹¹⁹¹

Although I agree that the 2003 Commentary and the Conduit Report did not play a significant role in the decision of the TCC, with regard to the decision by the FCA one cannot deny that that court regarded these as important guides. It was, after all, the only material that the FCA emphasised. It even addressed the question of the use of the revised Commentary.¹¹⁹² Based on this analysis, the decision of the FCA possibly favoured an international meaning being given.¹¹⁹³ However, in light of the fact that the FCA agreed with the meaning given by the TCC (which is arguably a domestic meaning), one should guard against placing too much emphasis on this aspect of the FCA’s judgment.

6.5.4.3 The meaning given by the court

It has been said that “Indofood is to *Ramsay/Furness* [sic] as *Prévost Car* is to *Duke of Westminster*”,¹¹⁹⁴ emphasising the fact that the judgments in *Prévost* are widely understood to have adopted a legal, rather than economic, meaning for the term.¹¹⁹⁵ With regard to this legal meaning, Jiménez argues that the TCC and FCA gave the beneficial ownership requirement a meaning that has reduced it to somewhat of an attribution rule.¹¹⁹⁶ This meaning pays little

¹¹⁸⁹ Kandeve & Wiener (2009) *Tax Notes International* 671 also noted that the court did not consider whether the ultimate recipients (Volvo and Henlys) were “improperly” taking advantage of the lower withholding rate, as stated in para 2 of the Conduit Report. That paragraph notes:

“This report deals with the ... situation ... where a company situated in a treaty country is acting as a conduit for channelling income economically accruing to a person in another State who is thereby able to take advantage ‘improperly’ of the benefits provided by a tax treaty” (emphasis added).

¹¹⁹⁰ Jiménez (2010) *World Tax J* 49 n 61.

¹¹⁹¹ Verdonder et al (2010) *Euro Tax* 422.

¹¹⁹² Discussed in part 7.5.7.

¹¹⁹³ Kemmeren “Preface to Articles 10 to 12” in Klaus Vogel (2015) 721 m.nr. 32 n 55; Du Plessis *Critical Issues Regarding the OECD Model Tax Convention* 258.

¹¹⁹⁴ Jezi (2010) *BFIT* 257. The *Ramsay* approach was discussed in part 5.3.3 and mentioned in the context of the decision in *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] STC 1195 in part 6.3.4.4. The famous statement in *IRC v Duke of Westminster* [1936] AC 1 is quoted at n 816 above.

¹¹⁹⁵ Boيدman & Kandeve (2009) *Tax Notes International* 864; Verdonder et al (2010) *Euro Tax* 422; Jiménez (2010) *World Tax J* 49; Li *Beneficial Ownership in Tax Treaties* 201.

¹¹⁹⁶ Jiménez (2010) *World Tax J* 48.

attention to the requirement's anti-avoidance purpose.¹¹⁹⁷ The view of the court is evaluated in more detail in part 6.6.3.2, once the decision of the TCC in *Velcro* has been discussed.

6.6 *Velcro*

Rossiter ACJ in the TCC delivered judgment in this case.¹¹⁹⁸ No appeal was reported.

6.6.1 Facts and the issue

Velcro Canada Inc (“Velcro Canada”) paid royalties under a license agreement to Velcro Industries BV (“Velcro Industries”), which was a resident of the Netherlands before its relocation to the Netherlands Antilles. Canada has no DTA with the Netherlands Antilles, but does have one with the Netherlands. Subsequent to Velcro Industries’ migration, it assigned the license agreement to a Dutch subsidiary, Velcro Holdings BV (“Velcro Holdings”), whilst remaining the owner of the intellectual property. Velcro Canada henceforth paid royalties to Velcro Holdings. The royalties were based on net sales of licensed products by Velcro Canada.

In terms of the agreement between Velcro Industries and Velcro Holdings, the latter was obliged, as consideration for acquiring the rights under the licence agreement, to pay to Velcro Industries certain amounts. These amounts were an arm’s length percentage of the net sales of licensed products, which was approved by the Dutch tax authorities for purposes of transfer pricing. According to the court, the amount paid by Velcro Holdings turned out to be approximately 90 per cent of the royalties that was paid by Velcro Canada.¹¹⁹⁹ Payment had to take place within 30 days after receipt of the royalties from Velcro Canada. Velcro Industries could enforce payment by Velcro Canada to Velcro Holdings, should the latter fail to do so.

Arnold points out that little information is provided in the judgment on Velcro Holdings. For example, it is not stated whether it had any employees or offices. Furthermore, it is not clear

¹¹⁹⁷ Li *Beneficial Ownership in Tax Treaties* 201; Watson & Baum (2012) *Can Tax J* 163.

¹¹⁹⁸ *Velcro Canada Inc. v the Queen* 2012 TCC 57 (CanLII).

¹¹⁹⁹ Arnold (2012) *BFIT* 324 argues that the court had misunderstood the facts. According to him, it is likely that Velcro Canada has withheld 10% withholding tax and that the entire amount received by Velcro Holdings was then paid by it to Velcro Industries. See also Arnold “Beneficial Ownership under Canadian Tax Treaties” in *Beneficial Ownership* (2013) 47. Irrespective of whether Arnold’s argument is correct, one has to consider the decision of the case based on the court’s interpretation of the facts.

what percentage of the income and expenses of Velcro Holdings was constituted by the royalties.¹²⁰⁰

The issue was whether Velcro Holdings was the “beneficial owner” of the royalties, as contemplated under the royalty article of the Canada/Netherlands DTA. The Canadian revenue authorities argued that Velcro Holdings was an agent or conduit and did not exercise the “incidences of ownership” as required by *Prévost*.¹²⁰¹

6.6.2 Judgment of the TCC

The court referred to both the 1977 and 2003 Commentaries and the Conduit Report, but did not elaborate on these.¹²⁰² It agreed with the test proposed by the Tax Court in *Prévost* (as had the parties themselves).¹²⁰³ It commented that “when asserting who is the beneficial owner of the items being considered (e.g. a payment of dividends or royalties), one must determine who has received the payments for his/her own use and enjoyment and assumed the risk and control of the payment he/she received.”¹²⁰⁴ It also noted that there was no “automatic flow of funds” here (despite the contractual obligation to make payments).¹²⁰⁵

It then interpreted the various attributes according to the ordinary meanings of the words and held that Velcro Holdings held all the attributes.¹²⁰⁶ The court also considered whether Velcro Holdings was the “agent”, or the “nominee”, of Velcro Industries. For this purpose, the court considered Canadian case law on the meaning of “agent” and a legal dictionary for the meaning of “nominee”.¹²⁰⁷ It held that Velcro Holdings was neither an agent, nor a nominee. The court also considered the meaning of a “conduit” by referring to a general dictionary and *Prévost*. The court held that Velcro Holdings was not a “mere channel” since it was not shown that it had no discretion with regard to the royalties.¹²⁰⁸

¹²⁰⁰ Arnold (2012) *BFIT* 323. See also Castro (2013) *International Tax Journal* 34.

¹²⁰¹ *Velcro Canada Inc. v the Queen* 2012 TCC 57 (CanLII) paras [18]-[20].

¹²⁰² Para [23].

¹²⁰³ Para [25].

¹²⁰⁴ Para [27].

¹²⁰⁵ Para [28].

¹²⁰⁶ In all these instances, the court referred to *Black’s Law Dictionary* for the meaning of these words. This aspect of the case is discussed in more detail in part 6.6.3.2.

¹²⁰⁷ Paras [46]-[50].

¹²⁰⁸ Paras [51]-[52]. The emphasis is in the original.

6.6.3 Comments on the judgment in *Velcro*

6.6.3.1 The choice between a domestic and international meaning

The TCC in *Velcro* made limited use of OECD material. It mainly placed reliance on the meaning given in *Prévost (TCC)*¹²⁰⁹ and dictionaries. It has thus been argued that the case supports a domestic meaning.¹²¹⁰ However, this conclusion is not without criticism, bearing in mind that in *Prévost (FCA)*¹²¹¹ the court arguably supported an international meaning, which just happened to correspond with the domestic meaning given in *Prévost (TCC)*. Given that the TCC is bound by decision of the FCA, it should arguably support an international meaning.

6.6.3.2 The “test” for beneficial ownership in *Prévost* and *Velcro*

Since the TCC in *Velcro* indicated that it was applying the test formulated in *Prévost (TCC)*, the meaning given in these two cases may be considered together. This is done under this heading, but before doing so, it is worth remembering that the expression “beneficial owner” is often used in the following two ways: firstly, to indicate that a (legal) owner’s ownership attributes have not been curtailed and that such owner thus owns the property “beneficially”;¹²¹² secondly, in jurisdictions where fragmentation in ownership is possible, to indicate that the person is the beneficial owner, as opposed to the legal owner, of property.¹²¹³ Bearing these comments in mind the following argument of the court in *Prévost (TCC)*, which was made in leading up to the important paragraph in which the “test” for beneficial ownership was set out,¹²¹⁴ is somewhat surprising:

“[T]he *Civil Code of Quebec* ... grants the owner of property the right to use, enjoy and dispose of the property fully and freely. *These are rights that in common law belong to the beneficial owner of property. In civil law, one person may be the bare owner ... of the property but another person, called the usufructuary, may use and enjoy the property and the usufructuary is the owner of the usufruct in his or her own right, subject to the obligation of preserving the*

¹²⁰⁹ *Prévost Car Inc. v The Queen* 2008 TCC 231.

¹²¹⁰ Arnold (2012) *BFIT* 324; Arnold “Beneficial Ownership under Canadian Tax Treaties” in *Beneficial Ownership* (2013) 46; Chew (2015) *Derivatives & Financial Instruments* heading 3.3.5.2.

¹²¹¹ *Prévost Car Inc. v Canada* 2009 FCA 57 (CanLII).

¹²¹² Part 3.5.2.1.

¹²¹³ Part 3.2.3.4.

¹²¹⁴ See the main text corresponding to n 1170 above. See also part 3.2.3.3 where it is mentioned that Quebec does not allow for fragmented ownership.

substance of the property: ... The usufructuary receives the income from the property as owner of the income. He or she is not accountable to the bare owner for any income. That person is similar to the ‘beneficial owner’ in common law of the income ...

In common law, a trustee, for example, holds property for the benefit of someone else. The trustee is the legal owner but does not personally enjoy the attributes of ownership, possession, use, risk and control. The trustee is holding the property for someone else and that, ultimately, it is that someone else who has the use, risk and control¹²¹⁵ of the property¹²¹⁶ ... There is no division of property in common law as there is in civil law. The word ‘beneficial’ distinguishes the real or economic owner of the property from the owner who is merely a legal owner, owning the property for someone else’s benefit, i.e., the beneficial owner.”¹²¹⁷

In the second sentence of the first paragraph, highlighted above, the court remarks that the “right to use, enjoy and dispose of the property fully and freely” belongs in common law to “the beneficial owner of the property”. Clearly a trust beneficiary does not (always) have the right to dispose of the trust property (capital). Possibly, the court uses the expression “beneficial owner” here to refer to the *legal* owner whose ownership attributes have not been curtailed, that is, in the manner first mentioned under this heading.

The court then continues to equate a usufructuary and a trust beneficiary: the usufructuary is the “owner” of the usufruct and receives the income from the property as owner of the income. The usufructuary is similar to the “beneficial owner” of trust income.

A usufructuary is sometimes loosely called the “beneficial owner” of the *property subject to the usufruct*. The whole point of the description is to explain that, by virtue of the usufructuary’s limited real right *in the property*, he or she has the right to use and enjoyment of the property. To refer to a usufructuary, even in this colloquial sense, as the “beneficial owner” of the income makes little sense. The usufructuary is simply the “owner” of the income.

With regard to trusts, it is similarly not unusual to refer to trust beneficiaries who have vested rights to income (but not trust capital) as the “beneficial owners” of the trust property.¹²¹⁸ If one wants to compare trust beneficiaries with usufructuaries (as the TCC does in the above

¹²¹⁵ The court seems to refer here to control of the trust property itself. It is not clear that a trust beneficiary will (always) be in control of the trust property, as mentioned in part 3.2.3.1.

¹²¹⁶ Interestingly, the court states expressly that the trust beneficiary has the attributes of use, risk and control, but leaves out the fourth attribute of possession. It is not clear whether this was done on purpose.

¹²¹⁷ *Prévost Car Inc. v The Queen* 2008 TCC 231 paras [97]-[98] (emphasis added, footnotes omitted).

¹²¹⁸ *Hayton Hayton and Marshall The Law of Trusts* 25, who argues that such a beneficiary has “equitable ownership” of the trust property generating the income.

statement), the point of the description is similarly to explain the interest of the beneficiaries with regard to the *trust property* (that generates income) rather than the income itself.

In both these cases the point of the description is thus that the usufructuary and trust beneficiary do not have *all* the ownership attributes in respect of the *property that generates the income*. Put differently, beneficial ownership in this comparison is not a description of the ownership attributes towards the income itself, but rather the property that generates the income.

The argument put forward here is that one should guard against overemphasising the importance of whether or not the “beneficial owner” has all the ownership attributes in respect of the income.¹²¹⁹ The point that the court seems to want to bring over is that the trust beneficiary receives the trust income “as owner of the income” and does not have to account to the trustee for how he or she uses it. The same can be said of a usufructuary: he or she receives the income (from the property that is subject to the usufruct) “as owner of the income” and does not have to account to the bare owner (of the property subject to the usufruct). The court regards both as “beneficial owners” of the income.

Contrary to the argument regarding ownership attributes put forward above, this consideration was taken up a notch in *Velcro*. There the court considered each attribute separately in respect of the direct recipient (Velcro Holdings). Below the meaning given by the court in respect of each attribute is set out and some of the facts stated by the court to support its conclusion that Velcro Holdings had the relevant attribute are repeated:

a) “possession”:

this means “having or holding property in one’s power” or “the exercise of dominion over property”. Some of the facts mentioned in the case that point toward Velcro Holdings being in possession of the dividends were:

i) Velcro Holdings had the right to receive the royalties.

¹²¹⁹ See also the questions raised by Du Toit (2010) *BFIT* 507 and note the following statement at *Prévost Car Inc. v The Queen* 2008 TCC 231 para [95]:

“The Commentary for Article 10(2) of the Model Convention explains that one should look behind ‘agents and nominees’ to determine who the beneficial owner is. Also, a ‘conduit’ company is not a beneficial owner. In these three examples, the person ... never has *any* attribute of ownership of the dividend” (emphasis added). If a person can only be a beneficial owner if such a person has *all* the attributes of ownership, then one would expect a conduit company to be denied beneficial ownership also if it has some, but not all of the attributes. The formulation that a conduit company is not a beneficial owner because it has *none* of the attributes is thus somewhat odd. Furthermore, in the case of *Williams v The Queen* 2005 TCC 558 (CanLII) paras [31] and [45]-[47] the TCC held that beneficial ownership, which was relevant for the interpretation of the CGT legislation, does not require that the person holds all the ownership attributes.

- ii) The royalties were deposited into an account owned by Velcro Holdings. It had “exclusive possession and control” over the account.
 - iii) The royalties were not subrogated from other monies of Velcro Holdings and were intermingled with its other monies.
 - iv) The amounts earned interest, which was for the credit of Velcro Holdings alone.
 - v) Velcro Holdings had various liabilities, which were paid from its accounts, including the royalty payments.
 - vi) The amount received by Velcro Holdings and the amount paid by it to Velcro Industries were not the same. The royalties did not simply go in and come out in an automated fashion.¹²²⁰
- b) “use”:
- this refers “to the application or employment of something: ‘a long continued possession or employment of a thing for which it is adapted’”. According to the court this translated into the question whether Velcro Holdings applied the royalty payments for its own benefit. Here the court referred back to the facts mentioned with regard to “possession”. It noted that the cash flow statements of Velcro Holdings show that royalties were co-mingled with other monies and used for a variety of things, such as to pay its various expenses and make investments. Furthermore, nothing in the documents indicated that Velcro Holdings was prevented from using the royalties as it saw fit.¹²²¹
- c) “risk”:
- it refers to “the chance of injury, damage or loss” or “liability for injury, damage or loss that occurs”, which the court interpreted to mean economic loss. Velcro Holdings assumed risk in relation to the royalties and had no indemnity from this risk since
- i) it assumed currency risk in that the monies were received in Canadian currency and then converted to US or Dutch currency;
 - ii) the royalties were the property of Velcro Holdings and were available to its creditors, with no priority given to Velcro Industries.¹²²²
- d) “control”:
- this means “to exercise power or influence over”. The court held that many of the facts mentioned above with regard to the other incidents also apply here, such as the facts

¹²²⁰ *Velcro Canada Inc. v the Queen* 2012 TCC 57 (CanLII) para [35].

¹²²¹ Paras [36]-[38].

¹²²² Paras [39]-[40].

that the royalties did not just flow through Velcro Holdings, but were co-mingled with its other funds and were subject to the risk of its creditors. Velcro Holdings exercised its control by subjecting the funds to interest and currency risk, as well as to pay its other outstanding obligations.¹²²³

What stands out from the reasoning in *Velcro* is that the court reused the same facts to substantiate the direct recipient having different attributes.¹²²⁴ Take, for example, the fact that the royalties received by the direct recipient were intermingled with its other accounts.¹²²⁵ To the court, this is proof that the direct recipient *possessed*, had the *use* of the dividends and *controlled* the dividends.

Just how difficult it is to talk about “ownership attributes” where payment rights are concerned, can be illustrated by focusing on the ownership attribute of possession. How does one “possess” a payment right? It was pointed out earlier that it is problematic to refer to “possession” of an incorporeal. *Quasi*-possession, which is what one is dealing with in the case of incorporeals, refers to the “exercise” of that right.¹²²⁶ But that then leads to the next question: how does one “exercise” a payment right?

Kruger, who considers the judgment in *Velcro* in order to give meaning to the South African definition of “beneficial owner” in the ITA (discussed in part 9.4), considered this question.¹²²⁷ He argues that, when the South African definition requires the beneficial owner to be “entitled to” the “benefit” of the dividend, this means that a recipient should have “the right (the *possession* trait of beneficial ownership...) of the use and enjoyment (the *use* trait...) of the dividend income”.¹²²⁸ On Kruger’s interpretation the traits of “possession” and “use” thus mean that the beneficial owner “possesses” the “use and enjoyment” of the dividend. On this reading it is difficult to identify the difference between the two traits: it

¹²²³ Paras [41]-[42].

¹²²⁴ The outlier is the attribute of risk.

¹²²⁵ Arnold (2012) *BFIT* 324; Arnold “Beneficial Ownership under Canadian Tax Treaties” in *Beneficial Ownership* (2013) 47 criticises the emphasis placed by the court on the fact that the royalties were intermingled with the other funds of Velcro Holdings in one bank account. He argues that this cannot be a reliable factor in deciding beneficial ownership. It is too easy to ensure compliance with this factor and it is within control of the direct recipient. Chew (2015) *Derivatives & Financial Instruments* heading 3.3.5.1 disagrees and argues that the “test” of commingling is feasible. He explains that if this test is considered in a negative sense, if no intermingling takes place, it would be a strong indicator that the conduit does not have the attributes of ownership set out in *Velcro*.

¹²²⁶ Part 3.2.3.

¹²²⁷ D Kruger “Who is a Beneficial Owner?” (2012) 3 *BTCLQ* 8 14.

¹²²⁸ 15.

appears that the beneficial owner must have the use and enjoyment of the dividend, but it is less clear whether “possession” has a separate meaning.¹²²⁹

With regard to a vested income beneficiary of a South African trust, Kruger also argues that such beneficiary has “possession (dominion) over the dividends in these circumstances (albeit that the dividend income may be paid to the trust *qua* owner of the shares)”.¹²³⁰ This may be contrasted with the view held by Du Plessis, who argues that “in most cases” it is the trustee that will possess the income “as the trustee usually receives and holds the income”. This applies even if the trustee does not accumulate the trust income.¹²³¹

To conclude, one may question whether it is helpful to place such emphasis on “ownership attributes”, at least when it comes to conduit company treaty shopping.¹²³² Returning to the judgment in *Prévost (TCC)*, the crux of that judgment lies in the court examining whether the direct recipient had any discretion to pay the dividends on to another person. If it has no discretion, it would not be the “beneficial owner”.

With regard to this formulation Cilliers argues that “doing what one desires” with income is perhaps not framing the question correctly since it focuses on whether the direct recipient has to defer to the ultimate recipient’s wishes to an appreciable extent.¹²³³ For him it is rather a question of accountability, i.e. whether the direct recipient is accountable to the ultimate recipient. This is, indeed, also the wording used by the TCC when it notes that a beneficial owner is “not accountable to any for how he or she deals with the dividend income”.¹²³⁴

In my view *Prévost (TCC)* asks the following question, which should be answered based on the legal relationships between the various parties, as governed by any applicable agreements

¹²²⁹ The difficulty in distinguishing between “ownership attributes” is further illustrated by the distinction made by Kruger between “use” and “control”. He concludes at 16 that a vested income beneficiary will have the “use” attribute since “he has the right to use the income as he deems fit”. With regard to the attribute of “control”, he notes that the vested beneficiary has control “in that it is able to utilise the funds without interference of anyone else.”

¹²³⁰ Kruger (2012) *BTCLQ* 16.

¹²³¹ Du Plessis *Critical Issues Regarding the OECD Model Tax Convention* 285.

¹²³² See also the argument advanced by Cilliers “Anti-Avoidance” in *Silke on International Tax* (2010) para 46.40:

“Finally, it must be pointed out that there is a fundamental conceptual difficulty associated with asking whether a particular person has ‘all’ the attributes of ownership namely, the implication that ownership is nothing more than the mere sum of a limited number of specific, identifiable individual ‘attributes’. In many countries, including South Africa, ownership is an umbrella term which will resist such reductionist treatment.”

¹²³³ Cilliers “Anti-Avoidance” in *Silke on International Tax* (2010) para 46.40. He does, however, note that the description at para [100] of this judgment of the beneficial owner as “a person who could do with the dividend as he or she desires” is “probably as close as one could get to a reasonable accurate plain English definition of beneficial ownership”.

¹²³⁴ *Prévost Car Inc. v The Queen* 2008 TCC 231 para [100].

(real ones, not shams) and/or legal rules: Does the direct recipient have a legal obligation to pay that amount, or part thereof, to another person? However, even this formulation is problematic. As explained in part 3.2.2, where money is deposited into a bank account (as would often be the case when large amounts of money are transferred), the money becomes the property of the bank, where it is mixed with all the other money of the bank. The direct recipient only has a personal right against this bank in respect of the amount credited to such direct recipient's bank account. Therefore, although one may intuitively understand what is meant when asking whether the direct recipient is under a legal obligation to pass on *that dividend or payment*, the question may also be phrased differently to take into account the fact that *that payment* cannot be identified. The question may be phrased as follows: Does the direct recipient have a legal obligation to transfer funds and does that obligation only arise if and to the extent that such direct recipient receives dividends in the first place?¹²³⁵

In this legal analysis factors such as the economic substance of the direct recipient plays no role. Therefore, whether the ultimate recipient "controls" the direct recipient is irrelevant. The purpose of inserting the direct recipient and factors such as that the direct recipient makes no spread and that there is only a very small time-lapse between receipt of the income by the direct recipient and the on-payment of the funds to the ultimate recipient are only relevant insofar as they may play a role in determining the legal rights, in the sense of identifying whether any of the transactions were shams or whether mislabelling as discussed in part 5.4 took place.

This view of the test in *Prévost* is also in line with (one way of understanding) the 2014 Commentary. It will be recalled that that Commentary notes that a direct recipient would not be regarded as having an obligation to pass on a payment received if "the contractual or legal obligations [to do so] 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."¹²³⁶

Therefore, with regard to *Velcro*, even if the royalties received by the direct recipient were the only income that it had received and no intermingling of funds took place, it would still have been the beneficial owner as foreseen in *Prévost (TCC)*. That is because the direct

¹²³⁵ To the extent that risk is, indeed, a valid factor in determining beneficial ownership, it is arguable that in these circumstances the direct recipient does not carry any risk in the sense of non-performance by the payor (the company declaring the dividend). See also n 813 above and the main text corresponding to n 1026 above.

¹²³⁶ Second paragraph of para 12.4 of the Commentary to Article 10.

recipient was legally obliged to pay royalties to the ultimate recipient, irrespective of whether it received payment from Velcro Canada. Therefore, the court in *Velcro* could have stood by the following statement:

“[T]here was no predetermined flow of funds. What there is is a contractual obligation by [the direct recipient] to pay ... a certain amount of monies within a specified time frame. These monies are not necessarily identified as specific monies, they may be identified as a percentage of a certain amount received by [the direct recipient] ..., but there is no automated flow of specific monies because of the discretion of VHBV with respect to the use of these monies.”¹²³⁷

6.7 Conclusion

There appears to be little convergence between the approaches followed by the cases studied in this chapter with regard to the issues listed in the introduction to this chapter.¹²³⁸

Turning first to the issue of whether a domestic or international meaning should be given to the term “beneficial owner”, Castro, who analysed a greater number of cases, concludes that courts most often refer to an international tax meaning and that they rely primarily on the Commentaries and the Conduit Report. He indicates that it is not clear whether this is because countries seldom have a domestic meaning for the term or because of the goal of common interpretation.¹²³⁹

If one compares this with the cases analysed in this chapter, it can be concluded that the TCC in *Prévost* favoured a domestic meaning, notwithstanding the fact that Quebec (where the company declaring the dividend was resident) follows civil law. In that case, the court considered both civil and common law to determine a meaning. The FCA possibly favoured an “international meaning”, but at the same time accepted that this corresponded with the domestic meaning of the court *a quo*. The *Market Maker*, *Real Madrid* and *Indofood* cases all fall within the “international meaning” category. However, in none of these cases was reference made to the general *renvoi* clause in the particular DTA. No attempt was thus made to reconcile the use of an international meaning with a domestic meaning. Also, all these

¹²³⁷ *Velcro Canada Inc. v the Queen* 2012 TCC 57 (CanLII) para [45].

¹²³⁸ In agreement: De Broe *International Tax Planning* 713; BJ Arnold “More on Beneficial Ownership” (2009) 63 *BFIT* 175176; Collier (2011) *BTR* 693; J Wheeler “The Missing Keystone of Income Tax Treaties Part II” (2011) *World Tax J* 247 258; Li *Beneficial Ownership in Tax Treaties* 188.

¹²³⁹ Castro (2013) *International Tax Journal* 37-38. See also Jiménez (2010) *World Tax J* 50.

judgments contain little to no analysis as to whether a meaning exists in domestic law.¹²⁴⁰ Of course, that might be because they all dealt with civil-law jurisdictions. Furthermore, with regard to *Indofood* it has been argued in part 6.3.4.1 that there are several factors that detract from the court's finding in favour of an international meaning. For these reasons one should be cautious to argue that there is overwhelming acceptance for an international meaning of beneficial ownership in these cases.

With regard to the sources for the international meaning, an analysis of the case law considered in this chapter corresponds with Castro's conclusion that the main sources for such meaning were the Conduit Report and the 2003 Commentaries. Little attention was paid to foreign case law.¹²⁴¹

That leaves one wondering why, despite the almost universal reference to the Conduit Report and the Commentaries, a uniform interpretation of the term "beneficial owner" has not resulted from these judgments.¹²⁴²

One possible reason is that domestic anti-avoidance measures or domestic approaches to interpretation influenced the way in which the court arrived at the international meaning. Li, for example, argues:

"As such, although OECD Materials were referred to, the conclusion in [*Indofood (CA)*] and [*Real Madrid*] seemed to rest on the domestic law approach [to interpretation]: Indonesian law ... in *Indofood*, and the Spanish business purpose test in *Real Madrid*."¹²⁴³

Another possible explanation is that the weight given to the Commentaries in these cases differs. The weight was substantial in *Indofood*. However, in the *Market Maker* case the court itself did not refer to the Commentaries. In *Prévost (TCC)* the weight was also not

¹²⁴⁰ Although, as indicated, in *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] STC 1195 the CA did point out that there was no Indonesian case law on any of the points that arose in the case.

¹²⁴¹ Jiménez (2010) *World Tax J* 50. See also Avi-Yonah & Panayi "Rethinking Treaty Shopping" in *Tax Treaties: Building Bridges* (2010) 40 with regard to other cases dealing with beneficial ownership.

¹²⁴² Vleggeert *Abuse of Tax Treaties* heading 4. Cilliers "Anti-Avoidance" in *Silke on International Tax* (2010) para 46.38 notes:

"Although courts may be open to being persuaded that the term beneficial ownership should bear an international meaning, this by itself is no guarantee that they will actually arrive at a consensus in this regard. Relying liberally on a variety of international materials regarding beneficial ownership (and by implication rejecting domestic meanings, both particular and in general) is not the same as adhering to or moving towards a unified international meaning, which is therefore likely to remain elusive."

¹²⁴³ Li *Beneficial Ownership in Tax Treaties* 199. See also Du Toit (2010) *BFIT* 507 and the following statement by Jiménez (2010) *World Tax J* 50:

"[A]lthough courts in different countries speak about the international meaning of the concept of beneficial ownership, it has not fully cut its nexus with internal law In fact, most of the decisions ... apply source country anti-abuse standards to attribute a meaning to beneficial ownership."

substantial. However, this argument is perhaps less convincing since the High Court in *Indofood* and the FCA in *Prévost (FCA)* both placed considerable weight on the Commentaries and still came to different conclusions. The same applies in respect of the conclusion by the High Court in *Indofood* in comparison with that of the CA. Yet another explanation is that the courts simply read the Commentaries differently. As explained in part 2.4, this divergence is also found among scholars.

What is noteworthy is that in all the cases where reference was made to the Commentaries, the 2003 version (which post-dated all the respective DTAs) was considered. In none of the cases, except for the judgment by the FCA in *Prévost*, did the court address the question whether reference to Commentaries amended after conclusion of the DTA would be acceptable.¹²⁴⁴

Turning to the issue whether a legal or economic approach was followed, it appears that the CA in *Indofood* followed both approaches, the AN in *Real Madrid* followed an economic approach and the other judgments followed a legal approach. Some authors, however, propose that the outcomes (if not the legal reasoning) in these cases show some convergence.

Jiménez argues that, despite what the courts had at times professed to do, in all these cases the courts have stuck to a legal analysis of the facts to determine who the owner of the income was, legally.¹²⁴⁵ Duff argues that, although the meaning given in *Prévost* seems narrower than the meaning in *Indofood (CA)*, if one focuses on whether there was an obligation to forward the received amounts, there is convergence between the judgments: in the Canadian case there was no such obligation, whereas the direct recipient in the UK case had no or very little discretion regarding the use of the interest received.¹²⁴⁶ He does not elaborate on how such obligation should be determined, but Du Toit and Hattingh point out that, in *Indofood*, there seemingly was a legal obligation on Newco to pay over the interest [“i]f it was true that Newco was bound to pay over the exact same payment that it received”].¹²⁴⁷

Jezi also sees a convergence between the judgments in *Prévost* and *Indofood (CA)*, but for different reasons. He focuses on the purpose for interposing the conduit company in each of these cases. According to him, whereas such an approach in *Indofood* lead to a denial of

¹²⁴⁴ Jiménez (2010) *World Tax J* 50; Du Toit (2010) *BFIT* 504.

¹²⁴⁵ Jiménez (2010) *World Tax J* 51.

¹²⁴⁶ Duff “Responses to Treaty Shopping” in *Tax Treaties: Building Bridges* (2010) 90.

¹²⁴⁷ Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.6.2.

beneficial ownership, in *Prévost* it did not since the direct recipient served an economic purpose, as the “corporate nexus” for the two unrelated investors.¹²⁴⁸

To conclude, if one focuses only on the reasoning in *Prévost* and *Indofood (CA)*, the first-mentioned supported a legal meaning. As argued in part 6.6.3.2, this meaning is that a recipient of dividends is the beneficial owner unless he is under an obligation to make a payment and that obligation only arises if and to the extent that the direct recipient receives the dividend.

With regard to *Indofood (CA)*, if one considers only the legal approach followed by the CA, on the CA’s reading of the documents Newco would not be allowed to source the money payable to the noteholders from any source other than the interest from ParentCo. Therefore, had Newco not received any interest from ParentCo, it would have been unable to pay interest to the noteholders. Put differently, had Newco not received any interest from ParentCo, it would not be under an obligation to pay the noteholders. There is thus convergence between these cases in this regard. However, there is no denying the fact that the CA was not satisfied to follow (only) the legal approach, a fact that cannot be ignored.

¹²⁴⁸ Jezzi (2010) *BFIT* 257.

CHAPTER 7
A SOUTH AFRICAN PERSPECTIVE ON THE INTERPRETATION OF DOUBLE
TAXATION AGREEMENTS AND A PROPOSED INTERNATIONAL MEANING
FOR “BENEFICIAL OWNER”

Chapter overview

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7.1 Introduction

In this chapter a South African perspective on some of the topics covered in previous chapters relating to the interpretation of DTAs and tax legislation is given and an international meaning for the beneficial owner requirement is proposed.

The chapter commences with a discussion of the South African perspective on the following three topics: the goals of common and uniform interpretation, the interpretative approach most likely to be adopted by South African courts under the Vienna rules and the interpretative approach followed by South African courts when interpreting tax legislation in scenarios where tax avoidance is suspected. Thereafter the chapter explores the manner in which South African courts have employed the Commentaries and selected other material in the interpretation of DTAs.¹²⁴⁹ The chapter concludes by proposing an international meaning for the term “beneficial owner”. This meaning takes into account the findings made in this study thus far.

7.2 The goals of common and uniform interpretation: A South African perspective

Support for the goal of common interpretation has been given in South African case law.¹²⁵⁰ An example is found in a South African case dealing with the Warsaw Convention, which South Africa has ratified.¹²⁵¹ When the AD interpreted this treaty in 1965,¹²⁵² both Steyn

¹²⁴⁹ In this chapter, as well as chapter 8, a number of South African cases dealing with tax treaties on income and capital (including a treaty in respect of sea and air transport) are considered. These are (in chronological order): *ITC 789* (1954) 19 SATC 434; *Baldwins (South Africa) Ltd v Commissioner for Inland Revenue* (1961) 24 SATC 270; *Case of LJ Downing (No. 6737)* (1972) Unreported; *SIR v Downing* 1975 (4) SA 518 (A); *ITC 1364* (1980) 45 SATC 23; *ITC 1473* (1989) 52 SATC 128; *ITC 1503* (1990) 53 SATC 342; *ITC 1544* (1992) 54 SATC 456; *ITC 1742* (1997) 65 SATC 146; *Cohen Brothers Furniture (Pty) Ltd v Minister of Finance of the National Government, RSA* 1998 (2) SA 1128 (SCA); *ITC 1735* (2002) 64 SATC 455; *ITC 1819* (2007) 69 SATC 159; *Volkswagen of South Africa (Pty) Ltd v Commissioner for South African Revenue Service* (2008) 70 SATC 195; *Grundlingh v Commissioner for the South African Revenue Service* (2009) 72 SATC 1; *ITC 1848* (2010) 73 SATC 170; *The Oceanic Trust Co Ltd NO v Commissioner for the South African Revenue Service* (2011) 74 SATC 127; *Commissioner for South African Revenue Service v Van Kets* (2011) 74 SATC 9; *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA); *Commissioner for South African Revenue Service v Krok and another* (2014) 76 SATC 119; *ITC 1878* (2015) 77 SATC 349 (2015); *Krok v CSARS* 2015 (6) SA 317 (SCA). The following Rhodesian/Zimbabwean cases were also considered: *ITC 1048* (1964) 26 SATC 226; *ITC 1087* (1966) 28 SATC 196; *COT v Aktiebolaget Tetra Pak* (1966) 28 SATC 213; *Anglo American Corporation of SA Ltd v Commissioner of Taxes* (1974) 37 SATC 45; *BAT v Commissioner of Taxes* (1994) 57 SATC 271. *Transvaal Associated Hide and Skin Merchants v Collector of Income Tax Botswana* (1967) 29 SATC 97 (BCA), decided in Botswana, was also considered. In this chapter and chapter 8, when reference is made to South African or local case law it includes the Rhodesian/Zimbabwean and Botswana cases mentioned in this footnote.

¹²⁵⁰ Du Plessis (2012) *SA Merc LJ* 50-51.

¹²⁵¹ This convention does not include an article comparable with Art 3(2) of the OECD MTC.

¹²⁵² *Pan American World Airways Incorporated v SA Fire and Accident Insurance Co Ltd* 1965 (3) SA 150 (A).

CJ¹²⁵³ and Ogilvie Thompson JA¹²⁵⁴ commented on the desirability of a common interpretation of its terms by the parties to the treaties. Steyn CJ was nevertheless prepared to express his doubt as to the correctness of an interpretation that was said to be followed by one of the treaty parties.¹²⁵⁵ More recently, when the same convention was interpreted, the SCA agreed that foreign case law of treaty partners is “useful”, although not always “harmonious”.¹²⁵⁶ As the foreign case law discussed in that case shows,¹²⁵⁷ there are differences in opinion as to the length a court will go to ensure a common interpretation.

Section 233 of the Constitution is also relevant to the goal of common interpretation. This (much underutilised)¹²⁵⁸ provision requires South African courts to prefer “any reasonable interpretation” consistent with international law over one that is not.¹²⁵⁹ The section has been quoted as justification for a common interpretation of treaty terms in the case of *Seton Co v Silveroak Industries Ltd*.¹²⁶⁰ In that case, the court made the following statement, followed by a reference to section 233:

“As [the South African Act] is based on the New York Convention [to which South Africa is a party] and as many other countries, including the United Kingdom and the United States of

¹²⁵³ Steyn CJ said at 164:

“In support of this submission counsel referred to cases decided in other countries... With due deference to others who have thought otherwise and conscious of the *desirability of uniformity* in a matter such as this ...” (emphasis added).

¹²⁵⁴ Ogilvie Thompson JA commented at 167:

“If attainable without doing violence to the language of the Convention, *uniformity* is, *in an international matter of this kind, manifestly desirable*” (emphasis added). This was also quoted, with approval, in *Potgieter v British Airways plc* 2005 (3) SA 133 (C) 140. In a case dealing with the interpretation of a DTA, *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA), the court also referred at para [21] to this statement, but apparently wanted only to draw attention to the phrase “without doing violence to the language of the Convention”.

¹²⁵⁵ *Pan American World Airways Incorporated v SA Fire and Accident Insurance Co Ltd* 1965 (3) SA 150 (A) 164. See also the reference to this case by Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.3 n 17.

¹²⁵⁶ *Impala Platinum Ltd v Koninklijke Luchtvaart Maatschappij NV and another* 2008 (6) SA 606 (SCA) paras [12]-[13] and see also paras [15] and [42]. See also the reference to this case by Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) paras 9.3 ns 17 and 18 and 9.13 n 127.

¹²⁵⁷ *Impala Platinum Ltd v Koninklijke Luchtvaart Maatschappij NV* 2008 (6) SA 606 (SCA) paras [24]-[26].

¹²⁵⁸ L Du Plessis “‘Transnasionale Konteks’ in die Regspraak van die Konstitusionele Hof in Suid-Afrika: ‘n Variasie op die Tema van Grondwetsvertolking” (2013) 10 *LitNet* 1 16.

¹²⁵⁹ This is generally regarded as entrenching a presumption that formed part of South African law before 1996, although, as noted by Du Plessis (2013) *LitNet* 16, the provision arguably has wider application.

¹²⁶⁰ *Seton Co v Silveroak Industries Ltd* 2000 (2) SA 215 (T). See also the reference to this case by Du Plessis (2012) *SA Merc LJ* 45. However, see the following criticism by N Botha & M Olivier “Ten Years of International Law in the South African Courts: Reviewing the Past and Assessing the Future” (2004) 29 *SAYIL* 42 65-66:

“Hartzenberg J proceeded to quote section 233 of the Constitution directing courts to interpret legislation in a manner that is consistent with international law, but went right on to consider British authority on international awards based on illegal contract. *This modus operandi leaves the impression that international law is to be found in ... court decisions on international law* and is regrettable in one of the first judgments to consider the application of section 233 of the Constitution” (emphasis added).

America, incorporated the New York Convention into their national legislation, the interpretation of the Convention by Courts of those countries has persuasive authority in our Courts.”¹²⁶¹

The view of Du Toit and Hattingh with regard to section 233 is also worth noting. They argue that section 233 requires that, when interpreting a term in a DTA, “regard must be had to the international law position, meaning that *cases of foreign jurisdictions on international tax conventions* ought to be taken into account”.¹²⁶² It is not clear whether they propose that, for purposes of this section, the foreign case law is “international law”, or whether the foreign case law is merely a source of a “reasonable interpretation” of international law.

If they argue that foreign cases may provide a “reasonable interpretation”, that statement is agreed with. However, section 233 is not prescriptive regarding where a “reasonable interpretation” should be derived from and thus does not *require* a court to refer to foreign cases for a “reasonable interpretation”.

If Du Toit and Hattingh argue that “international law” in section 233 includes foreign case law,¹²⁶³ it should be noted that it is unlikely that a South African court must prefer the “reasonable interpretation” of *any* foreign court, irrespective of its standing, in respect of any DTA based on the OECD MTC. And what to do if there are two conflicting, yet both “reasonable”, interpretations by foreign courts?

It is also important to note that, as discussed elsewhere,¹²⁶⁴ DTAs are somewhat unusual in that they contain *renvoi* clauses that prescribe the use of domestic meanings for undefined treaty terms, unless the context otherwise provides. A (reasonable) interpretation that gives a domestic meaning to a treaty term would thus not be “inconsistent” with “international law” (which arguably includes the DTA being interpreted by the South African court).¹²⁶⁵ This

¹²⁶¹ *Seton Co v Silveroak Industries Ltd* 2000 (2) SA 215 (T) 229.

¹²⁶² Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.13. See also J Hattingh “South Africa: The Volkswagen Case and the Secondary Tax on Companies: Part 2 – The Effect on the Taxation of Dividends with Emphasis on Deemed (Constructive) Dividends” (2009) 63 *BFIT* 509 n 125; J Hattingh “An Overview of the Court System of South Africa with Emphasis on the Resolution of Tax Disputes” (2011) 65 *BFIT* 127 130.

¹²⁶³ The exact scope of “international law” in s 233 of the Constitution is unclear. See in this regard the criticism against the use of foreign cases under s 233 at n 1260 above, but see also the discussion by Du Plessis (2013) *LitNet* 16-17.

¹²⁶⁴ Parts 4.5 and 8.1.

¹²⁶⁵ See Du Plessis (2012) *SA Merc LJ* 38 for a similar argument, although her argument did not deal with a general *renvoi* clause. But see also the question raised by T Gutuza “Tax Treaties, the Income Tax Act and the Constitution - Trump or Reconcile” (2016) 29 *SA Merc LJ* 480 497 as to whether s 233 takes precedence over the general *renvoi* clause in the sense that a meaning “more in line with international law” rather than domestic law must be given.

should hold true even if there is case law from a foreign jurisdiction in which the term that is being interpreted has been given an international meaning rather than a domestic meaning. That is because the “context” taken into account by that foreign court under the general *renvoi* clause in that DTA would include, for example, the domestic tax legislation of that foreign jurisdiction and (possibly distinctive) provisions in that DTA. The context would thus necessarily be different from the “context” that needs to be taken into account by a South African court.

To date in not a single South Africa decision in which a term in a DTA was interpreted, was reference made to a meaning given to that term by the courts of its treaty partner.¹²⁶⁶ It is acknowledged, though, that this might be due to a lack of such foreign judgments. It should also be noted that a South African court has referred to, and agreed with, an interpretation proposed in the technical explanation issued by its treaty partner.¹²⁶⁷

With regard to the goal of uniform interpretation, both South African scholars¹²⁶⁸ and courts have recognised the international character of DTAs. For example, the Natal Special Income Tax Court,¹²⁶⁹ in an early case concerning the interpretation of a South African DTA, stated:

“I do not think that [a] special approach, deviating materially from ... the norm, is necessary to the interpretation of a convention such as we are concerned with...In certain treaties between independent States it may be necessary to have regard to reasonableness and *uniformity* when determining the meaning of the words used, but the important point is still ‘to get at the real intention’, which is primarily to be ascertained from the words used...In *COT vs Aktiebolaget Tetra Pak*, 28 SATC 211 at 217, *Beadle, CJ*, said that in interpreting ... a convention ... ‘the ordinary rules of construction applicable to the interpretation of a municipal statutory instrument must apply’. No doubt, however, circumstances in any given case may be such as to

¹²⁶⁶ R Eskinazi “Interpretation of Double Taxation Conventions - South Africa” in *IFA Cahiers De Droit Fiscal International Vol. 78a* (1993) 545 547 and 552 argues that *SIR v Downing* 1975 (4) SA 518 (A) indicated that emphasis should be placed on the common intention of the contracting states, although he does not refer to any specific parts of the judgment. See the quote from the court *a quo* in *Case of LJ Downing (No. 6737)* (1972) Unreported, quoted in the main text corresponding to n 1270 below, which seems to support the goal of common interpretation.

¹²⁶⁷ *ITC 1878* (2015) 77 SATC 349 paras [36]-[39]. Also, in *Anglo American Corporation of SA Ltd v COT* (1974) 37 SATC 45 52 the Zimbabwean High Court referred to an opinion of a South African scholar (“Silke South African Income Tax 6 ed 1317”) in interpreting the DTA between South Africa and Zimbabwe. There is, however, no indication given by the court that it regarded this as a source of a common interpretation, or that it was endeavouring to reach a common interpretation.

¹²⁶⁸ Brincker “Silke on International Tax” in *Silke on International Tax* (2010) para 12.8.9 indicates that DTAs should be interpreted according to “international tax practice”. As indicated in part 4.2, Olivier & Honiball *International Tax* 309 also argue that the “ordinary meaning” in Art 31(1) of the VCLT refers to the “international uniform legal use” of the word.

¹²⁶⁹ *Case of LJ Downing (No. 6737)* (1972) Unreported.

require some modification of locally accepted canons of construction or some degree of deviation of approach, *in recognition of the international flavour of the agreement*. (cf the observations of Lord Macmillan in *Stag Line, Ltd, vs Foscole Mango and Co*, (1932) AC, 328 at 350.)¹²⁷⁰

Furthermore, in *ITC 1878*¹²⁷¹ the court described non-uniform interpretation of DTAs based on the OECD MTC as a “problem” which must be avoided.¹²⁷² However, in that case the court was prepared to interpret a term in a South African DTA contrary to the Commentaries (despite the fact that the court had previously noted that the Commentaries would reduce the risk of this problem materialising).¹²⁷³

Recently, the Davis Tax Committee stated the following:

“The fact that a DTA is an international treaty implies that *its international nature* should be taken into account by a South African court when it has to establish the intention of the contracting governments. This implies that the agreement should have the same meaning in South African law as it has in *international law*.”¹²⁷⁴

Turning to the question whether South African courts give autonomous meanings to terms used in South African treaties, it must be admitted that this is not easily answered. Du Plessis points out that South African courts often give “the natural or ordinary meaning of words” when interpreting treaties.¹²⁷⁵ However, the problem is that the everyday meaning of words will often (although not necessarily) be the same across borders,¹²⁷⁶ so that there are seldom “domestic” or “autonomous” everyday meanings as such.¹²⁷⁷ When one considers the material used by South African courts when interpreting DTAs, as is done in part 7.6, one

¹²⁷⁰ The judgment is published as an appendix to AP de Koker & E Brincker *Silke on International Tax* (2010) with no paragraph or page numbers. The paragraph is quoted here as it was published as an appendix to that book, unless otherwise indicated. The emphasis also occurs in the original.

¹²⁷¹ *ITC 1878* (2015) 77 SATC 349.

¹²⁷² Para [15]. In addition, in *ITC 1544* (1992) 54 SATC 456 463 the court indicated that its interpretation of a DTA was in line with “international practice” as evidenced by a book written by an international scholar.

¹²⁷³ As discussed in part 7.5.4.

¹²⁷⁴ *Davis Tax Committee's Interim Report on Action Plan 6* 34 (emphasis added, footnotes omitted).

¹²⁷⁵ Du Plessis (2012) *SA Merc LJ* 50-51. In a number of South African and Rhodesian cases, all dealing with the interpretation of DTAs, the courts gave meanings which they regarded as falling within the everyday use of the words and thus constituting “ordinary meanings”. An example is *COT v Aktiebolaget Tetra Pak* (1966) 28 SATC 213. As discussed in part 7.3, in that case the Rhodesian court (when interpreting the word “commercial” in a DTA) gave at 218 a meaning that the word would have in “ordinary commercial life”, which accorded with its meaning in the “ordinary popular sense”. Another example is *SIR v Downing* 1975 (4) SA 518 (A) where the AD (when interpreting the phrase “in the ordinary course of his business” in a DTA) agreed at 528 that the phrase could bear the “natural meaning” which was given by the tax court. A last example is *ITC 1735* (2002) 64 SATC 455, discussed in part 7.6.1, where the court settled at para 12.6.1 on a dictionary meaning (which the court described as the “modern ordinary meaning”) for the term “athlete” in a DTA.

¹²⁷⁶ The position may be different with regard to technical meanings. See the discussion in part 4.3.2.

¹²⁷⁷ See Pötgens *Income from International Private Employment* 559.

notes that it is often the same as the material that the courts consider when seeking the everyday meaning of terms in domestic legislation.¹²⁷⁸ These include dictionaries and case law,¹²⁷⁹ the latter often dealing with the meaning of the term in contexts that differ from the one before the court.¹²⁸⁰ This seems to indicate that the courts are looking for the everyday meaning of the word, rather than a “domestic” or “autonomous” meaning.

To summarise: South African courts in principle subscribe to the goals of both common and uniform interpretation, but have also been prepared to depart from such common and uniform interpretation. This is further illustrated when the use of the Commentaries and international precedents by South African courts are considered later in this chapter.

7.3 The interpretative approach most likely to be adopted by South African courts under the Vienna rules

It was indicated in part 4.3.1 that South African courts are bound to adhere to the Vienna rules when interpreting DTAs. According to Olivier and Honiball, a South African court has never specifically decided the issue of whether the international law rules or domestic rules apply when South African courts interpret DTAs, but that the court in *Downing*¹²⁸¹ seems to indicate that the international rules should apply. These authors do not provide reasons for their view.¹²⁸² Du Plessis argues that the manner in which the court in *Downing* interpreted the DTA shows that the court “in effect adopted an interpretation in accordance with the rules of international law”. She refers specifically to its use of the “natural meaning” and reading the words in the context of the article as a whole.¹²⁸³

¹²⁷⁸ See, e.g. the following statement in *ITC 1503* (1990) 53 SATC 342 347:

“The meaning of the agreement must be determined according to the principles governing the interpretation of contracts in the Republic of South Africa. The court must determine what the language of the document *would ordinarily be understood to mean*. It matters not, in my view, that on proclamation the arrangements therein contained shall insofar as they relate to immunity, exemption, or relief from taxation in the Republic have the effect as if enacted in the Income Tax Act (s 108(2) refers)” (emphasis added).

¹²⁷⁹ As will become evident from the discussion in part 7.6, mainly local and, to a far lesser extent, foreign case law is considered.

¹²⁸⁰ To name one example of where a court relied on case law dealing with the meaning of a treaty term in an unrelated context: as discussed in part 7.6.2.1, in *ITC 1087* (1966) 28 SATC 196 201, where the term “commercial” in a DTA was at issue, the court found South African case law dealing with the Usury Act 37 of 1926 useful, despite noting its wariness in considering case law dealing with a non-tax matter.

¹²⁸¹ *SIR v Downing* 1975 (4) SA 518 (A).

¹²⁸² Olivier & Honiball *International Tax* 546.

¹²⁸³ Du Plessis (2016) *TSAR* 493-494. She reaches a similar conclusion at 494 with regard to *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA). With regard to *ITC 1878* (2015) 77 SATC 349, she argues at 495 that the court’s approach also corresponds with the Vienna rules.

Article 31(1) of the VCLT requires that a treaty 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*.”¹²⁸⁴ This does not, however, provide much clarity on the interpretative approach to be followed and domestic courts are thus given much latitude, as argued in part 4.3.6. The question considered here is which approach a South African court is likely to adopt.

Recently the SCA in *Krok*¹²⁸⁵ indicated that the Vienna rules are “essentially no different” from the domestic rules of interpretation pertaining to legislation and contracts.¹²⁸⁶ One should pause here to point out that there would at least be *some* differences when interpreting treaties if compared with interpreting domestic legislation. These differences follow, firstly, from the international nature of treaties. The goals of common and uniform interpretation, for example, are not present when interpreting domestic legislation. Secondly, as pointed out in part 4.3.3, under Article 31 of the VLCT only a limited “context” *must* be considered when meaning is given to a treaty term. This context includes only limited extra-textual material although additional extra-textual material *may* be considered as “supplementary” aids, and be applied if the circumstances foreseen under Article 32 of the VCLT are present. (However, as explained in part 4.3.5, the “supplementary” role allocated to such extra-textual material should not be overemphasised). In contrast, South African courts are not bound by such a distinction. For example, in *Natal Joint Municipal Pension Fund v Endumeni Municipality* (“*Natal JMPF*”)¹²⁸⁷ the court referred to the fact that courts “must” consider “material responsible for [the document’s] production” and “the background to the preparation and production of the document”.¹²⁸⁸ Since these aids form part of the “context”, they enjoy equal status with the text.

¹²⁸⁴ Emphasis added.

¹²⁸⁵ *Krok v CSARS* 2015 (6) SA 317 (SCA).

¹²⁸⁶ Para [27]. Burt (2017) *BTCLQ* 13 n 37 agrees, with reference to *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) para [19], discussed in the main text corresponding to n 1295 below. South African courts have on a number of occasions stated that they interpret DTAs in the same manner as domestic (tax) legislation. Brincker “Silke on International Tax” in *Silke on International Tax* (2010) para 12.7.5. An early example of a statement confirming this is *Case of LJ Downing (No. 6737)* (1972) Unreported, quoted in the main text corresponding to n 1270. In *ITC 1503* (1990) 53 SATC 342 347 the court stated that the meaning of the DTA in question had to be determined according to the principles governing the interpretation of contracts in South Africa, as reflected in the statement quoted at n 1278 above.

¹²⁸⁷ *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA).

¹²⁸⁸ Para [18]. Cassidy (2012) *Stell LR* 335-336 points out that in many cases courts still refer to a much more limited “context”, limited to the legislation itself, and disregard extra-textual material.

That brings one back to the following question: what is the approach to the interpretation of domestic legislation in South Africa to which the SCA in *Krok* is referring? Unlike what the statement in *Krok* may suggest, no single, consistent approach has been followed over the years and is even currently followed.¹²⁸⁹ Here it should be noted that approaches change over time,¹²⁹⁰ making referring to less recent material¹²⁹¹ a somewhat hazardous exercise.¹²⁹² It is thus most instructive to focus on more recent case law.

According to *Krok*, the approach to the interpretation of domestic legislation is to be found in the following statements made by the SCA in *Natal JMPF* (which has received approval by Constitutional Court):¹²⁹³

“[18] Over the last century there have been significant developments in the law relating to the interpretation of documents, both in this country and in others that follow similar rules to our own... The present state of the law can be expressed as follows: Interpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or contract, having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence. *Whatever the nature of the document, consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production.* Where more than one meaning is possible each possibility must be weighed in the light of all these factors. *The process is objective, not subjective.* A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document. Judges must be alert to, and guard against, the temptation to substitute what they regard as reasonable, sensible or businesslike for the words actually used. To do so in regard to a statute or statutory instrument is to cross the divide between interpretation and legislation; in a contractual context it is to make a contract for the parties other than the one they in fact made. The ‘inevitable point

¹²⁸⁹ As pointed out by Cassidy (2012) *Stell LR*.

¹²⁹⁰ As confirmed by the SCA in *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) para [25].

¹²⁹¹ No attempt is made here to identify any time frame for what may be considered “recent”. GK Goldswain “Hanged by a Comma, Groping in the Dark and Holy Cows – Fingerprinting the Judicial Aids used in the Interpretation of Fiscal Statutes” (2012) 16 *Southern African Business Review* 30 32 suggests that the Constitution, particularly s 39(2), might have influenced the interpretation of domestic tax legislation, but see Cassidy (2012) *Stell LR* 333-336 for a different view.

¹²⁹² The 1993 report of Eskinazi “Interpretation - South Africa” in *Cahiers Vol. 78a* (1993) on the interpretation of DTAs in South Africa may probably be regarded as outdated and no longer representative of the (only) approach followed by South African courts. However, as discussed by Cassidy (2012) *Stell LR* 332-333, the literal approach to interpretation that is described in that report at 547 and 549 has not become extinct.

¹²⁹³ *Democratic Alliance v African National Congress and another* 2015 (2) SA 232 (CC) para [136].

of departure is the language of the provision itself’ read in context and having regard to the purpose of the provision and the background to the preparation and production of the document.

[19] All this is consistent with the ‘emerging trend in statutory construction’. It clearly adopts as the proper approach to the interpretation of documents the second of the two possible approaches mentioned by Schreiner JA in *Jaga v Dönges NO and Another; Bhana v Dönges NO and Another*,¹²⁹⁴ namely that from the outset one considers the context and the language together, with neither predominating over the other... The path that Schreiner JA pointed to is now received wisdom elsewhere. Thus Sir Anthony Mason CJ said:

‘Problems of legal interpretation are not solved satisfactorily by ritual incantations which emphasise the clarity of meaning which words have when viewed in isolation, divorced from their context. *The modern approach to interpretation insists that context be considered in the first instance, especially in the case of general words, and not merely at some later stage when ambiguity might be thought to arise.*’

More recently, Lord Clarke SCJ said ‘the exercise of construction is essentially one unitary exercise’.¹²⁹⁵

The other case that is noteworthy is the SCA’s 2015 decision in *Bosch*, the facts of which were discussed in part 5.4. The court noted the following regarding the interpretation of (tax) legislation:

“The words of the section provide the starting point and are considered in the light of their context, the apparent purpose of the provision and any relevant background material.¹²⁹⁶ There may be rare cases where words used in a statute or contract are only capable of bearing a single meaning, but outside of that situation *it is pointless to speak of a statutory provision or a clause in a contract as having a plain meaning. One meaning may strike the reader as syntactically and grammatically more plausible than another, but, as soon as more than one possible meaning is available, the determination of the provision’s proper meaning will depend as much on context, purpose and background as on dictionary definitions or what Schreiner JA referred*

¹²⁹⁴ In *Jaga v Dönges, NO and another; Bhana v Dönges, NO and another* 1950 (4) SA 653 (A) 662-663 the court indicated two possibilities with regard to how “context” should be taken into account when interpreting domestic legislation: (a) The ordinary meaning of the words used should be determined first and only in those instances where more than one meaning is possible, should the context be considered; (b) the language used and the context should be interpreted together from the beginning. See the discussion of this case in Du Plessis *Interpretation of Statutes* 107-108 and GE Devenish *Interpretation of Statutes* (1992) 58-59.

¹²⁹⁵ Emphasis added, footnotes omitted.

¹²⁹⁶ The footnote in the original text here refers to *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) para [18].

to as ‘excessive peering at the language to be interpreted without sufficient attention to the [historical] contextual scene’.”¹²⁹⁷

What conclusions can one make from these two sets of quotes regarding the interpretation process? Firstly, *Natal JMPF* stresses the fact that interpretation is a “unitary” process.¹²⁹⁸ Secondly, *Natal JMPF* makes it clear that context and purpose are always to be considered, not only if the meaning is unclear or in the case of ambiguity. The following passage from that case further confirms this:

“[The] disadvantages [of expressions such as ‘the intention of the legislature’ or ‘the intention of the parties’] ... lie at opposite ends of the interpretative spectrum. At the one end, they may lead to a fragmentation of the process of interpretation by conveying that it must commence with an initial search for the ‘ordinary grammatical meaning’ or ‘natural meaning’ of the words used seen in isolation, to be followed in some instances only by resort to the context. At the other, they beguile judges into seeking out intention free from the constraints of the language in question, and then imposing that intention on the language used. Both of these are contrary to *the proper approach, which is from the outset to read the words used in the context of the document as a whole and in the light of all relevant circumstances*. That is how people use and understand language and it is sensible, more transparent and conduces to greater clarity about the task of interpretation for courts to do the same.”¹²⁹⁹

The reference in *Bosch* to “rare cases” where this may not be required is in line with this view. This approach should be contrasted with what is often referred to as the “golden rule” of interpretation, which indicates that words should have their literal meaning, unless it would lead to absurdity.¹³⁰⁰ The approach is still evident in recent judicial decisions.¹³⁰¹

¹²⁹⁷ *CSARS v Bosch* 2015 (2) SA 174 (SCA) para [9] (emphasis added).

¹²⁹⁸ See also para [24] of *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA), quoted in the main text corresponding to n 1299 below, where the court warns against the “fragmentation” of the interpretation process. See also with regard to the VCLT De Broe *International Tax Planning* 239-240; Becerra (2011) *BFIT* 4-5; Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 3.5.1.2; Burt (2017) *BTCLQ* 12.

¹²⁹⁹ *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) para 24 (emphasis added, footnotes omitted).

¹³⁰⁰ Du Plessis *Re-Interpretation of Statutes* 94 and 103-104; Cassidy (2012) *Stell LR* 333.

¹³⁰¹ Cassidy (2012) *Stell LR* 332-333. See also M van Staden “The Role of the Judiciary in Balancing Flexibility and Security” (2013) 46 *DJ* 470 n 51; M van Staden “The Case of the Speluncean Explorers in the South African Constitutional Court” (2015) 36 *Obiter* 1 8.

Thirdly, both *Natal JMPF*¹³⁰² and *Bosch*¹³⁰³ give equal importance to the literal meaning of words on the one hand and the context and purpose on the other. Recently, in the 2012 decision in *CSARS v Tradehold* (“*Tradehold*”)¹³⁰⁴ (in dealing with the interpretation of a DTA) the SCA recognised that “[t]he need to interpret international treaties in a manner which gives effect to the *purpose* of the treaty and *which is congruent with the words employed in the treaty is well established.*”¹³⁰⁵

*Tetra Pak*¹³⁰⁶ is an example of a case where a court in interpreting a DTA gave much consideration to context, including the purpose of the treaty.¹³⁰⁷ In that case the Rhodesian court gave meaning to the phrase “industrial or commercial profits” used in the Rhodesia/Sweden DTA. The following historical setting was given at the outset of the judgment: In 1958 a treaty that was initially concluded between Britain and Sweden was extended under an “Extention Agreement” to some of the British territories, including Rhodesia.¹³⁰⁸ In terms of this agreement, certain modifications were made to the original DTA. The modifications made with respect to how the treaty applied to Rhodesia differed from those made with respect to the other British territories. Having set the historical context, the court explained the importance of the purpose of the DTA in the interpretation process:

“The object of a statutory instrument is often a useful aid to interpretation and here it must be borne in mind that the object of this particular statutory instrument [the DTA] is to avoid double taxation. All other things being equal, therefore, an interpretation which achieves this object should be favoured above one which does not.”¹³⁰⁹

After a consideration of the dictionary meanings of the word “commercial” yielded more than one possibility, the court turned to case law dealing with the Rhodesian income tax

¹³⁰² In *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) para [19]: “It clearly adopts as the proper approach to the interpretation of documents ... namely that from the outset one considers the context and the language together, with neither predominating over the other”.

¹³⁰³ In *CSARS v Bosch* 2015 (2) SA 174 (SCA) para [9]: “[T]he determination of the provision’s proper meaning will depend as much on context, purpose and background as on dictionary definitions”.

¹³⁰⁴ *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA), discussed in part 8.6.2.

¹³⁰⁵ Para [21] (emphasis added).

¹³⁰⁶ *COT v Aktiebolaget Tetra Pak* (1966) 28 SATC 213.

¹³⁰⁷ The purpose of a DTA has also been considered in more recent South African cases dealing with DTAs. For example, in *ITC 1878* (2015) 77 SATC 349 para [48] the court interpreted a 183-rule in a DTA in a manner that would not defeat one of the objects of the DTA, being the elimination of tax avoidance. In *CSARS v Van Kets* (2011) 74 SATC 9 the issue was whether the provisions in a DTA regarding exchange of information could be read with the definition of “taxpayer” in South African tax legislation to give the term an extended meaning. In its consideration of the matter the court pointed out at para [27] that the purpose of the DTA included the “prevention of fiscal evasion”.

¹³⁰⁸ *COT v Aktiebolaget Tetra Pak* (1966) 28 SATC 213 216 and 219.

¹³⁰⁹ 217.

legislation.¹³¹⁰ This indicated to the court that the word should have the meaning that it would have in “ordinary commercial life”, which also accorded with the meaning in its “ordinary popular sense”.¹³¹¹ Having reached its decision on the appropriate meaning (for which it also found support in a UK non-tax case),¹³¹² the court said that “prima facie” the meaning was unambiguous and that the enquiry should stop there,¹³¹³ an approach which is contrary to the modern approach discussed above. One of the parties, however, argued that the court also had to look at the wider context, being the treaty in its entirety, especially considering the question whether the meaning given by the court made sense in light of the other provisions of the treaty.¹³¹⁴ The court in turn indicated that, if a wider context is to be considered, the modifications made by the entire “Extension Agreement”, including modifications made with regard to the other British territories, had to be considered.¹³¹⁵ The court found confirmation for its meaning in differences in the manner in which the definition of “industrial or commercial profits” was modified with regard to Rhodesia on the one hand and the other territories on the other hand. The court also held that the meaning it preferred gave effect to the purpose of the treaty, being the avoidance of double taxation.¹³¹⁶

7.4 The South African approach to the interpretation of tax legislation when tax avoidance is argued

In part 5.3 it was argued that domestic courts, when interpreting DTAs where tax avoidance is suspected, may be influenced by the way in which they interpret domestic legislation if similar considerations are present.

¹³¹⁰ 217.

¹³¹¹ 218.

¹³¹² 218. This decision concerned the meaning of the term “commercial” used in an English non-tax ordinance.

¹³¹³ 218.

¹³¹⁴ 218-219.

¹³¹⁵ The court indicated at 219 that the entire Extension Agreement had become part of domestic legislation.

¹³¹⁶ 219-220.

Turning to the position in South Africa, a number of scholars argue that South African courts generally give legal meanings to terms and do not apply tax legislation based on the economic results of a transaction.¹³¹⁷ This does not change when tax avoidance is suspected. The authors of *Income Tax in South Africa* argue:

“[W]here the legal form [of a transaction] is clear and does represent the intention of the parties concerned [and is thus not a sham],¹³¹⁸ then the facts and the form must, it is submitted, be given effect to in determining the tax consequences of the transaction *or series of events* concerned. The economic substance of a transaction is then irrelevant.”¹³¹⁹

The decision in *Bosch* confirms this statement. The facts of *Bosch* were given in part 5.4. It will be recalled that the Commissioner had argued that the deferred delivery scheme considered in that case gave the employee, upon exercise of an option, only a *conditional* right to delivery of shares after a number of years. One basis for the Commissioner’s argument was that the purchase agreement was subject to a suspensive condition since the employees, on exercising the options, did not acquire a “benefit” and “the sale was not implemented ‘in any meaningful sense’”.¹³²⁰ In rejecting this argument, the court explored the legal meaning of a suspensive condition.¹³²¹

Another argument raised by the Commissioner was that the tax benefit described above would only be available if there was “sufficient certainty” at the time of the exercise of the options that the shares would be acquired in future. The argument was that the contracts entered into by the employees were subject to a “fiscal condition”, based on the judgment in *CIR v Golden Dumps*.¹³²² In that case, when considering whether expenditure was “actually incurred” for purposes of the ITA, the AD indicated that there was no difference between “a case where liability is contingent in the legal sense and one where it is contingent in the

¹³¹⁷ HV Vorster *The Parameters of Tax Planning A Comparative Analysis of Legislative, Administrative and Judicial Techniques employed in Combating Tax Avoidance* LLM (Tax Law) thesis University of the Witwatersrand (1984) 152-153; Clegg (1991) *Tax Planning* 35 (unless the “juristic ... form of a transaction is unclear”); Cilliers “Anti-Avoidance” in *Silke on International Tax* (2010) para 46.6.

¹³¹⁸ Discussed in part 5.4.

¹³¹⁹ D Clegg & R Stretch *Income Tax in South Africa* (2017) para 26.6.5 (emphasis added). This statement takes into account the decision in *Commissioner, South African Revenue Service v Airworld CC and another* 2008 (3) SA 335 (SCA). In that case the majority of the court considered the meaning of a term in an anti-avoidance provision concerning STC. In giving meaning to the term the majority adopted, out of several possible meanings for the term, the one that met this purpose.

¹³²⁰ *CSARS v Bosch* 2015 (2) SA 174 (SCA) para [23].

¹³²¹ Para [23].

¹³²² *Commissioner for Inland Revenue v Golden Dumps (Pty) Ltd* 1993 (4) SA 110 (A).

popular sense.”¹³²³ The court in *Bosch*, however, held that the context in which those statements were made, was different and persisted with the legal definition of a condition.¹³²⁴

Bosch is thus a good example of a recent case where transactions were structured to obtain tax benefits (amongst other purposes), but the SCA nevertheless gave legal meanings (from the law of contract) to words used in the tax legislation and considered transactions with regard to the legal rights created under the transactions. It is proposed that, when it comes to the interpretation of DTAs, it is likely that a South African court will follow a similar approach.

In part 5.3 it was also shown that courts in Canada and the Netherlands are inclined to give undefined terms in income tax legislation a legal meaning and consider transaction based on the legal rights created even if tax avoidance is suspected. In the case of the Netherlands, however, judicial anti-avoidance rules such as *fraus legis* and *fiscal kwalificatie* may come into play.

With regard to the UK, the *Ramsay* approach was highlighted. The question was asked in that chapter whether the *Ramsay* approach is likely to be followed by a South African court when interpreting the beneficial ownership requirement. As pointed out there, although the *Ramsay* approach is nowadays more readily regarded as an interpretative approach rather than a stand-alone rule, some scholars do not regard this as being settled. To the extent that the *Ramsay* approach is a stand-alone rule, there is no basis for accepting it in South Africa.¹³²⁵

However, if the *Ramsay* approach is an interpretative approach, the possibility does exist that a South African court may follow that approach. In the context of conduit company treaty shopping the argument may be along the following lines: “beneficial owner” refers to the real owner, i.e. the person who, “in reality”, enjoys the benefit of a dividend. This requires the court to consider the transactions “realistically”. As part of this consideration the court will consider whether a pre-ordained set of transactions is present, which may be how a conduit company treaty shopping structure will be perceived. (Although, as argued in that

¹³²³ 118. The court also stated an accounting meaning of a “contingency”.

¹³²⁴ *CSARS v Bosch* 2015 (2) SA 174 (SCA) para [36].

¹³²⁵ In South Africa the *Ramsay* approach as a “stand-alone” rule has been rejected in *ITC 1611* (1995) 59 SATC 126 142-145. (This case went on appeal to the AD, who did not reconsider this part of the judgment. The judgment of the higher court is reported as *Relier (Pty) Ltd v CIR* [1998] 1 All SA 183 (A)). In Canada the SCC in *Stuart Investments Ltd v the Queen* [1984] 1 SCR 536 considered, but did follow, the *Ramsay* approach. At 557, the majority remarked that UK courts are moving “to something approaching the United States *bona fide* business purpose rule” and subsequently at 575-576 rejected a business purpose rule. It should be noted that the SCC’s judgment was delivered without the benefit of the more recent decisions of the House of Lords referred to at ns 860 and 861 above.

discussion,¹³²⁶ there is still considerable uncertainty regarding the circumstances under which such a pre-ordained set of transactions will be present.) If any steps were inserted in this pre-ordained set of transactions that have no commercial purpose apart from the avoidance of a liability to tax, the court will disregard the inserted steps and look at the “end result”, rather than the individual steps. Therefore, if the only purpose with inserting the direct recipient was to get the treaty benefit of a reduced withholding rate, the court will ignore the direct recipient and will consider the transaction based on the assumption that the ultimate recipient received the dividend directly. The court thus has to consider whether the ultimate recipient is the “beneficial owner” on the assumption that such ultimate recipient received the dividend directly.

The *Ramsay* approach has been referred to with approval in the context of the application of South Africa’s previous GAAR¹³²⁷ and sham transactions (in the sense mentioned in part 5.4).¹³²⁸ Some South African scholars have also argued that one can recognise the *Ramsay* approach in a number of South African judgments, although the courts in these cases did not base their decisions (expressly) on the *Ramsay* approach. Locke’s argument in respect of *Consolidated News Agencies (Pty) Ltd (in liquidation) v Mobile Telephone Networks*,¹³²⁹ discussed in part 5.7.1, is an example.¹³³⁰

However, as argued above, South African courts are inclined to give words in tax legislation a legal meaning and to consider transactions relating to the legal rights created. This was

¹³²⁶ See the main text corresponding to ns 867 and 868 above.

¹³²⁷ *ITC 1606* (1995) 58 SATC 328 337.

¹³²⁸ E.g. in *ITC 1690* (1999) 62 SATC 497 the court held:

“It is the task of this Court to determine the legal nature of a transaction to which it is sought to attach a tax consequence and if that transaction is part of a series of transactions the whole combination of transactions has to be considered. The Court is not limited to consider the genuineness or import of a single transaction in isolation but may consider the scheme as a whole. *WT Ramsay Ltd v Inland Revenue Commissioners* 1982 AC 300 at 232G-H ([1978] 2 All ER 321 (ChD)).”

(This page reference seems to be erroneous. Presumably, the court meant to refer to 323G-H. However, in that part of the *Ramsay* judgment the House of Lords expressly dealt with transactions that were genuine, not shams.)

¹³²⁹ *Consolidated News Agencies (Pty) Ltd (in liquidation) v Mobile Telephone Networks (Pty) Ltd* 2010 (3) SA 382 (SCA).

¹³³⁰ Other examples include the following: *SIR v Hartzenberg* 1966 (1) SA 405 (A), discussed by Burt (2004) SALJ 751; *Erf 3183/1 Ladysmith (Pty) Ltd v CIR* 1996 (3) SA 942 (A) and *Relier (Pty) Ltd v CIR* [1998] 1 All SA 183 (A), mentioned in this context by RD Jooste “Offshore Trusts and Foreign Income - the Specific Anti-Avoidance Provisions” (2002) 17 AJ 186 194-195, which is traditionally seen as having been decided on the basis of simulation in the sense discussed in part 5.4.

recently confirmed in *Bosch*.¹³³¹ There is arguably no real possibility that a South African court will follow the *Ramsay* approach.

7.5 The Commentaries: A South African perspective

Turning now to the treatment of the Commentaries under South African law, it will be recalled that the issue was raised in part 4.4.1 whether the Commentaries are binding on domestic courts. One argument put forward in favour of the Commentaries being binding is that they are customary international law. A number of South African authors make this argument.¹³³² It is, however, not clear whether their views relate to the entire Commentaries, or only to parts thereof.

Olivier and Honiball argue that the Commentaries are “probably” customary international law. Regarding the problematic *opinion iuris* requirement in terms of which a legal rule will only be customary international law if courts regard themselves as being legally obliged to follow the rule, Olivier and Honiball argue that the requirement is met based on the Commentaries’ “acceptance in South African case law”.¹³³³ The only South African case law referred to in this part of their book is that of *Downing*.¹³³⁴ In respect of this case they state that it is authority for South African courts having accepted that the Commentaries may be used in interpreting DTAs.¹³³⁵

Elsewhere in the same contribution Olivier and Honiball state as follows:

“Therefore [based on s 232 of the Constitution], to the extent that there are OECD guidelines on the interpretation of the concept [of ‘effective management’] or other international commentaries which express the common meaning of the phrase as utilised in tax treaties

¹³³¹ *CSARS v Bosch* 2015 (2) SA 174 (SCA).

¹³³² C West A *Critical Analysis of the Relevance of the OECD Model Article 17 in Double Tax Agreements from a South African Perspective and the Misalignment of this Article in South African DTAs (in Force at 1 June 2008) when Compared against the Final Withholding Tax on the Gross Earnings of Nonresident Sportspersons Performing in South Africa* PhD thesis University of Cape Town (2009) 35 argues that the Commentary is not customary international law, but “the commentaries in existence at the time the DTA was entered into may be used as an interpretational tool of customary international law.” AW Oguttu “The Challenges that E-Commerce Poses to International Tax Laws: ‘Controlled Foreign Company Legislation’ from a South African Perspective (Part 1)” (2008) 20 *SA Merc LJ* 347 356 (and see also Oguttu *Offshore Tax Avoidance* 569) supports the view expressed by Olivier & Honiball *International Tax* 312 referred to in the main text corresponding to n 1333 below.

¹³³³ Olivier & Honiball *International Tax* 312.

¹³³⁴ There are two judgments pertaining to this matter: the judgment of the Natal Special Income Tax Court in *Case of LJ Downing (No. 6737)* (1972) Unreported and the judgment of the AD in *SIR v Downing* 1975 (4) SA 518 (A).

¹³³⁵ Olivier & Honiball *International Tax* 311.

worldwide, South African courts would *take cognisance* of such guidelines and commentaries to interpret the meaning in the context of a tax treaty.”¹³³⁶

According to section 232 of the Constitution, customary international law is “law of the Republic”.¹³³⁷ Therefore, if the Commentaries were to be regarded as customary international law, South African courts would be obliged to follow the meaning given in the Commentaries and not merely take it into account when interpreting a treaty.¹³³⁸ In the cases considered next attention will be given as to whether they support a finding that the South African courts are obliged to follow the meaning given in the Commentaries.¹³³⁹

Other issues mentioned in part 4.4 are the place of the Commentaries within the Vienna rules and whether an ambulatory or stationary approach should be followed with regard to Commentaries amended after conclusion of a DTA. These issues will also be considered in the discussion that follows.

7.5.1 The use of the Commentaries in *Downing*

In this case the 1967 DTA between South Africa and the Swiss Federal Council was considered. The taxpayer, a Swiss resident, owned a portfolio of shares that was managed in South Africa by a South African stockbroker. When the profits made from the sale of the taxpayer’s shares were subjected to income tax in South Africa, the taxpayer objected. One of the arguments raised by the taxpayer was that Article 7(1) of the DTA (which is comparable with Article 7(1) in the current version of the OECD MTC) precluded South Africa from taxing the profits.

The Natal Special Income Tax Court,¹³⁴⁰ which made several references to the 1963 Commentary in its judgment, first heard the case.¹³⁴¹ Apart from confirming that the 1963

¹³³⁶ 42 (emphasis added).

¹³³⁷ This applies unless the customary international law is inconsistent with the Constitution or an Act of Parliament.

¹³³⁸ Du Plessis (2013) *LitNet* 11.

¹³³⁹ Little reference is made to the Commentaries in South African DTAs and protocols and this study thus focuses on case law. One example of such a reference is in Art 7(a) of the 2009 South Africa/Mexico protocol, which provides:

“It is understood that the Contracting States shall endeavour to apply the provisions of this Agreement in accordance with the Commentaries on the Articles of the Model Tax Convention on Income and on Capital drawn up from time to time by the OECD Committee of Fiscal Affairs to the extent that the provisions contained in the Agreement correspond to those set forth under that Model.”

Other examples include Art 4 of the Additional Protocol with Austria (2011) and Art 2(h) of the Memorandum of Understanding to the 2013 Treaty with Mauritius (2015).

¹³⁴⁰ *Case of LJ Downing (No. 6737)* (1972) Unreported.

OECD MTC served as a model for the conclusion of DTAs and that the OECD has prepared “explanatory notes and comments” in respect of the OECD MTC, no explanation is given for the basis on which reference was made to the Commentary.

The tax court referred to the Commentaries with regard to the argument raised by the Commissioner that Article 7(1) did not apply on the facts since the proceeds from the sale of the taxpayer’s shares were not subject to tax in Switzerland. Thus, no actual double taxation arose on the facts, which the Commissioner argued was a prerequisite for the granting of exemption from tax in South Africa. After having reached its conclusion that Article 7(1) did not set such a requirement, the court referred to the fact that the 1963 Commentary took a similar view.

The court then turned to the issue of whether the taxpayer’s South African stockbroker constituted a permanent establishment (“PE”), as defined in Article 5 of the DTA. This turned on the question whether the stockbroker acted “in the ordinary course of [his] business” when managing the taxpayer’s portfolio.¹³⁴² In the judgment the 1963 Commentary is the only extrinsic aid referred to when interpreting this phrase.¹³⁴³ According to the 1963 Commentary, if an agent “habitually acts... as a permanent agent having an authority to conclude contracts” it would not fall within the ordinary course of his own business.¹³⁴⁴ The court, however, was not prepared to accept that this statement would be true in all circumstances and also not on the facts before it.¹³⁴⁵

On appeal, the only issue that remained was whether the stockbroker constituted a PE of the taxpayer. Apart from also acknowledging that the 1963 OECD MTC formed the basis for the

¹³⁴¹ Apart from the examples given in the main text, the court also referred to the 1963 Commentary for a definition of “double taxation” and in respect of Art 2 of the OECD MTC.

¹³⁴² Art 5(5) of the DTA was comparable with the current Art 5(6) of the OECD MTC.

¹³⁴³ This may be compared to the earlier case of *Transvaal Associated Hide and Skin Merchants v Collector of Income Tax Botswana* (1967) 29 SATC 97 (BCA), heard by the Court of Appeal of Botswana in 1967. There the court had to determine whether an office rented by a South African enterprise in Botswana was a “permanent establishment” for purposes of a 1959 DTA. The court did not refer to the Commentary, although it should be noted that the DTA predated the 1963 Commentary.

¹³⁴⁴ Para 20 of the Commentary (1963) to Art 5.

¹³⁴⁵ The court stated:

“But that passage [in the Commentary] pre-supposes that the commission agent, by acting habitually, as a permanent agent, and by exercising authority to conclude contracts, would not be acting in the ordinary course of his own business or trade. And that was the essence of [the Commissioner’s] submission. The evidence, however, is against him. It may be that the exercise of authority to conclude transactions on behalf of [or] in the name of a principal may fall beyond the scope of the ordinary business of certain types of agents or brokers but that is not necessarily, nor even probably, so in the case of a stockbroker handling a portfolio for a client” (emphasis added).

DTA in question, as well as other DTAs (including DTAs concluded by South Africa),¹³⁴⁶ no direct reference is made to the 1963 OECD MTC or the Commentary. With regard to the meaning of the phrase “in the ordinary course of [his] business”, the court, after quoting the tax court’s observations on the Commentary, agreed with that court’s interpretation of the phrase.¹³⁴⁷

Scholars have expressed different views on the relevance of the use of the Commentaries in these two judgments. It has been said that *Downing* has recognised the Commentary as a guide to the interpretation of South African DTAs.¹³⁴⁸ However, it has also been put more strongly, stating that the court in *Downing* accepted that South African courts are “required”¹³⁴⁹ or “bound”¹³⁵⁰ to take cognisance of the Commentaries. The Davis Committee noted that no indication was given in this case on the question as to whether the Commentaries bind a South African court.¹³⁵¹

In conclusion it can be said that, although the tax court in *Downing (TC)* clearly did not foresee any difficulty in referring to the Commentaries, there is no indication that it regarded itself bound to do so. It clearly also did not regard the Commentaries to be binding in any way, hence the fact that it was prepared to depart from the explanation given in the Commentaries on a relevant point. By only referring indirectly to the Commentaries, the judgment of the AD does not add much to the discussion on the use of the Commentaries except to indicate perhaps that the AD did not appear troubled by the tax court’s position on the Commentaries.

7.5.2 The use of the Commentaries in *ITC 1503*

In *ITC 1503*¹³⁵² the taxpayer was a foreign company that carried on a business as an international airline. As part of that business it also operated a South African branch that earned interest on moneys received from, inter alia, the sale of airline tickets. The question arose whether the interest was taxable in South Africa. In accordance with a treaty for the

¹³⁴⁶ *SIR v Downing* 1975 (4) SA 518 (A) 523.

¹³⁴⁷ 526.

¹³⁴⁸ See the sources referred to by Du Plessis (2012) *SA Merc LJ* 46.

¹³⁴⁹ Oguttu (2008) *SA Merc LJ* 356. See also C de Matos Ala “The Place of Effective Management Criterion for Determining the Tax Residence of Persons other than Natural Persons: *Oceanic Trust Co Ltd NO v Commissioner for South African Revenue Service: Notes*” (2015) 132 *SALJ* 41 48.

¹³⁵⁰ Olivier & Honiball *International Tax* 42.

¹³⁵¹ OECD *Public Discussion Draft BEPS Action 6: Preventing the granting of treaty benefits in inappropriate circumstances* (2014) 35.

¹³⁵² *ITC 1503* (1990) 53 *SATC* 342.

avoidance of double taxation from the business of sea or air transport, interest “derived” from the business of air transport would not be taxable.

The judgment indicates that “a written statement of facts on which the appeal was to be determined and agreed upon between the appellant and the Commissioner for Inland Revenue was handed in at the hearing of the appeal”. One of the “facts” recorded in this statement was that the “parties are entitled to refer to the text and commentaries of the 1977 OECD Model agreement without any admissions being made as to the evidentiary value and subject to permission of the court.” It is perhaps worth pointing out that the title of the treaty, recorded in the judgment, indicates that the “Union of South Africa” entered into the treaty.¹³⁵³ Since the Union of South Africa became a republic in 1961, there is a strong possibility that the signature of this treaty predates the 1977 Commentaries.¹³⁵⁴ However, no reference is made to this fact in the judgment.

As discussed later in this chapter, the court reached its decision firstly by considering dictionaries and case law.¹³⁵⁵ Only after having reached its decision based on these sources (that the interest was derived from the air transport business) did it refer to the Commentary to confirm its finding.

To summarise, it can be said that the Commentary was only referred to in order to confirm a meaning that the court had already derived at. Furthermore, the reference to the Commentary might be explained by virtue of the “fact” stated in the written statement of facts that the Commentaries could be referred to by the parties.¹³⁵⁶

7.5.3 The (indirect) reference to the Commentaries in *Oceanic Trust*

In this case, *The Oceanic Trust Co Ltd NO v Commissioner for the South African Revenue Service* (“Oceanic Trust”),¹³⁵⁷ the court was requested to issue a declaratory order, declaring that a trust established and registered in Mauritius was not a “taxpayer” of South Africa. Relevant to this enquiry was whether or not the trust had its place of effective management

¹³⁵³ 346.

¹³⁵⁴ The other contracting country is not mentioned in the reported judgment, nor is the date of conclusion of the DTA.

¹³⁵⁵ *ITC 1503* (1990) 53 SATC 342 347-348.

¹³⁵⁶ See also Du Plessis (2012) *SA Merc LJ* 46.

¹³⁵⁷ *The Oceanic Trust Co Ltd NO v CSARS* (2011) 74 SATC 127.

(“POEM”) in Mauritius. This required a consideration of a provision in the South Africa/Mauritius DTA based on Article 4(3) of the OECD MTC.¹³⁵⁸

The taxpayer relied on the CA’s judgment in the UK case of *Commissioner for Her Majesty’s Revenue & Customs v Smallwood & another* (“*Smallwood*”),¹³⁵⁹ where that court also considered whether or not a trust had its POEM in Mauritius. The court in *Oceanic Trust* quoted extensively from the UK judgment, including the references made in that judgment to the 2000 version of the Commentary to Article 4.¹³⁶⁰ Following this the South African court formulated what it called the “*Smallwood* test”,¹³⁶¹ the first part of which is an almost verbatim re-statement of the 2000 version of the Commentary.¹³⁶²

At best one can thus say that the court, indirectly, referred to the Commentary on this issue. It is interesting to note that the 2000 version of the Commentary, which forms the basis for *Oceanic Trust*’s version of the *Smallwood* test, postdates the conclusion of the South Africa/Mauritius DTA, concluded in 1996. The court in *Oceanic Trust* was thus, indirectly, referring to a version of the Commentary that was amended after conclusion of the DTA. This was also true for *Smallwood*, in which the conclusion of the UK/Mauritius DTA preceded the changes made to the Commentary in 2000. In part 4.4.2 it was pointed out that the Special Commissioners had specifically taken this into account in their judgment. However, the South African court did not raise this issue.

On the other issue raised in this case, as to whether the trust had a PE in South Africa (which is defined in the South African ITA to bear the same meaning as in Article 5 of the OECD MTC),¹³⁶³ no reference was made to the Commentaries.¹³⁶⁴

¹³⁵⁸ The question as to whether the trust was a “taxpayer” in SA depended, amongst other things, on whether it was “resident” in South Africa. For this enquiry, the South Africa/Mauritius DTA was relevant since the DTA provided that, if the trust had its POEM in Mauritius, it would not be resident in South Africa.

¹³⁵⁹ *Commissioner for Her Majesty’s Revenue & Customs v Smallwood & another* [2010] EWCA Civ 778.

¹³⁶⁰ Para 24 of the Commentary (2000) to Art 4.

¹³⁶¹ *The Oceanic Trust Co Ltd NO v CSARS* (2011) 74 SATC 127 para [56].

¹³⁶² De Matos Ala (2015) *SALJ* 49 states that this “implies that [*Oceanic Trust*’s version of the] *Smallwood* test is the same as para 24 of the *Commentary*.” See also 53-54 where the author states: “Unfortunately, *Oceanic Trust*’s interpretation of the *Smallwood* test is inaccurate. It appears to regard that test as no more than para 24 of the *Commentary* on art 4(3) of the OECD MTC.”

¹³⁶³ Definition of “permanent establishment” in s 1.

¹³⁶⁴ See the criticism in this regard by Du Plessis (2012) *SA Merc LJ* 48.

7.5.4 The use of the Commentaries in *ITC 1878*

In *ITC 1878*¹³⁶⁵ the court considered a paragraph in the definition of a PE in the South Africa/US DTA concluded in 1997. The relevant part of the definition read as follows:

“5(1) For the purposes of this Convention, the term ‘permanent establishment’ means a fixed place of business through which the business of an enterprise is wholly or partly carried on.”

5(2) The term ‘permanent establishment’ *includes especially* –...

(k) the furnishing of services... within a Contracting State by an enterprise ..., but only if activities of that nature continue (for the same or a connected project) within that State for a period or periods aggregating more than 183 days in any twelve-month period commencing or ending in the *taxable year* concerned.”¹³⁶⁶

Article 5(1) and paragraphs (a)-(f) of Article 5(2) were identical to those of the OECD MTC, but Article 5(2)(k) had no equivalent in the OECD MTC.¹³⁶⁷ The issue before the court was whether, in order to establish a PE under Article 5(2)(k), the requirements under Article 5(1) also had to be met. This turned on the meaning of the phrase “includes especially” in the opening sentence of Article 5(2).

The court started the interpretation process by referring to the Commentary on Article 5. During its judgment it made several general statements regarding the Commentaries, indicating that it would not be “uncommon” to rely on the Commentaries where treaties include the same provisions as the OECD MTC.¹³⁶⁸ It also indicated that the “explanations provided in the Commentary are of immense value in understanding or interpreting any article”¹³⁶⁹ and that commentaries such as these minimise the possibility for different interpretation of the same terms by parties that use the same model as basis for their DTAs.¹³⁷⁰

¹³⁶⁵ *ITC 1878* (2015) 77 SATC 349.

¹³⁶⁶ Emphasis added.

¹³⁶⁷ This clause, dealing with so-called “service PEs”, also differs in a number of import aspects from the formulation for service PE’s inserted into para 42.23 of the Commentary to Art 5 in 2008 (thus after conclusion of the South Africa/US DTA).

¹³⁶⁸ *ITC 1878* (2015) 77 SATC 349 para [14].

¹³⁶⁹ Para [22].

¹³⁷⁰ Para [15].

Regarding the part of the Commentary dealing with the relationship between Article 5(1) and 5(2), which the court regarded as supporting an interpretation that Article 5(1) also has to be met in order for a PE to exist,¹³⁷¹ it noted that the Commentary’s interpretation has been accepted internationally “in many courts”. However, the court proceeded to state that the Commentary does not take into account the phrase “includes especially”.¹³⁷² After repeating the statement in *Tradehold* that treaties must be interpreted “in a manner which gives effect to the purpose of the treaty *and which is congruent with the words employed in the treaty*”,¹³⁷³ it then held that dictionaries and case law indicated that the word “include” is often used in statutes to extend the meaning of a concept.¹³⁷⁴

Turning to the treaty itself, the court rejected the meaning put forward in the Commentary and concluded that

“the definition [of PE], by virtue of the bridging phrase ‘includes especially’, is a composite one. This clearly expresses the purpose of the treaty. To break it up and treat the two articles separately would be to ignore the natural and ordinary meaning of the phrase ‘includes especially’.”¹³⁷⁵

In an attempt at damage control the court indicated that the Commentary’s above-mentioned interpretation did not extend to Article 5(2)(k) (which did not appear in the OECD MTC) and, since there were important differences between this paragraph and the others in Article 5(2),¹³⁷⁶ one could not assume that the Commentary’s explanation would be extended to apply to paragraph (k) too.¹³⁷⁷ Despite this argument, there is no getting away from the fact that the court thought that the Commentary does not properly take into account the actual wording (“includes especially”) used in the DTA (and the OECD MTC).¹³⁷⁸ In another attempt to play down its finding in this regard the court then found that on the facts the taxpayer in any event also met the requirements of Article 5(1).¹³⁷⁹

¹³⁷¹ Para 12 of the Commentary to Art 5.

¹³⁷² *ITC 1878* (2015) 77 SATC 349 para [18].

¹³⁷³ Para [23] (emphasis added).

¹³⁷⁴ Para [29].

¹³⁷⁵ Para [30].

¹³⁷⁶ See also E Mazansky “South African Tax Court Departs from Commentary on Article 5 of the OECD Model in Finding a Permanent Establishment” (2015) 69 *BFIT* 494 495.

¹³⁷⁷ *ITC 1878* (2015) 77 SATC 349 para [31].

¹³⁷⁸ Du Plessis (2016) *TSAR* 487 also comments that in this part of the judgment the court “criticised” the Commentary.

¹³⁷⁹ *ITC 1878* (2015) 77 SATC 349 paras [41]-[44]. For this reason Mazansky (2015) *BFIT* 496 argues that the part of the judgment regarding the meaning of the phrase “includes especially” may be *obiter dictum*. Du Plessis

The court next turned to the phrase “a period or periods aggregating more than 183 days in any twelve-month period commencing or ending in the taxable year concerned” in Article 5(2)(k). The question was whether the 183-day rule was met in respect of some of the years of assessment in question since some days were “double-counted”. The court quoted from the Commentary to Article 15 of the OECD MTC.¹³⁸⁰ This part of the Commentaries was amended in 2005,¹³⁸¹ and the court quoted the amended wording. There is, however, no indication that the court was aware of the fact that it was referring to Commentaries that were revised after conclusion of the DTA.¹³⁸²

The court rejected the taxpayer’s interpretation of the 183-day rule, stating as follows:

“This interpretation, which is the one we are enjoined by the appellant to adopt, defeats the object of the DTA, is contrary to the intention of the parties and stands *in stark contrast to the interpretation proffered in the OECD Commentary*. Finally, it bears remembering that double computation of the days ... does not result in the non-resident being taxed twice for the same income (or profit) by the Contracting State.”¹³⁸³

It is thus clear that the court placed considerable weight on the Commentaries in this regard. It was also the only external aid referred to by the court on this issue.

7.5.5 The use of the Commentaries in *Krok*

In 2015 the SCA¹³⁸⁴ considered the application of a treaty provision based on Article 27 of the OECD MTC in the South Africa/Australia DTA. This provision was inserted into the DTA by a protocol. The taxpayer argued that the new provision did not apply to taxes claimed by the Australian Tax Office for income years that preceded a date stipulated in the protocol. In the initial judgment of the High Court,¹³⁸⁵ no reference was made to the Commentary on Article 27 of the OECD MTC. On appeal, the SCA specifically mentioned

(2016) TSAR 490 also comments that it was not necessary for the court to depart from the meaning in the Commentary, considering its conclusion that, on the facts, the taxpayer met the requirements in Art 5(1).

¹³⁸⁰ Para 4 of the Commentary to Art 15.

¹³⁸¹ The OECD 2005 Update to the Model Tax Convention Public Discussion Draft (2004) notes that the change to the Commentary was brought about “to clarify” the issue of overlapping periods in Article 15(2). See also Pötgens *Income from International Private Employment* 63, where he states that the amendment “confirms” that overlap is possible. See in this regard the argument for allowing the ambulatory approach to the Commentary in part 4.4.2 if the amendments are merely “clarifying”.

¹³⁸² The written judgment has at this point a link at n 23 to a version of the Commentaries that does not indicate the history of amendments to the Commentaries.

¹³⁸³ Para [48] (emphasis added).

¹³⁸⁴ *Krok v CSARS* 2015 (6) SA 317 (SCA).

¹³⁸⁵ *CSARS v Krok* (2014) 76 SATC 119.

the fact that the taxpayer based his argument on, amongst other things, the Commentary.¹³⁸⁶ The SCA rejected the argument, holding that the UK CA in *Ben Nevis (Holdings) Ltd and Metlika Trading Ltd v HMRC*,¹³⁸⁷ in dealing with a provision in the South African/UK DTA, rejected a similar argument. In this regard, the SCA referred (with approval) to the UK court's finding that the Commentary allowed for the possibility that the provision be applied to assist with the collection of taxes in the manner argued for by the Commissioner.¹³⁸⁸

7.5.6 Conclusions on the use of Commentaries by South African courts

Before making conclusions on the use of the Commentaries in the cases discussed above, it must also be pointed out that there are plenty of recent examples where no reference was made to the Commentaries in South African case law on the interpretation of DTAs. Examples include *Grundlingh v CSARS* (“Grundlingh”),¹³⁸⁹ *Volkswagen of South Africa (Pty) Ltd v CSARS* (“Volkswagen”),¹³⁹⁰ and *Tradehold*,¹³⁹¹ all judgments of the High Court and SCA. With regard to *Tradehold* it should be noted that the Commentaries have been referred to by the Dutch *Hoge Raad* in cases in which a similar issue than the issue that arose in *Tradehold*, was considered.¹³⁹² In summary, *Krok*¹³⁹³ is the only case in which reference was directly made to the Commentaries by a South African court other than the tax court.

What deductions can one make on the use of the Commentaries by South African courts? Firstly, South African courts regard reference to the Commentaries as discretionary, not mandatory.¹³⁹⁴ Secondly, in those cases in which the Commentaries have been referred to, the

¹³⁸⁶ Para 14 of the Commentary to Art 27.

¹³⁸⁷ *Ben Nevis (Holdings) Ltd and another v Revenue and Customs Commissioners* (2013) 76 SATC 243.

¹³⁸⁸ *Krok v CSARS* 2015 (6) SA 317 (SCA) para [38].

¹³⁸⁹ *Grundlingh v CSARS* (2009) 72 SATC 1. See the criticism in this regard by J Hattingh “The Tax Treatment of Partnerships under Model-Based Bilateral Tax Treaties: Some Lessons from Grundlingh v The Commissioner for the South African Revenue Service” (2010) 127 *SALJ* 38 45 and Du Plessis (2012) *SA Merc LJ* 47.

¹³⁹⁰ *Volkswagen of South Africa (Pty) Ltd v CSARS* (2008) 70 SATC 195. See the discussion in this regard in Du Plessis (2012) *SA Merc LJ* 47-48.

¹³⁹¹ *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA), discussed in part 8.6.2.

¹³⁹² See the cases mentioned at n 1642 below.

¹³⁹³ *Krok v CSARS* 2015 (6) SA 317 (SCA).

¹³⁹⁴ The question whether the Commentaries may be considered by South African courts to be evidence of *contemporanea expositio* and *subsecuta observationi* (discussed by Du Plessis *Re-Interpretation of Statutes* 260-261), is an issue that has not yet come up in South African case law on the interpretation of DTAs. In 2014 it was considered in *Master Currency (Pty) Ltd v Commissioner, South African Revenue Service* 2014 (6) SA 66 (SCA) paras [9] and [10], in relation to the levying of value-added tax. This may be an issue worth further exploring and it should be noted that there is Indian case law on this, including *Metchem Canada Inc v Deputy Commissioner of Income Tax* 2006 100 ITD 251 Mum para 6. Reference may also be made here to s 233 of the Constitution, which provides that, when interpreting legislation, a court must prefer a reasonable interpretation consistent with “international law”. Du Plessis (2012) *SA Merc LJ* 44 (and Du Plessis (2016) *TSAR* 488) argues that the Commentaries are not “international law” and for that reason s 233 of the Constitution does not require

courts did not regard themselves bound to the Commentaries. In *Downing (TC)*¹³⁹⁵ and *ITC 1878*¹³⁹⁶ (in respect of the interpretation of the words “includes especially”), the court departed from the Commentaries’ interpretation. The latter case is especially illuminating since the court took the time to recognise the value of the Commentaries, only to depart from them. Arguably, the Commentaries thus fail to meet the *opinion iuris* requirement and is not customary international law in South Africa.¹³⁹⁷ At best it can be said that Brincker’s view that the Commentaries should have “persuasive influence” in South Africa is supported by the decisions.¹³⁹⁸

Thirdly, in those cases in which the Commentaries have been referred to, no attempt has been made to explain the use of the Commentaries within the Vienna rules.¹³⁹⁹ In *Krok* the court specifically accepted that the Vienna rules apply to the interpretation of DTAs generally. The court’s acceptance of the Commentaries as an interpretative tool in that case may be an indication that the court at least regarded the use of the Commentaries as reconcilable with the Vienna rules. The Commentaries have at times been used in South African case law as nothing more than a confirmation of a meaning that the court had already reached by way of other methods; in other words, much like the manner in which supplementary means of interpretation as contemplated in Article 32 of the VCLT may be used. *ITC 1503*¹⁴⁰⁰ is an example of this, as well as the reference to the Commentary in *Downing (TC)* (with regard to the argument that Article 7(1) of the DTA only applied in the case of actual double-taxation). However, in other cases the Commentaries formed the starting point of the interpretation process. The tax court cases of *Downing (TC)* (with regard to the meaning of the phrase “in the ordinary course of his business”) and *ITC 1878*¹⁴⁰¹ are examples of these, although in

a court to prefer a reasonable interpretation that is consistent with the Commentaries (but for a contrary view, that the Commentaries do fall within s 233, see BA van der Merwe “The Phrase ‘Place of Effective Management’ Effectively Explained” (2006) 18 *SA Merc LJ* 121 136). The Commentaries are neither a treaty, nor customary international law and as such do not form part of what is sometimes loosely referred to as “binding” international law. The question whether the Commentaries may form part of “non-binding” international law and whether such “non-binding” international law must be taken into account under s 233 of the Constitution is a possibility worth exploring in future. The possibility that “non-binding” international law may be taken into account under s 233 is supported by Du Plessis (2013) *LitNet* 10-11, 14 and 16-17, although he does not consider whether the Commentaries would fall within “non-binding” international law.

¹³⁹⁵ *Case of LJ Downing (No. 6737)* (1972) Unreported, confirmed on appeal in *SIR v Downing* 1975 (4) SA 518 (A).

¹³⁹⁶ *ITC 1878* (2015) 77 SATC 349.

¹³⁹⁷ In agreement: Du Plessis (2012) *SA Merc LJ* 43 and 51-52; Du Plessis (2016) *TSAR* 488.

¹³⁹⁸ Brincker “Silke on International Tax” in *Silke on International Tax* (2010) para 12.11.2.

¹³⁹⁹ In agreement: Du Plessis (2012) *SA Merc LJ* 50; Du Plessis (2016) *TSAR* 487 and 489-490.

¹⁴⁰⁰ *ITC 1503* (1990) 53 SATC 342.

¹⁴⁰¹ *ITC 1878* (2015) 77 SATC 349.

both these cases the courts were prepared to adopt different meanings than those proposed by the Commentaries.

7.5.7 The 2003 and 2014 amendments to the Commentaries to Article 10

As discussed in chapter 2, substantial amendments were made in 2003 and 2014 to the Commentaries to Article 10 on the meaning of the beneficial ownership requirement. In part 4.4.2 it has been questioned whether revisions made to the Commentaries after conclusion of a DTA can be taken into account when interpreting that DTA. The question is thus, firstly, whether the 2003 amendments can be taken into account with regard to DTAs concluded before 2003 and, secondly, whether the 2014 amendments can be taken into account with regard to DTAs concluded before 2014.¹⁴⁰²

The above analysis of South African case law does not provide much insight into this debate. Although the tax court in *ITC 1878*¹⁴⁰³ (and possibly in *ITC 1503*)¹⁴⁰⁴ quoted a version of the Commentaries that had been revised after the relevant DTA was signed, there is no indication that the court was aware of this fact. It is proposed that this cannot be seen as confirmation that South African courts abide by the ambulatory approach. The same can be said of the indirect reference to the revised Commentaries in *Oceanic Trust*.¹⁴⁰⁵

In part 4.4.2 two alternative bases for accepting revised Commentaries were put forward. The first basis is that revised Commentaries may be considered if they are merely clarifying and do not “fill gaps” in previous versions of the Commentaries and do not contradict these previous versions.

Starting with the 2003 amendments, Collier argues that they did not “make profound changes to the meaning of the term.”¹⁴⁰⁶ Yet Wardzynski argues that the 2003 Commentary has “markedly changed the perception on beneficial ownership in many States”.¹⁴⁰⁷ Whether or not the amendments in 2003 are merely clarifying, requires one to compare the 1977 and

¹⁴⁰² The same can be asked regarding DTAs concluded before 1977 and which include the beneficial ownership wording in respect of the amendments made to the Commentary to Article 10 in 1977. However, none of the South African DTAs concluded before 1977 that are still in force includes the term “beneficial owner” in the article dealing with dividends.

¹⁴⁰³ *ITC 1878* (2015) 77 SATC 349, discussed in part 7.5.4.

¹⁴⁰⁴ *ITC 1503* (1990) 53 SATC 342, discussed in part 7.5.2.

¹⁴⁰⁵ *The Oceanic Trust Co Ltd NO v CSARS* (2011) 74 SATC 127.

¹⁴⁰⁶ Collier (2011) *BTR* 690. He also argues that the 2003 Commentary does not “contemplate a materially different standard” than the 1977 version.

¹⁴⁰⁷ Wardzynski (2015) *Intertax* 186. He also refers to scholars who claim that case law after 2003 has interpreted the term substantially different.

2003 versions. That comparison will depend on how one understands the meanings put forward under the two versions. In none of the foreign cases discussed in the previous chapter was the 1977 version considered in any detail. One accordingly does not have the benefit of the courts' views in respect of that version. The 2003 version has been discussed by the courts, but no uniform view appears.¹⁴⁰⁸ When it comes to scholarly writings, there is also little agreement with regard to how these versions should be understood.¹⁴⁰⁹

The most controversial element of the Commentaries is arguably whether direct recipients other than agents and nominees, thus "conduit companies", are excluded from beneficial ownership. There is a good argument that the 2003 Commentaries exclude at least some conduit companies. This is seen in the reference to the fact that the beneficial ownership requirement should be understood in its context, which includes the purposes of DTAs to prevent fiscal evasion and avoidance.¹⁴¹⁰ The 2003 version also specifically refers to a direct recipient who "acts as a conduit for another person who in fact receives the benefit of the income concerned".¹⁴¹¹

With regard to the 1977 version, the answer is less apparent. The phrase "intermediary, such as an agent or nominee" in the 1977 version includes the possibility that direct recipients other than agents and nominees in the legal sense could have been excluded under the 1977 version. This has been at the centre of the different ways in which scholars have understood the 1977 version and little can be served to repeat the arguments mentioned earlier.¹⁴¹² One is, however, forced to take a view here in order to decide this enquiry.

I find it unlikely that a company, the quintessential example of a non-transparent entity,¹⁴¹³ that receives income as a principal and not as a trustee or agent (or nominee)¹⁴¹⁴ can be seen as an "intermediary". That is unless one reads the Commentaries as a layman would, without regard for any legal rules regarding separate legal personality and legal rights created under a contract. Such an approach would be quite startling in the case of a document such as the Commentaries, which are a guide to the interpretation of (highly complex) treaties relating to taxing rights. I also do not think that the anti-avoidance purpose of the beneficial ownership

¹⁴⁰⁸ Part 6.7.

¹⁴⁰⁹ Parts 2.3.5 and 2.4.

¹⁴¹⁰ Although, on its own, this can refer to the insertion of agents or nominees to get treaty benefits.

¹⁴¹¹ Para 12 and para 12.1 of the Commentary (2003) to Art 10.

¹⁴¹² Parts 2.3.5 and 2.4.

¹⁴¹³ See n 49 above.

¹⁴¹⁴ See the discussion of these expressions in part 3.6.

requirement comes through strongly enough in the 1977 Commentary so as to completely abandon this legal approach.

Therefore, I argue that the 1977 Commentary to Article 10 was seen as having a gap in that it did not address conduit companies (other than agents and nominees). This gap was highlighted in the (1986) Conduit Report and filled when the Commentaries were redrafted in 2003. The 2003 Commentaries are thus not simply “clarifying”.¹⁴¹⁵

However, an opposite conclusion was reached in *Prévost (FCA)*.¹⁴¹⁶ There are some aspects of this conclusion that should be noted. The first is that the FCA considered Canadian case law and the view of the CFA¹⁴¹⁷ on whether, in principle, the ambulatory approach in respect of the Commentaries could be followed,¹⁴¹⁸ but did not attempt to analyse the 1977 and 2003 versions to determine whether the changes were only clarifying.¹⁴¹⁹ Also, the FCA noted that both parties have accepted that the revised Commentaries could be taken into account in this case.¹⁴²⁰ The court thus did not have the benefit of hearing opposing arguments on this point. For these reasons the judgment is arguably not great authority for accepting that the 2003 Commentaries are merely clarifying.¹⁴²¹ However, there is a strong possibility that a South African court will be prepared to accept the view of the FCA.

With regard to the 2014 amendments, the working party responsible for the drafting of the amendments was clearly aware of the argument in favour of disallowing revised Commentaries if the amendments are not merely clarifying. This is seen in the fact that both the discussion documents leading up to the 2014 amendments were labelled as “clarifications”. The working party also expressly stated that it regarded the amendments in

¹⁴¹⁵ Du Toit (2010) *BFIT* 505 agrees. At 504 n 31 he also notes: “It may be questioned though whether, on the issues of introducing a ‘as a practical matter’ test and also directly referring to an anti-avoidance purpose, the [2003] amendments were not more than simply ‘elucidating’.”

¹⁴¹⁶ See the discussion in part 6.5.4.2. A similar conclusion was reached by the Danish Eastern High Court in the 2011 case of *Minister of Taxation v FS Equity II SKM 2012.121*. For a short mention of this aspect of the judgment, see Arnold (2012) *BFIT* 327; Bundgaard “Beneficial Ownership in Danish Tax Law” in *Beneficial Ownership* (2013) 97; Hansen et al (2013) *BFIT* 196 and Booker (2013) *Euro Tax* 165.

¹⁴¹⁷ See n 729 above.

¹⁴¹⁸ *Prévost Car Inc. v Canada* 2009 FCA 57 (CanLII) paras [9] and [11].

¹⁴¹⁹ Du Toit (2010) *BFIT* 504 n 31 notes: “It can further be questioned whether or not the court [in *Prévost Car Inc. v Canada* 2009 FCA 57 (CanLII)], in fact, applied these two principles [“elucidating” and not “contradicting”] in its decision.” The court *a quo* in *Prévost Car Inc. v The Queen* 2008 TCC 231 did mention at para [32] the amendments made in 2003, but there is no attempt to compare the 1977 and 2003 versions.

¹⁴²⁰ *Prévost Car Inc. v Canada* 2009 FCA 57 (CanLII) para [9].

¹⁴²¹ Elliffe *Applying the 2003 OECD Commentary to Pre-2003 Treaties* para 4.1 goes so far as to state that it is “strongly arguable” that the statement by the FCA was made *obiter*.

this manner.¹⁴²² Although it is doubtful whether the working party would have ever admitted otherwise, the scholar Baker agrees that the 2014 amendments are merely clarifying.¹⁴²³

When one considers the 2014 version, it has been noted earlier that the working party took care to leave most of the 2003 version intact. It was also noted that arguments could be made that an economic view is possible under both versions, although the economic factors that can be taken into account under the 2014 versions are possibly narrower. At the same time, however, there have been arguments that both versions (only) support a legal approach.¹⁴²⁴

The argument that the 2014 amendments are merely clarifying is stronger than the argument with regard to the 2003 amendments.¹⁴²⁵ Given the conclusion that South African courts are likely to regard the 2003 amendments as clarifying in light of foreign precedent, it is thus likely that the 2014 amendments will also be accepted as merely clarifying.

Even if a South African court does not regard both sets of amendments as merely clarifying, there is a further possibility that will allow for the ambulatory approach to be followed. This possibility arises if one, firstly, agrees that the Commentaries should be seen as a source for the “ordinary meaning” of a term in the DTA in terms of Article 31(1).¹⁴²⁶ It was already pointed out in part 4.4.2 that there is support for viewing Article 31(1) as the place fitting for the Commentaries. The second requirement is that the contracting parties, when they concluded the DTA, must have intended for the term “beneficial owner” in Article 10 to change as tax law practice (as reflected in the Commentaries) develops. As indicated in part 2.3, it is not clear why the expression “beneficial owner” was decided on in the first place. It is, however, a pliable expression, with many nuances. This is appreciated when one considers the many diverse ways in which the expression is used in South African case law alone.¹⁴²⁷ It was also pointed out that the term usually has no meaning in civil-law countries and that is argued that it is unlikely that the civil-law members of the OECD (which far outnumbered the common-law members when the expression was introduced in 1977)¹⁴²⁸ would have intended to adopt the common-law meaning (even if such a meaning does exist).¹⁴²⁹ By choosing such

¹⁴²² 2012 Revised Discussion Draft para 32.

¹⁴²³ Baker “Beneficial Ownership’ as Applied to Dividends” in *Taxation of Intercompany Dividends* (2012) 95.

¹⁴²⁴ Part 2.6.

¹⁴²⁵ Du Plessis *Critical Issues Regarding the OECD Model Tax Convention* 284 regards the amendments relating to the statements regarding trusts as “substantial”.

¹⁴²⁶ Part 4.4.1.

¹⁴²⁷ This is analysed in ch 3.

¹⁴²⁸ See n 199 above.

¹⁴²⁹ Part 2.4.1.

an open-ended term, which did not have a legal meaning in the majority of the OECD member countries, the members arguably had no clear idea of what would be included.¹⁴³⁰ Since then, countries have generally persisted with the use of the term when concluding new DTAs without attempting to define it. These factors possibly support an argument that parties to a DTA intend for the meaning of the term to change as tax policy (as expressed in the Commentaries) changes.

Even if both these bases for accepting the ambulatory approach relating to the 2003 and 2014 Commentaries fail, a South African court may be induced to follow a more practical approach and consider the amended versions, but afford less weight to them.¹⁴³¹

7.6 A South African view on the use of selected material in the interpretation of DTAs

7.6.1 Dictionaries

With regard to the interpretation of domestic legislation by South African courts, general dictionaries are common guides to the meaning of words.¹⁴³² The same holds true for technical and legal dictionaries and legal reference works with regard to the technical or legal meanings of words.¹⁴³³

An analysis of local decisions dealing with the interpretation of DTAs shows that South African courts often use general (defining) dictionaries¹⁴³⁴ as part of the interpretation process, which is in line with the approach internationally.¹⁴³⁵ Legal dictionaries and legal reference works have also been used in these cases, but on a less frequent basis.

The following are examples of where a South African court referred to dictionaries and legal reference works as part of the interpretation process in interpreting DTAs: In *ITC 1503*¹⁴³⁶ the court interpreted the word “derived” in a treaty with reference to a general dictionary,¹⁴³⁷ a

¹⁴³⁰ Baker “‘Beneficial Ownership’ as Applied to Dividends” in *Taxation of Intercompany Dividends* (2012) 94. See also the following statement in para 12.1 of the Commentary (2014) to Art 10: “[I]n fact, when [the term] was added to the [OECD MTC], the term did not have a precise meaning in the law of many countries”.

¹⁴³¹ Part 4.4.2.

¹⁴³² Du Plessis *Interpretation of Statutes* 105; Devenish *Interpretation of Statutes* 140; Goldswain (2012) *Southern African Business Review* 43.

¹⁴³³ Du Plessis *Re-Interpretation of Statutes* 203.

¹⁴³⁴ Including non-British dictionaries, e.g. in *ITC 1735* (2002) 64 SATC 455 paras 12.5.1 and 12.5.2. See in this regard Du Plessis *Interpretation of Statutes* 105 and also Devenish *Interpretation of Statutes* 141.

¹⁴³⁵ See part 4.3.2, where it is explained that dictionaries are often used to determine the everyday meaning of words.

¹⁴³⁶ *ITC 1503* (1990) 53 SATC 342, discussed in part 7.5.2.

¹⁴³⁷ The court referred at 347 to the “Shorter Oxford English Dictionary”.

legal dictionary¹⁴³⁸ and a legal reference work.¹⁴³⁹ In *ITC 1735*¹⁴⁴⁰ the court was concerned with the taxation of payments received by a non-resident golf professional relating to a South African golf tournament. Several issues arose, amongst other the interpretation of various undefined terms in the South Africa/UK DTA, namely that of “copyright”, “professional services” and “athlete”. With regard to the undefined term “copyright”, the court referred to the *Law of South Africa*,¹⁴⁴¹ and with regard to the terms “professional services”¹⁴⁴² and “athlete”¹⁴⁴³ respectively, to general and legal dictionaries. In *Tetra Pak*¹⁴⁴⁴ (interpreting “commercial”) and *ITC 1878*¹⁴⁴⁵ (interpreting “includes especially”) the courts also referred to general dictionaries as part of the interpretation process.

Dictionaries have not always been accepted as useful guides, though. In *ITC 1087*¹⁴⁴⁶ (interpreting “commercial”) the court indicated that it found case law on the meaning of the term a more useful guide than dictionaries.¹⁴⁴⁷ And in *Tradehold*¹⁴⁴⁸ (interpreting “alienation”) the court adopted a meaning which differed substantially from the dictionary meaning proposed by the Commissioner.¹⁴⁴⁹

¹⁴³⁸ The court referred at 347 to “Stroud Judicial Dictionary” to give meaning to the word “revenue”, which was in turn relevant for the interpretation of the term “derived”.

¹⁴³⁹ The court referred at 347 to “Words and Phrases Legally Defined” to give meaning to the word “derive”.

¹⁴⁴⁰ *ITC 1735* (2002) 64 SATC 455.

¹⁴⁴¹ The court referred at para 12.4 to “JC Copeling and AJ Smith in ‘The Law of South Africa’ (Vol 5 Part 2 of First Reissue)”.

¹⁴⁴² The court referred at para 12.5.1 to “The Shorter Oxford Dictionary” and “Black’s Law Dictionary (7 ed)”. These were the only guides considered by the court.

¹⁴⁴³ The court mentioned at para 12.5.2 the “Concise Oxford Dictionary” and the “Heritage Dictionary”. It was also referred to a meaning proposed by an international scholar, but preferred the dictionary meanings, which it called the “modern ordinary meaning”, over the scholar’s “impractical and limited meaning”. See in this regard also part 7.6.3.2.

¹⁴⁴⁴ *COT v Aktiebolaget Tetra Pak* (1966) 28 SATC 213 217, where the court referred to “The Oxford English Dictionary, 1933 ed., vol. 2, p. 678”. This case is discussed in part 7.3. See also Du Toit *Beneficial Ownership of Royalties* 192, where this case is mentioned in a similar context.

¹⁴⁴⁵ *ITC 1878* (2015) 77 SATC 349 para [25], where the court referred to “Collins English Dictionary (Complete and Unabridged)”. This case is discussed in part 7.5.4.

¹⁴⁴⁶ *ITC 1087* (1966) 28 SATC 196.

¹⁴⁴⁷ 201.

¹⁴⁴⁸ *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA).

¹⁴⁴⁹ The court in *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA) para [13] was referred to the “Shorter Oxford English Dictionary”, as discussed in part 8.6.2. It was also referred to case law, as mentioned in part 7.6.2.1.

7.6.2 South African case law and writings of local scholars

7.6.2.1 South African case law

An analysis of South African court decisions in which DTAs were interpreted shows that it is not unusual for local cases (which includes here cases from Rhodesia/Zimbabwe and Botswana)¹⁴⁵⁰ to be referred to. The analysis also shows that reference to local court decisions has served different purposes.

Firstly, local case law has served as authority for matters relating to the interpretation process itself,¹⁴⁵¹ with the SCA's decision in *Downing*¹⁴⁵² being frequently quoted.

Secondly, local case law (usually dealing with non-taxation matters) has also been used to supplement the dictionary meaning of an undefined term. Although, as explained above, dictionaries are often used as guides to the meaning of undefined terms in a DTA, they are seldom the only material considered¹⁴⁵³ and these dictionary meanings are often confirmed by referring to local case law.¹⁴⁵⁴ In the Rhodesian case of *ITC 1087*¹⁴⁵⁵ (interpreting “commercial”) the court, after having been referred to dictionaries by one of the parties, instead found South African case law on the Usury Act¹⁴⁵⁶ “quite as useful, if not more so” than dictionaries, despite noting its wariness in considering case law dealing with a non-tax

¹⁴⁵⁰ The reason for including the Rhodesian and Botswana cases is that they are readily available on the same databases on which the South Africa cases are reported and thus easily accessible to South African courts. See also n 1249 above.

¹⁴⁵¹ Examples include *Case of LJ Downing (No. 6737)* (1972) Unreported (where the court referred to a 1915 decision of the Cape Provincial Division on the interpretation of treaties); *Baldwins (South Africa) Ltd v CIR* (1961) 24 SATC 270 281; *ITC 1544* (1992) 54 SATC 456 462, *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA) paras [12] and [21]; *Krok v CSARS* 2015 (6) SA 317 (SCA) paras [26] and [40]; and *ITC 1878* (2015) 77 SATC 349 n 15.

¹⁴⁵² *SIR v Downing* 1975 (4) SA 518 (A), discussed in part 7.5.1. This case has been used to explain the incorporation of DTAs into South African law by way of s 108 of the ITA in, e.g. *ITC 1544* (1992) 54 SATC 456 460; *ITC 1848* (2010) 73 SATC 170 para [11]; *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA) para [16]. It has also served as authority for the fact that South African DTAs are generally based on the OECD MTC in cases such as *ITC 1503* (1990) 53 SATC 342 348; *ITC 1848* (2010) 73 SATC 170 para [12]; *ITC 1878* (2015) 77 SATC 349 para [14]. See also *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA) para [18] the court referred to *SIR v Downing* 1975 (4) SA 518 (A).

¹⁴⁵³ But see *ITC 1735* (2002) 64 SATC 455 para 12.5.1, discussed in part 7.6.1. There the court, in defining “professional services”, only considered dictionaries. In *Association of Amusement and Novelty Machine Operators v Minister of Justice* 1980 (2) SA 636 (A) 660 the court explained that, although the “normal and permissible method” for a court to determine the ordinary meaning of words is to turn to dictionaries, it may also consider any other “literary help” in doing so. See also Du Plessis *Interpretation of Statutes* 105.

¹⁴⁵⁴ Apart from the examples mentioned in the main text, the following cases may also be referred to: *ITC 1878* (2015) 77 SATC 349 paras [26] and [27] (discussed in part 7.5.4) and *ITC 1503* (1990) 53 SATC 342 347-348 (discussed in part 7.5.2.)

¹⁴⁵⁵ *ITC 1087* (1966) 28 SATC 196. This case was taken on appeal, the judgment of which was reported as *COT v Aktiebolaget Tetra Pak* (1966) 28 SATC 213.

¹⁴⁵⁶ Usury Act, 1926.

matter.¹⁴⁵⁷ In *Tradehold*¹⁴⁵⁸ the court was, in addition to a dictionary, also referred to South African case law (dealing with the law pertaining to insolvency), but preferred a different meaning,¹⁴⁵⁹ as discussed in part 8.6.2.

Where an undefined term in a DTA was interpreted with reference to a definition in the ITA, as was the case in *ITC 789*,¹⁴⁶⁰ the court also referred to local case law to interpret the definition in the ITA and thus, indirectly, the undefined treaty term.¹⁴⁶¹

Only rarely has a local court, when interpreting a DTA, referred to local case law which dealt with a treaty provision comparable to the one under consideration. This is to be expected, due to the scarcity of local case law on the interpretation of DTAs.¹⁴⁶² The decision of the tax court in *Downing (TC)*¹⁴⁶³ provides an early example. In that case the court noted (although it was not in dispute) its view that a non-resident of South Africa who was taxed in South Africa contrary to a provision of the DTA was entitled to avail him- or herself of the DTA. In doing so, the court referred both to *Transvaal Associated Hide and Skin Merchants v Collector of Income Tax Botswana*¹⁴⁶⁴ (where doubts were expressed in this regard in an *obiter* statement) and *Tetra Pak*¹⁴⁶⁵ (the views of which corresponded with the view of the tax court in *Downing (TC)*). A more recent example is the case of *ITC 1503*,¹⁴⁶⁶ where the court had to decide whether interest earned on the receipts from the sale of tickets was “derived” from the taxpayer’s business as an air transporter. During the judgment the court referred with approval to *ITC 1048*.¹⁴⁶⁷ In the latter case the taxpayer, which carried on a similar business in Southern Rhodesia, had received commission for arranging sea passages for some

¹⁴⁵⁷ *ITC 1087* (1966) 28 SATC 196 201.

¹⁴⁵⁸ *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA).

¹⁴⁵⁹ Para [13].

¹⁴⁶⁰ *ITC 789* (1954) 19 SATC 434, discussed in parts 8.2 and 9.4.1.2.5.

¹⁴⁶¹ 440-441.

¹⁴⁶² Apart from the examples mentioned in the main text, reference may also be had to the following cases: in *Baldwins (South Africa) Ltd v CIR* (1961) 24 SATC 270 (discussed in parts 8.2 and 8.7.3.1) reference was made to the decision in *ITC 789* (1954) 19 SATC 434 (see especially n 1657 below); in *Cohen Brothers Furniture (Pty) Ltd v Minister of Finance of the National Government, RSA* 1998 (2) SA 1128 (SCA) 1132 the court referred to *ITC 1544* (1992) 54 SATC 456, but found it unnecessary to consider that judgment.

¹⁴⁶³ *Case of LJ Downing (No. 6737)* (1972) Unreported, discussed in part 7.5.1. Apart from the examples mentioned in the main text, refer also to *BAT v COT* (1994) 57 SATC 271 278-279, where the court considered a non-discrimination provision in the Zimbabwe/UK DTA and specifically whether a non-resident shareholder tax on dividends fell foul of this provision. The court quoted extensively from the judgment in *ITC 1544* (1992) 54 SATC 456, where the court considered a similar issue that arose under the South Africa/Netherlands DTA.

¹⁴⁶⁴ *Transvaal Associated Hide and Skin Merchants v Collector of Income Tax Botswana* (1967) 29 SATC 97 (BCA).

¹⁴⁶⁵ *COT v Aktiebolaget Tetra Pak* (1966) 28 SATC 213.

¹⁴⁶⁶ *ITC 1503* (1990) 53 SATC 342, discussed in part 7.5.2.

¹⁴⁶⁷ *ITC 1048* (1964) 26 SATC 226, referred to by *ITC 1503* (1990) 53 SATC 342 347.

of its passengers and the issue was whether this commission was “derived from operating aircraft” under the UK/Federation of Rhodesia and Nyasaland DTA.

7.6.2.2 South African scholars

From time to time, references to the views of South Africa scholars are made in local case law in which DTAs were interpreted. A common work referred to with regard to substantive issues is “*International Tax: A South African perspective*”.¹⁴⁶⁸ Apart from referring to local scholars with regard to substantive issues,¹⁴⁶⁹ local courts have also referred to them with regard to the interpretative approach to DTAs.¹⁴⁷⁰

7.6.3 Foreign case law and writings of foreign scholars

7.6.3.1 International case law

7.6.3.1.1 The use of international case law when interpreting DTAs

Keeping in mind the goals of common and uniform interpretation, one would expect that foreign case law would feature prominently in the interpretation of DTAs.¹⁴⁷¹ However, internationally, foreign case law is not often used by domestic courts in the interpretation of DTAs¹⁴⁷² (although this trend may be changing).¹⁴⁷³ With regard to “treaty cases” in South Africa, Hattingh indicated in 2011 that foreign case law is seldom referred to and that “it is something of a hit-and-miss affair to predict whether or not a South Africa court will consider

¹⁴⁶⁸ L Olivier and M Honiball co-authored the fifth edition.

¹⁴⁶⁹ Examples include: in *Volkswagen of South Africa (Pty) Ltd v CSARS* (2008) 70 SATC 195 203 the court, in deciding whether STC was a tax on dividends for purposes of the South Africa/Germany DTA, referred to a number of contributions by South African scholars in which the nature of the domestic tax was described, namely “Lynette Olivier, Emil Brincker, Michael Honiball in their work titled *International Tax – A South African Perspective*”, “*Integritax Newsletter: SAICA*, August 1994 – Contributor: Ernst & Young” and “RC Williams *Income Tax in South Africa, Law and Practice* 2ed”; in *Anglo American Corporation of SA Ltd v COT* (1974) 37 SATC 45 52 the court referred to “*Silke South African Income Tax* 6 ed 1317” to explain what was meant by the fact that a PE was to be regarded as an “independent enterprise” for purposes of allocating profits to it.

¹⁴⁷⁰ Examples include: in *CSARS v Van Kets* (2011) 74 SATC 9 para [24] the court quoted from “Olivier and Honiball *International Tax, A South African Perspective* (2011)”; in *ITC 1878* (2015) 77 SATC 349 n 11 (discussed in part 7.5.4) the court referred to “Lynette Olivier and Michael Honiball, *International Tax: A South African Perspective 2011*, (Fifth Ed)”.

¹⁴⁷¹ See n 580 above.

¹⁴⁷² With regard to UK courts, Schwarz *Schwarz on Tax Treaties* para 12-200 comments that they have taken a “critical approach” to foreign case law. JF Avery Jones “Interpretation of Double Taxation Conventions - United Kingdom” in *IFA Cahiers De Droit Fiscal International Vol. 78a* (1993) 597 610 indicates that this might be attributable to the UK courts being mindful of the fact that different countries have different approaches to the interpretation of treaties.

¹⁴⁷³ Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) paras 3.5.2 and 10.

international tax law materials, especially foreign cases that are relevant to the tax case at hand”.¹⁴⁷⁴

If one restricts the analysis to South African case law on the interpretation of DTAs, courts determine the meaning of undefined treaty terms primarily with regard to dictionaries and South African case law, and to a lesser extent, foreign case law. Furthermore, reference to foreign case law is often done with regard to interpretation, rather than substantive, issues.¹⁴⁷⁵

The limited reference to foreign case law may be attributed to the lack of such precedent.¹⁴⁷⁶ However, this is not true in a number of instances. One example is *Tradehold*¹⁴⁷⁷ (and the judgment of the tax court)¹⁴⁷⁸ where the courts did not refer to foreign decisions dealing with the same substantive issue.¹⁴⁷⁹

Another reason why foreign precedent on substantive issues may not frequently be used in cases dealing with DTAs, is that DTAs sometime require reference to domestic law for the interpretation of the treaty (although this should not necessarily obviate the relevance of foreign precedent). In *Volkswagen*¹⁴⁸⁰ the court held that amounts deemed to be dividends under the secondary tax on companies (“STC”) regime did not constitute “dividends” for purposes of a provision in the South Africa/Germany DTA, without referencing any of the foreign case law that exists on this topic.¹⁴⁸¹ Du Plessis comments that this may be partially explained by the fact that the treaty provision required the application of South African law.¹⁴⁸² Furthermore, if the court in *Tradehold* gave a domestic law meaning to the term “alienation”,¹⁴⁸³ this may go some way towards explaining the lack of reference to foreign precedent in that case.

¹⁴⁷⁴ Hattingh (2011) *BFIT* 130. Du Plessis (2016) *TSAR* 497, on the other hand, indicates that “foreign precedent is often relied on as persuasive authority”.

¹⁴⁷⁵ As Du Plessis *Re-Interpretation of Statutes* 266 explains, South African courts commonly refer to UK case law on matters relating to the interpretation process.

¹⁴⁷⁶ See, e.g. the statement in *Potgieter v British Airways plc* 2005 (3) SA 133 (C) 140 explaining why a more extensive analysis of foreign case law was not carried out by the court in *Pan American World Airways Incorporated v SA Fire and Accident Insurance Co Ltd* 1965 (3) SA 150 (A) when interpreting the Warsaw Convention (and thus not a DTA).

¹⁴⁷⁷ *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA).

¹⁴⁷⁸ *ITC 1848* (2010) 73 SATC 170.

¹⁴⁷⁹ As Du Plessis (2012) *SA Merc LJ* 49-50 points out, the SCA did refer to foreign case law. However, as pointed out in ns 1493 and 1495, these cases did not deal with the substantive issue that arose in the matter.

¹⁴⁸⁰ *Volkswagen of South Africa (Pty) Ltd v CSARS* (2008) 70 SATC 195.

¹⁴⁸¹ See a summary of these cases in Hattingh (2009) *BFIT* para 11.

¹⁴⁸² Du Plessis (2012) *SA Merc LJ* 48.

¹⁴⁸³ This question is considered in part 8.6.2.2.

The goals of common and uniform interpretation justify a reference to judicial decisions of, firstly, the other contracting party and, secondly, other countries that have entered into DTAs with similar wording. International scholars agree that, despite the usefulness of foreign decisions, these are not binding.¹⁴⁸⁴ This is confirmed with regard to the position in South Africa by statements by South African courts, dealing with the interpretation of DTAs. These statements note that foreign decisions are only of “instructive” value.¹⁴⁸⁵

In determining how much weight foreign decisions should carry, it is usually accepted that the status of the foreign court and the extent to which its decisions are binding on other courts in the same country are important considerations.¹⁴⁸⁶ Furthermore, foreign case law of the treaty partner may carry greater weight than other case law due to the goal of common interpretation.¹⁴⁸⁷ Vogel and Prokisch thus argue that any deviation from case law of the treaty party should be explained “explicitly and convincingly”.¹⁴⁸⁸ As pointed out in part 7.2, section 233 of the Constitution has also been interpreted to mean that decisions by courts of the treaty partner have “persuasive” value.¹⁴⁸⁹

To the extent that foreign decisions are referred to by South African courts in interpreting DTAs, a preference is shown for case law from the UK¹⁴⁹⁰ and Canada.¹⁴⁹¹ Hattingh indicates that, to his knowledge, reference has never been made to “tax case law” of civil-law countries.¹⁴⁹²

South African courts have referred to foreign cases when interpreting DTAs for different purposes. In a great number of instances where reference was made to foreign case law, such foreign case law served as authority for the approach to interpretation (rather than the

¹⁴⁸⁴ Orow (2005) *Adelaide Law Review* 92; Vogel & Rust “Introduction” in *Klaus Vogel* (2015) 43-44 m.nr. 94; Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) paras 3.5.2 and 9.1.

¹⁴⁸⁵ *ITC 1878* (2015) 77 SATC 349 para [36]; *Krok v CSARS* 2015 (6) SA 317 (SCA) para [38].

¹⁴⁸⁶ Avery Jones et al (1984) *BTR* 101; Orow (2005) *Adelaide Law Review* 94; Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) 3.5.2.

¹⁴⁸⁷ Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.13.

¹⁴⁸⁸ Vogel & Prokisch “Interpretation - General Report” in *Cahiers Vol. 78a* (1993) 63. Olivier & Honiball *International Tax* 319 state that these decisions should “have greater value than merely being of persuasive value to a South African court”, but that these decisions do not have to be “accepted uncritically, without review”.

¹⁴⁸⁹ *Seton Co v Silveroak Industries Ltd* 2000 (2) SA 215 (T) 229.

¹⁴⁹⁰ Hattingh (2011) *BFIT* 130.

¹⁴⁹¹ The Canadian scholar Li *Beneficial Ownership in Tax Treaties* 204 argues that, generally, the decisions of common-law countries “carry more weight because of the style of judicial writing” and since “English language materials are more easily accessible”.

¹⁴⁹² Hattingh (2011) *BFIT* 130.

meaning of the specific treaty term).¹⁴⁹³ The UK case of *Ostime*¹⁴⁹⁴ features prominently in this regard.¹⁴⁹⁵

There are also a number of examples where reference was made to foreign decisions to decide substantive issues, but these foreign decisions did not deal with comparable issues.¹⁴⁹⁶ In both *Tetra Pak*¹⁴⁹⁷ (interpreting “commercial”) and *ITC 1878*¹⁴⁹⁸ (interpreting “includes especially”) the courts referred to foreign non-tax cases to confirm meanings first established by reference to dictionaries and South African case law.

Lastly, not that common are examples where reference was made to foreign case law where a comparable issue had been considered.¹⁴⁹⁹ And in these instances, the foreign precedent has often not been followed. The usual reasons advanced by the courts for not following such precedent were differences in the wording of the treaties, the interpretative approaches or the facts.¹⁵⁰⁰ *ITC 1878*¹⁵⁰¹ is an example of a judgment where all the above reasons were given

¹⁴⁹³ Examples include: in *Case of LJ Downing (No. 6737)* (1972) Unreported the court referred to two UK decisions, reported in 1932 and 1965 respectively, regarding matters concerning the interpretational approach; *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA) para [11]; *Krok v CSARS* 2015 (6) SA 317 (SCA) paras [26], [28] and [29] and [40]; and the cases mentioned at n 1495 below. In *ITC 1878* (2015) 77 SATC 349 paras [1] and [2] the court referred to UK case law to explain the historical need for DTAs.

¹⁴⁹⁴ *Ostime v Australian Mutual Provident Society* [1960] AC 459.

¹⁴⁹⁵ Examples include: *COT v Aktiebolaget Tetra Pak* (1966) 28 SATC 213 215 (at 217 the court also referred to the High Court decision in the same matter); *Case of LJ Downing (No. 6737)* (1972) Unreported; *SIR v Downing* 1975 (4) SA 518 (A) 523; *ITC 1544* (1992) 54 SATC 456 460; *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA) paras [18] and [20].

¹⁴⁹⁶ Apart from the examples in the main text, see the 1967 case of *Transvaal Associated Hide and Skin Merchants v Collector of Income Tax Botswana* (1967) 29 SATC 97 (BCA), in which case the DTA concerned preceded the 1963 draft OECD MTC. The court was required to give meaning to the terms “business” and “permanent establishment”. In deciding the meaning of these terms, the court referred at 114-115 to an English case (which dealt with a non-tax matter) and an Australian case (which dealt with the interpretation of a provision in Australian tax legislation in a context entirely different from that of the DTA). Another example is *ITC 1503* (1990) 53 SATC 342 347 where the court, in interpreting the treaty term “derived”, referred to the meaning given to a related term (“revenue”) in a legal dictionary, which meaning the court noted was based on a UK case.

¹⁴⁹⁷ *COT v Aktiebolaget Tetra Pak* (1966) 28 SATC 213 218. This case is discussed in part 7.3.

¹⁴⁹⁸ *ITC 1878* (2015) 77 SATC 349 para [28]. This case is discussed in part 7.5.4.

¹⁴⁹⁹ Apart from the cases mentioned in the main text, other examples include: in *Case of LJ Downing (No. 6737)* (1972) Unreported the court referred to a foreign judgment regarding the issue whether Art 7(1) of the DTA, which was based on the same provision in the OECD MTC, only applied in the case of actual double-taxation. It also referred to two other foreign cases relating to the interaction between the DTA and the ITA, which the Commissioner had put forward in support of his argument. The court, however, held that these judgments did not support the Commissioner’s argument; in *BAT v COT* (1994) 57 SATC 271 276 the taxpayer referred to several foreign cases regarding the manner in which the nationality and residence of a company are to be determined.

¹⁵⁰⁰ Apart from the example in the main text, see also *ITC 1087* (1966) 28 SATC 196. In this case, the Rhodesian Special Court had to interpret the phrase “industrial or commercial profits” for purposes of the DTA between Sweden and the former Federation of Rhodesia and Nyasaland. In the judgment reference is made at 200 to the UK case of *Ostime v Australian Mutual Provident Society* [1960] AC 459 where a similar phrase in the UK/Australia DTA was considered. However, in that case the definition of the phrase read differently and was thus considered to be of no great assistance in the Rhodesian case.

for rejecting foreign precedent. In that case, the court referred to the judgment of the FCA in *Dudney*,¹⁵⁰² a case relied on by the taxpayer with regard to the interpretation of the phrase “includes especially”. The South African court pointed out that there were substantial differences in the wording of the treaty provisions, as a result of which “superimpos[ing] the [Canadian] interpretation ... would be wrong. Its instructive value, too, is doubtful given that the two treaties are so different”.¹⁵⁰³ It also held (without explaining its reasoning) that the Canadian court’s judgment did not conform to South African rules of interpretation.¹⁵⁰⁴ Lastly, with regard to the interpretation of Article 5(1) of the DTA, it also distinguished the Canadian judgment on the facts.¹⁵⁰⁵

There are a few cases where the foreign precedent was referred to with approval. In *Oceanic Trust*¹⁵⁰⁶ the court was prepared to consider UK case law with regard to the question as to whether a trust had its POEM in South Africa. In *Krok*¹⁵⁰⁷ the SCA elected to follow the reasoning in *Ben Nevis (Holdings) Ltd and Metlika Trading Ltd*,¹⁵⁰⁸ a foreign judgment in which the UK CA dealt with a provision in the South Africa/UK DTA. Despite differences in the issues raised in these cases, the SCA regarded the UK judgment as “instructive”¹⁵⁰⁹ and thought that the UK court had “aptly contextualise the DTA and the meaning and purpose” of the relevant treaty provision.¹⁵¹⁰

7.6.3.1.2 Foreign case law as a source for the “ordinary meaning” of the term “beneficial owner”

Foreign case law plays at least two roles with regard to the interpretation of the term “beneficial owner”. It can play a role in deciding whether the context requires that a domestic meaning should not be given to an undefined treaty term under the general *renvoi* clause, as discussed in part 9.6. The other role comprises giving meaning to the term “beneficial owner” under the Vienna rules. A number of observations about this latter role are made here.

¹⁵⁰¹ *ITC 1878* (2015) 77 SATC 349, discussed in part 7.5.4.

¹⁵⁰² *The Queen v Dudney WA* (2000) DTC 6169.

¹⁵⁰³ *ITC 1878* (2015) 77 SATC 349 para [36].

¹⁵⁰⁴ Para [36].

¹⁵⁰⁵ Para [42].

¹⁵⁰⁶ *The Oceanic Trust Co Ltd NO v CSARS* (2011) 74 SATC 127, discussed in part 7.5.3.

¹⁵⁰⁷ *Krok v CSARS* 2015 (6) SA 317 (SCA), discussed in part 7.5.5.

¹⁵⁰⁸ *Ben Nevis (Holdings) Ltd v Revenue and Customs Commissioners* (2013) 76 SATC 243.

¹⁵⁰⁹ *Krok v CSARS* 2015 (6) SA 317 (SCA), para [38].

¹⁵¹⁰ Para [39].

Firstly, it is not clear where case law fits into the Vienna rules: should it be regarded as a source of the ordinary meaning of the term as contemplated under Article 31(1), or as supplementary material under Article 32? There is support for both.¹⁵¹¹

A second issue with regard to case law is that the analysis in this chapter shows that South African courts regularly use dictionaries and legal reference works, and to a lesser extent local case law, to give meaning to undefined terms in DTAs. They, however, are less inclined to refer to foreign judgments that deal with the same substantive issue.

A third issue with reference to foreign decisions is that the foreign courts may rely on domestic interpretative approaches that differ from the South African approach. This issue was highlighted earlier¹⁵¹² and it has been shown that South African courts have refrained from following foreign precedent where they are of the view that such foreign precedent does not correspond to South African interpretative approaches.¹⁵¹³

A fourth issue, this time with regard to foreign case law on the beneficial ownership requirement specifically, concerns the basis for the courts' decisions. In *Prévost (TCC)*¹⁵¹⁴ the court arguably based its decision on the domestic (Canadian) meaning of the term. That raises the question whether such a meaning will equally apply in South Africa. In the other cases an international meaning was given. But, at least according to the courts' reasoning in the respective judgments, such meaning was primarily based on the Commentaries.¹⁵¹⁵ In this sense, the case law becomes merely a way of interpreting the Commentaries, rather than providing an alternative meaning for the term "beneficial owner".

The last issue is the fact that the foreign cases discussed in the previous chapter do not provide a uniform meaning for the beneficial ownership requirement. The question is then which of the foreign cases South African courts are more likely to find authoritative? The *Hoge Raad* is the highest court in the Netherlands on taxation matters. That court's judgments should thus carry great weight.¹⁵¹⁶ The CA and FCA, on the other hand, are not the highest courts on taxation matters in the UK and Canada respectively. However, South African courts are more inclined to following decision by courts from common-law jurisdictions, especially the UK and Canada, than civil-law jurisdictions such as the

¹⁵¹¹ Part 4.3.5.

¹⁵¹² Parts 5.2 and 6.7.

¹⁵¹³ Part 7.6.3.1.1.

¹⁵¹⁴ *Prévost Car Inc. v The Queen* 2008 TCC 231.

¹⁵¹⁵ Part 6.7.

¹⁵¹⁶ Part 7.6.3.1.1.

Netherlands.¹⁵¹⁷ Since foreign courts have been influenced when interpreting the treaty term “beneficial owner” by the way in which they interpret domestic legislation when faced with tax avoidance,¹⁵¹⁸ South African courts are more likely to find of value decisions of courts from jurisdictions that adhere to the same domestic interpretative approach to interpretation in similar circumstances, as pointed out above. Of all the jurisdictions considered, Canada is probably the closest, as discussed in parts 5.3 and 7.4.¹⁵¹⁹ The FCA in *Prévost*¹⁵²⁰ approved the meaning adopted by the TCC. The TCC in turn considered both the *Market Maker*¹⁵²¹ and *Indofood (CA)*¹⁵²² judgments. Furthermore, the judges that handed down the decisions in that case arguably had more experience dealing with taxation matters than the bench in *Indofood (CA)*.¹⁵²³ Canada has both common and civil law (in Quebec) and uses both the official languages (English and French) in which the OECD MTC appears in its tax legislation.¹⁵²⁴ This comes through in the judgment of the TCC, where the TCC considered dictionaries in both languages. The TCC also considered aspects of both common and civil law to reach its conclusion.¹⁵²⁵

For all these reasons the judgments in the *Prévost* are likely to carry the greatest weight with regard to the interpretation of the treaty term “beneficial owner”,¹⁵²⁶ always heeding Cilliers’s advise that “it would be rash to predict that a South African court would directly ‘follow’” these judgments.¹⁵²⁷

7.6.3.2 International scholars

Avery Jones indicates that domestic courts are usually prepared to refer to international scholars although this differs from country to country.¹⁵²⁸ In respect of the position in South Africa, Du Plessis indicates that this material is “often relied on as persuasive authority” in

¹⁵¹⁷ Part 7.6.3.1.1.

¹⁵¹⁸ Parts 5.3 and 6.7.

¹⁵¹⁹ Despite the statement in *ITC 1878* (2015) 77 SATC 349 to the contrary, referred to in part 7.6.3.1.1.

¹⁵²⁰ *Prévost Car Inc. v Canada* 2009 FCA 57 (CanLII).

¹⁵²¹ *Decision by the Hoge Raad* (6 April 1994) 28638 BNB 1994/217.

¹⁵²² *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] STC 1195.

¹⁵²³ Refer to to the main text corresponding to n 1011 above, as well as n 1119 above.

¹⁵²⁴ Du Toit (2010) *BFIT* 506.

¹⁵²⁵ See also Du Toit (2010) *BFIT* 504 and Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.6.3.

¹⁵²⁶ Du Toit (2010) *BFIT* 506 agrees although he does not consider the question from a South African perspective.

¹⁵²⁷ Cilliers “Anti-Avoidance” in *Silke on International Tax* (2010) para 46.38.

¹⁵²⁸ Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 3.5.2. For a UK perspective, see Schwarz *Schwarz on Tax Treaties* para 12-200.

South African case law on the interpretation of treaties and gives as examples *ITC 1544*¹⁵²⁹ and *ITC 1735*.¹⁵³⁰ In both these cases reference was made to passages from an earlier edition of *Klaus Vogel on Double Taxation Conventions*,¹⁵³¹ which passages dealt with similar substantive issues than those considered by the courts.¹⁵³² In the case of *ITC 1735*,¹⁵³³ though, the meaning given in this book was rejected by the court.¹⁵³⁴ Apart from this book, other works of international scholars have also been referred to in connection with the substantive issue that arose in the matter.¹⁵³⁵ International scholars have also been referred to regarding matters pertaining to the interpretative process.¹⁵³⁶

7.7 Conclusion: an international meaning

In the first part of the study the focus was on establishing an autonomous (international) meaning for the treaty term “beneficial owner”. I conclude this part by proposing such a meaning in the context of conduit company treaty shopping as determined under the Vienna rules by drawing on the findings that have been made thus far.

A South African court must adhere to the Vienna rules when interpreting a DTA, as acknowledged by the SCA.¹⁵³⁷ This requires the court to determine the “ordinary meaning” of the treaty term “beneficial owner”, in light of the context and the purpose of the treaty.¹⁵³⁸ In cases such as *Natal JMPF*¹⁵³⁹ and *Bosch*,¹⁵⁴⁰ the SCA, with regard to the interpretation of

¹⁵²⁹ *ITC 1544* (1992) 54 SATC 456 463.

¹⁵³⁰ *ITC 1735* (2002) 64 SATC 455 para 12.6.1.

¹⁵³¹ According to Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 3.5.1.4, editions of this book have often been referred to by foreign courts too.

¹⁵³² In *ITC 1544* (1992) 54 SATC 456 463 the court held that its interpretation of a non-discrimination clause was in line with “international practice”, as evidenced by an earlier edition of *Klaus Vogel on Double Taxation Conventions*.

¹⁵³³ *ITC 1735* (2002) 64 SATC 455, discussed in part 7.6.1.

¹⁵³⁴ The court rejected at para 12.6.1 the view expressed in the earlier edition of *Klaus Vogel on Double Taxation Conventions* on the meaning of the term “athlete” in favour of a dictionary meaning.

¹⁵³⁵ Examples include: in *Case of LJ Downing (No. 6737)* (1972) Unreported the court referred to “*Whiteman and Wheatcroft’s Income Tax and Surtax*”; in *ITC 1503* (1990) 53 SATC 342 348 the court referred to “*Passos Tax Treaty Law*”; in *ITC 1878* (2015) 77 SATC 349 n 13 the court referred to “*Philip Baker QC, Double Taxation Conventions*, para 5B.14”; in *ITC 1473* (1989) 52 SATC 128 131-132 the court referred to “*Carr on International Tax Treaties*”. In this work, the scholar referred to a ruling and a letter from the Federal Minister of Finance of the other contracting party. It is not clear, though, to what extent Carr’s work merely reproduces these, or whether Carr’s views on the issue at hand are given. See also the reference to this case in *Olivier & Honiball International Tax* 546.

¹⁵³⁶ E.g. *Case of LJ Downing (No. 6737)* (1972) Unreported, where the court referred to “*Oppenheim, International Law*, 8th ed” and *ITC 1503* (1990) 53 SATC 342 347, where the court referred to “*Passos Tax Treaty Law*”.

¹⁵³⁷ Part 7.3.

¹⁵³⁸ Part 4.3.1.

¹⁵³⁹ *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA).

¹⁵⁴⁰ *CSARS v Bosch* 2015 (2) SA 174 (SCA).

domestic legislation, adopted an approach in terms of which meaning cannot be given to text without a consideration of the context and purpose. These cases give equal importance to the literal meaning of the words and the context and purpose. This approach is allowed under the Vienna rules and is likely to be adopted when the beneficial ownership requirement in South African DTAs is interpreted.¹⁵⁴¹ South African courts are furthermore inclined to give words in tax legislation a legal meaning and to analyse transactions based on the legal rights created by the parties, even if tax avoidance is suspected. They are likely to follow the same approach with regard to the interpretation of DTAs.¹⁵⁴²

Turning now to the “ordinary meaning” of the treaty term “beneficial owner”, South African courts often determine the “ordinary meaning” of treaty terms with reference to general dictionaries.¹⁵⁴³ It is also noteworthy that in *Prévost (TCC)*¹⁵⁴⁴ the court was referred to general English and French dictionaries regarding the meanings of “beneficial” and “owner” as separate words, after having been informed that there is no definition in English dictionaries for the phrase “beneficial owner”.¹⁵⁴⁵ The court, however, did not seem to attach much significance to these dictionary meanings. It was pointed out in part 4.3.2 that it is unlikely that the expression “beneficial owner” will have an everyday, man-in-the-street meaning that will be useful in this context. General dictionaries are thus unlikely to be useful.¹⁵⁴⁶

It is more probable that the term has a technical meaning. As mentioned in part 4.3.2, such a technical meaning may still be regarded as an “ordinary meaning” as contemplated in Article 31(1) of the VCLT. A possible source of such a meaning is a legal dictionary, for example, *Black’s Law Dictionary*, from which this study quoted.¹⁵⁴⁷ South African courts have in the past referred to this legal dictionary when interpreting DTAs.¹⁵⁴⁸ However, the first part of the definition of “beneficial owner” in this dictionary focuses on fragmented ownership recognised in the law of equity. Such a meaning will not assist in (civil-law) countries that do not allow for split ownership and thus cannot serve as an international meaning.¹⁵⁴⁹ The rest of that definition deals with limited meanings under company and intellectual property law

¹⁵⁴¹ Parts 4.3.6 and 7.3.

¹⁵⁴² Part 7.4.

¹⁵⁴³ Parts 4.3.2 and 7.6.1.

¹⁵⁴⁴ *Prévost Car Inc. v The Queen* 2008 TCC 231.

¹⁵⁴⁵ Part 6.5.2. However, see the meanings from law dictionaries quoted in part 3.6.

¹⁵⁴⁶ De Broe *International Tax Planning* 704 agrees.

¹⁵⁴⁷ Part 3.6.

¹⁵⁴⁸ Part 7.6.1.

¹⁵⁴⁹ Part 2.4.1. For a description of fragmented ownership under the law of equity, see part 3.2.3.4.

which are unlikely to be applicable beyond those narrow contexts. A Canadian law dictionary and a South African law and economics dictionary provide broader meanings,¹⁵⁵⁰ but these meanings are not precise enough to serve as “ordinary meanings” in the context of conduit company treaty shopping.

Upon exhausting the usual avenues for ascertaining the “ordinary meanings” of the treaty term “beneficial owner”, South African courts will turn to other avenues. One possibility is that the “ordinary meaning” may be the meaning that the term has in common-law jurisdictions. This is understood by Du Toit to refer to the person whose ownership attributes outweigh all others. Du Toit makes a very convincing argument as to why a meaning in the common-law countries might have been the meaning that was originally intended when the term was included in the OECD MTC. The main problem, however, is that there is not wide support for the view that Du Toit’s meaning, or any other meaning, is shared amongst the common-law jurisdictions.¹⁵⁵¹

Another possibility is the description of beneficial ownership in the Commentaries to Article 10. There is an argument that the Commentaries can be a source for the “ordinary meaning” of a treaty term as contemplated in Article 31(1).¹⁵⁵² This is also a possibility when it comes to the ordinary meaning of “beneficial owner”. In this regard the meaning in the 2014 Commentaries is likely to be relevant for all DTAs, even those entered into before 2014.¹⁵⁵³

In making the argument that the meaning in the Commentaries may serve as the “ordinary meaning” I have not lost sight of the fact that the Commentaries have failed thus far to result in a uniform interpretation by either scholars¹⁵⁵⁴ or foreign courts¹⁵⁵⁵ and that the 2014 Commentaries may not fare much better.¹⁵⁵⁶ Nor have I disregarded the argument that, where the Commentaries go beyond illustrating or explaining the text, the meaning should not be given simply because it is contained in the Commentaries.¹⁵⁵⁷

I have also not ignored the fact that South African case law confirms that South African courts are not obliged to refer to the Commentaries. This case law also shows that reference

¹⁵⁵⁰ Part 3.6.

¹⁵⁵¹ Parts 2.4.1 and 3.2.3.4.

¹⁵⁵² Part 4.4.1.

¹⁵⁵³ Part 7.5.7.

¹⁵⁵⁴ Part 2.4.

¹⁵⁵⁵ Part 6.7.

¹⁵⁵⁶ Part 2.6.

¹⁵⁵⁷ Part 4.4.

to the Commentaries is inconsistent and that, even where the Commentaries have been referred to, they were not necessarily followed.¹⁵⁵⁸

For all of these reasons, one should be careful to rely only on the meaning in the Commentaries.¹⁵⁵⁹ It is, however, difficult to divorce the meaning in the Commentaries from the remaining possible sources on the ordinary meaning of the term “beneficial owner”, the first being foreign scholarly writing.¹⁵⁶⁰ That is because scholarly writing often simply refers back to the Commentaries,¹⁵⁶¹ rather than providing an alternative meaning. Those scholars who do not look to the Commentaries for a meaning often use as their starting point the perceived purpose for which the beneficial ownership requirement was inserted in the OECD MTC in the first place. From this starting point they then work backwards to give a meaning to the beneficial ownership requirement that accords with this purpose. Whilst such an approach may pay due deference to the “context”, which would include the purpose for which the term was included,¹⁵⁶² one has to question whether it properly takes into account the “ordinary meaning” of the term as an integral element of the interpretation process.

According to one argument, foreign case law could also be a source of the ordinary meaning of undefined treaty terms.¹⁵⁶³ Of all the cases discussed in chapter 6, the decisions in the *Prévost* matter are likely to carry the most weight in South Africa.¹⁵⁶⁴ *Prévost (TCC)*¹⁵⁶⁵ is also the only of the judgments that takes the time to establish a meaning outside the Commentaries. The court considered both the civil and common law and the meaning given by the court is thus arguably a meaning that would be acceptable in both civil and common-law jurisdictions.¹⁵⁶⁶ The *Prévost* meaning can also be reconciled with (one way of reading) the 2014 Commentaries.¹⁵⁶⁷

Notably the *Prévost* meaning includes the possibility that the ultimate recipient may be the beneficial owner of a dividend received by the direct recipient despite not having any rights

¹⁵⁵⁸ Part 7.6.

¹⁵⁵⁹ In part 4.4 I pointed out that some scholars argue that the Commentaries cannot be referred to as the only source. I am not convinced that, if the Commentaries are considered under Article 31(1) of the VCLT, this argument will hold water. However, I agree that it would make for a much more thorough interpretational approach if this is not the only source for an “ordinary meaning” that is considered.

¹⁵⁶⁰ Part 4.2.

¹⁵⁶¹ Parts 2.4 and 7.6.3.1.2.

¹⁵⁶² Part 4.3.4.

¹⁵⁶³ Part 4.3.5.

¹⁵⁶⁴ Part 7.6.3.1.2.

¹⁵⁶⁵ *Prévost Car Inc. v The Queen* 2008 TCC 231.

¹⁵⁶⁶ Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.6.3.

¹⁵⁶⁷ Part 6.6.3.2.

to the dividend itself. This is in line with the finding in chapter 3 that there is South African case law in which the expression “beneficial owner” was used to refer to someone who only has an interest in property, rather than any rights to such property.

One has to question though whether this “ordinary meaning” places enough emphasis on the anti-avoidance purpose of the beneficial ownership requirement and thus the “context” contemplated in Article 31(1).¹⁵⁶⁸ On the one hand, this meaning may catch financial arrangements despite the fact that there may be no intention to obtain the treaty benefits of a reduced withholding tax rate. On the other hand, and perhaps more problematic in the context of this study, this meaning may not be able to combat various forms of conduit company treaty shopping. As pointed out in chapter 2, despite the uncertainty regarding the initial purpose of inserting the beneficial ownership requirement, it has been accepted numerous times by scholars and courts to have an anti-avoidance purpose of combatting conduit company treaty shopping (beyond the agent/nominee scenarios). Since 2003 the Commentaries have also expressly stated this.¹⁵⁶⁹ (Although the Commentaries as a source to determine the purpose of a provision in a DTA is controversial, there is some scholarly support for such an argument).¹⁵⁷⁰

Apart from the purpose of the beneficial ownership requirement itself, one must also consider the purpose of the treaty as a whole as contemplated in Article 31(1). The new purpose included in the MLC and proposed for the OECD MTC makes it clear that DTAs should not create opportunities for reduced taxation through treaty-shopping arrangements.¹⁵⁷¹ In *Indofood (CA)*¹⁵⁷² the court took the treaty purpose of eliminating tax evasion into account when giving meaning to the term “beneficial owner” although it possibly did not play a central role in that decision.¹⁵⁷³

The narrow legal meaning in *Prévost* leaves plenty of room for treaty shopping to take place.¹⁵⁷⁴ It is also important to bear in mind that the TCC and FCA in *Prévost* seemingly accepted that there was no (main) tax avoidance purpose with the insertion of the direct recipient and that the court thus paid little attention to this purpose when giving meaning to

¹⁵⁶⁸ Part 6.5.4.3.

¹⁵⁶⁹ Part 2.3.4.

¹⁵⁷⁰ Part 4.3.4.

¹⁵⁷¹ Part 4.3.4.

¹⁵⁷² *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] STC 1195.

¹⁵⁷³ Part 6.3.4.4. See also n 1307 above where a similar purpose in South African DTAs was taken into account by South African courts in cases unrelated to the beneficial ownership requirement.

¹⁵⁷⁴ Wardzynski (2015) *Intertax* 183-184.

the term. The problem is especially considerable in structures where the direct recipient forms part of a group of companies.¹⁵⁷⁵ In such a scenario, ultimate recipients, by virtue of their control over the direct recipient, may not be inclined to build in contractual safeguards to ensure that dividends are passed on. In these cases, the narrow meaning in *Prévost* will not prevent such structures from accessing the treaty benefits.

The obvious way to overcome this shortcoming (if one restricts one's quest to the beneficial ownership requirement) is to give the beneficial requirement an economic meaning. Such meaning may be based on, for example, the economic substance of the direct recipient or control of the ultimate recipient over the direct recipient,¹⁵⁷⁶ or on whether a person is the ultimate recipient in related transactions (however that may be defined),¹⁵⁷⁷ or on whether the sole purpose of inserting the direct recipient was to acquire the treaty benefit.¹⁵⁷⁸ However, if this is the case, there is a strong argument that one is allowing context and purpose to override the "ordinary meaning" of the term. This is not in accordance with how South African courts are likely to interpret DTAs under the Vienna rules, as explained above. That is because there is little indication that the "ordinary meaning" of the term supports such a meaning. It is true that in South African case law the expression is sometimes used in the context of shams and piercing of the corporate veil, both scenarios often associated with avoidance of tax rules.¹⁵⁷⁹ However, these isolated examples are not sufficient to give beneficial ownership an "ordinary meaning" that allows for this consideration to be taken into account. Furthermore, despite the fact that the 2014 Commentaries refer to the anti-avoidance purpose of the beneficial ownership requirement, at least one way of reading the Commentaries is that they only support the narrow legal meaning in *Prévost*, as explained above.

Also, if one considers the purpose of a DTA as a whole, preventing tax avoidance by way of treaty shopping is not a DTA's only purpose. It must be remembered that South Africa has

¹⁵⁷⁵ Du Toit (2010) *BFIT* 508.

¹⁵⁷⁶ Danon's view, explained in part 2.4.2, includes this factor.

¹⁵⁷⁷ This is the manner in which De Broe reads the decision in *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] STC 1195, as mentioned in part 6.3.4.4. See also the decision in *Real Madrid F.C. v Oficina Nacional de Inspeccion* Judgments of the AN of 18 July 2006 (JUR\2006\204307, JUR\2007\8915 and JUR\2007\16549), 10 November 2006 (JUR\2006\284679), 20 July 2006 (JUR\2007\16526), 13 November 2006 (JUR\2006\284618), 26 March 2007 (JUR\2007\101877), as discussed in part 6.4.

¹⁵⁷⁸ This is the manner in which Jezzi reads the decisions in *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] STC 1195 and *Prévost Car Inc. v Canada* 2009 FCA 57 (CanLII), as mentioned in part 6.3.4.4.

¹⁵⁷⁹ Part 3.5.2.2.

also opted to include in the MLC the object of developing economic relationships.¹⁵⁸⁰ Legal certainty regarding tax liability is important to any investor¹⁵⁸¹ and the development of countries' economic relationships would include increasing investment between residents of these countries. The Commentaries have also since 1977 noted the fostering of international trade and investment as a purpose of DTAs.¹⁵⁸² Therefore, a narrow legal meaning for the beneficial ownership requirement, which will catch some treaty shopping structures and which provide clarity on when it will be applied, will serve all the purposes of a DTA better than a wide economic meaning that may avoid more forms of treaty shopping, but which may discourage investment due to the uncertainty caused by such an approach.

I should also note that I do not agree that the mere existence of other anti-avoidance measures that may also be used to combat conduit company treaty shopping should mean that the beneficial ownership must be interpreted narrowly.¹⁵⁸³ I do, however, agree that anti-avoidance measures have boundaries in the law within which they operate. That creates legal certainty. There may be areas where these boundaries overlap, so that more than one measure may be used to combat tax avoidance. But of course, there may also be gaps between the boundaries. That means that any given anti-avoidance measure will be appropriate to deal with some forms of tax avoidance, but not others. It also means that there may be some forms of tax avoidance that may, as much as tax authorities regard them as inappropriate, not be caught.

Here one should also pause to reflect that it has long been recognised by South African courts that an interpretative approach under which transactions are considered according to the legal rights created by the parties may create the possibility that the approach be (mis)used to ensure that the transaction falls within a favourable provision in tax legislation. In the *NWK* judgment¹⁵⁸⁴ the SCA (on one way of reading that judgment) took a stand against such an approach by attempting to extend the boundaries of the sham doctrine, but in the decisions in *Roshcon*¹⁵⁸⁵ and *Bosch*¹⁵⁸⁶ the SCA reconfirmed the boundaries of that doctrine in South African law. In these later judgments, the SCA also confirmed that an approach, which

¹⁵⁸⁰ Part 4.3.4.

¹⁵⁸¹ Part 2.2. See also the statement of the FCA in *Prévost Car Inc. v Canada* 2009 FCA 57 (CanLII) quoted in the main text corresponding to n 1179 above.

¹⁵⁸² Part 4.3.4. See also Wardzynski (2015) *Intertax* 183 (although he goes on to argue against a restrictive legal meaning.).

¹⁵⁸³ For a different view, see De Broe *International Tax Planning* 686.

¹⁵⁸⁴ *CSARS v NWK Ltd* 2011 (2) SA 67 (SCA).

¹⁵⁸⁵ *Roshcon (Pty) Ltd v Anchor Auto Body Builders CC* 2014 (4) SA 319 (SCA).

¹⁵⁸⁶ *CSARS v Bosch* 2015 (2) SA 174 (SCA).

analyses transactions based on the legal rights created by the parties, is still valid in South African law.¹⁵⁸⁷

I thus agree that the test in *Prévost* strikes the right balance between the “ordinary meaning” of the term and the context and purpose elements of Article 31(1) of the VCLT.

I should also consider whether my conclusion will be affected in the event that foreign case law and the Commentaries cannot be seen as sources for the “ordinary meaning” as contemplated under Article 31, but rather as supplementary aids under Article 32. In such an event the court will have to fall back on other “ordinary meanings”, possibly the meaning in legal dictionaries. The court may (and probably would) then turn to foreign case law and the Commentaries to determine whether they, firstly, confirm that meaning. If not, it may be an indication that another meaning is possible under Article 31, which the latter sources can then confirm. But again, it is not clear that an alternative is readily available. More likely, foreign case law and the Commentaries will indicate that there is an ambiguity, which means that these sources can instead be used to determine the meaning. That brings one back to the *Prévost* meaning which accords to one way of reading the 2014 Commentaries.¹⁵⁸⁸

I thus propose that the international meaning which a South African court should adopt for the term “beneficial owner” in provisions in South African DTAs based on Article 10 of the OECD MTC in the case of conduit company treaty shopping is the direct recipient, unless such direct recipient is, firstly, an agent or, secondly, has a legal obligation to transfer funds to another person and that obligation only arises if and to the extent that such direct recipient receives the dividend.¹⁵⁸⁹

Lastly, I acknowledge the limitations of this study, which focuses on conduit company treaty shopping only. The necessary implication of this scope is that in this study the direct recipient is always a company.¹⁵⁹⁰ I therefore cannot propose that this meaning will work in the problematic areas of direct recipients that are trusts (or trustees) or tax transparent entities.¹⁵⁹¹ I pause, however, to reflect here that it is unlikely that one rule can serve both anti-avoidance and attribution purposes without having to make some adjustments depending on the circumstances in which it is used. One is already seeing this in the fact that the Commentaries

¹⁵⁸⁷ Part 5.4.

¹⁵⁸⁸ Part 4.3.5.

¹⁵⁸⁹ Part 6.6.3.2.

¹⁵⁹⁰ Part 1.6.

¹⁵⁹¹ See the meaning at n 49 above.

are attempting to deal with beneficial ownership of CIVs separately and one would hope that further work would be done in other areas, such as trusts. It should also be noted that the 2014 Commentaries thought it necessary to expressly state that a trust (or trustee) can be a beneficial owner, recognising perhaps that one may otherwise find it difficult to fit a trust (or trustee) into the rest of the Commentary to Article 10.¹⁵⁹²

In the remaining part of the study the general *renvoi* clause will be considered to determine whether, instead of this international meaning, a South African court will likely give a domestic meaning to the treaty term “beneficial owner”.

¹⁵⁹² As pointed out in part 2.4.1.

CHAPTER 8

GENERAL *RENOI* CLAUSES BASED ON ARTICLE 3(2) OF THE OECD MTC

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8.1 Introduction

As mentioned briefly in part 4.5, the OECD MTC expressly deals with the interpretation of undefined terms, which is somewhat unusual in a treaty context. The OECD MTC does this under Article 3(2). This provision currently reads:

"As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that

time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.”¹⁵⁹³

This directive seems to go against the goals of common and uniform interpretation discussed earlier,¹⁵⁹⁴ and can have the result that countries may ascribe different meanings to the same term. This is explained by the need for flexibility, in that a DTA, which restricts taxes that are levied in terms of the contracting states’ domestic laws, must link with these domestic laws.¹⁵⁹⁵

After having been included in the 1963 draft version of the OECD MTC,¹⁵⁹⁶ Article 3(2) underwent some changes when it re-appeared in the 1977 OECD MTC and was again amended in September 1995. All South African DTAs include a version of the provision.¹⁵⁹⁷ Generally, in those South African DTAs entered into before September 1995 (and also in some DTAs signed during the first few years after 1995)¹⁵⁹⁸ the provision is based on the 1977 OECD version; and in those entered into after 1995, on the 1995 version of Article 3(2). Only a few are still based on the 1963 OECD version.

This chapter explores aspects of Article 3(2) that are particularly relevant to this study. It considers firstly whether an ambulatory or statutory approach should be followed in those cases where the general *renvoi* clause does not expressly deal with this issue. The chapter then considers how one chooses between domestic meanings if more than one exists, as well as selected other issues. This is followed by an analysis of South African case law in which domestic meanings were given to terms in DTAs. In the last part of the chapter the rider to Article 3(2), “unless the context otherwise requires”, is considered.

¹⁵⁹³ Art 3(2) of the UN Model is identical. Art 3(2) of the SADC Model only differs in the following respects: “Convention” is replaced by “Agreement” and the opening phrase instead reads: “As regards the application of the provisions of the Agreement” (emphasis added to indicate the difference in wording).

¹⁵⁹⁴ Parts 4.2 and 7.2.

¹⁵⁹⁵ Part 4.5.

¹⁵⁹⁶ For a history of the introduction of Art 3(2), see JF Avery Jones “The Interaction between Tax Treaty Provisions and Domestic Law” in G Maisto (ed) *Tax Treaties and Domestic Law* (2006) 123 125.

¹⁵⁹⁷ The provision in the DTA with Israel, concluded in 1978, is perhaps the one that deviates most from the OECD’s version. An Afrikaans version is included in Art 3(2) of the 1973 DTA with Germany and reads as follows:

“*Wat betref die toepassing van hierdie ooreenkoms deur ’n Kontrakterende Staat het ’n uitdrukking wat nie anders in die ooreenkoms omskryf is nie, tensy die samehang anders vereis, die betekenis wat daaraan geheg word ooreenkomstig die wette van daardie staat betreffende die belastings waarop die ooreenkoms van toepassing is.*”

¹⁵⁹⁸ E.g. the DTA with Iran, which was concluded in 1997.

8.2 The ambulatory versus static meanings of terms

A particular important issue in the context of this study is whether a definition that is included in domestic legislation after conclusion of a DTA can qualify as a potential meaning under Article 3(2). Before 1995, a Canadian court in *R v Melford Development Inc*¹⁵⁹⁹ stated that Article 3(2) required a static rather than ambulatory approach. Under a static approach, the domestic meaning that existed at time of conclusion of the DTA is used,¹⁶⁰⁰ whilst under the ambulatory approach the domestic meaning that exists at the time of application of the DTA is used.

One argument against the ambulatory meaning is that it gives a contracting state the ability to change the effect of a treaty by changing the meaning of a term under its domestic law. However, it should be noted that this problem may be dealt with when one considers whether or not the context requires that the (amended) domestic meaning not be used.¹⁶⁰¹ Avery Jones for example argues that, when a change is aimed at enlarging a country's taxing jurisdiction, it is not "in good faith" and the context would then require that the amended domestic meaning not be used.¹⁶⁰²

In 1995, the wording of Article 3(2) was amended so that the provision now explicitly states that it is the domestic meaning "at that time" that is the one to be taken into account; in other words, an ambulatory approach should be followed. Despite the decision in the above-mentioned Canadian case, the Commentary had already from 1992 (thus after the decision in *Melford Development Inc* but before the amendment to the wording of the provision) stated that the ambulatory approach was the correct one.¹⁶⁰³ There is support for the ambulatory approach before the 1995 amendment to Article 3(2) in a number of foreign decisions¹⁶⁰⁴ and

¹⁵⁹⁹ *R v Melford Development Inc* 82 DTC 6281. See the discussion in Avery Jones et al (1984) *BTR* 27-28, 40 and 42-43; Baker *Double Taxation Conventions* para E.23.

¹⁶⁰⁰ Avery Jones et al (1984) *BTR* 46 argue that the "most logical date" for the application of the static approach, if followed, is the date of signature of the treaty.

¹⁶⁰¹ Avery Jones et al (1984) *BTR* 41 and 48; Avery Jones (1986) *BFIT* 82 (opinion expressed by Ward); Rust "Article 3(2)" in *Klaus Vogel* (2015) 211 m.nr. 119 and 213 m.nr. 124. See also *Martin Frederick Fowler v The Commissioners* [2016] UKFTT 0234 (TC) para 115, where the court states that the "requirements of good faith imposed by Art 31(1) of the Vienna Convention and by international law generally" would dictate a departure from the rule in Art 3(2) in certain circumstances. See also De Broe *International Tax Planning* 289-290, discussed in part 5.2.3.

¹⁶⁰² Avery Jones "Treaty Interpretation" in *Global Tax Treaty Commentaries* (2015) para 7.5 and see the discussion in part 5.2.3.

¹⁶⁰³ Para 11 of the Commentary to Art 3 (before amendment in 1995). For a discussion of the positions in various countries and taken by various scholars, see Avery Jones et al (1984) *BTR* 42-46.

¹⁶⁰⁴ See the cases mentioned in Baker *Double Taxation Conventions* para E.24 and Avery Jones "Treaty Interpretation" in *Global Tax Treaty Commentaries* (2015) para 7.7.2.

scholarly writings.¹⁶⁰⁵ One argument in favour of following an ambulatory approach is that it is too cumbersome to go continually back to “old law”,¹⁶⁰⁶ especially in light of the fact that DTAs often have a long lifespan. Furthermore, if changes are made to the scope of the domestic tax liability, the rule in the DTA will no longer follow that scope if an ambulatory approach is not followed. The application of the limitations imposed by the DTA thus becomes problematic, pointing to the need for flexibility mentioned earlier.¹⁶⁰⁷ Also, it might have been the intention when concluding the DTA that the meaning would change as domestic laws change, again in light of DTAs’ long lifespan.¹⁶⁰⁸

According to Eskinazi, the South African Revenue Service (“SARS”) already followed the ambulatory approach in 1993.¹⁶⁰⁹ No South African case deals with this issue directly, but Du Toit and Hattingh regard *Baldwins (South Africa) Ltd v Commissioner for Inland Revenue (“Baldwins”)*¹⁶¹⁰ as supporting the static approach.¹⁶¹¹ *Baldwins* concerned the interpretation of the South Africa/UK DTA signed in 1946, which included a general *renvoi* clause that did not specify whether an ambulatory or static approach should be followed.¹⁶¹² The court was asked to determine whether a UK resident was a “public company” and thus qualified under the DTA for exemption from non-resident shareholders’ tax (“NRST”). NRST was first levied under the 1941 income tax legislation of the Union of South Africa (the “1941 ITA”).¹⁶¹³ The 1941 ITA included a definition of a “public company”,¹⁶¹⁴ which applied for purposes of the entire Act.

The problem was that this definition included categories of companies that could only apply to local (but not foreign) companies and the question was whether this was an indication that it was not the intention of the treaty countries that the definition in the 1941 ITA would apply

¹⁶⁰⁵ Wattel & Marres (2003) *Euro Tax* 223; Baker *Double Taxation Conventions* para E.25. See also Rust “Article 3(2)” in *Klaus Vogel* (2015) 211 m.nr. 118, where it is stated that there was “nearly a unanimous consensus” in this regard, and 214 m.nr. 129.

¹⁶⁰⁶ Avery Jones et al (1984) *BTR* 41; Wattel & Marres (2003) *Euro Tax* 223; Rust “Article 3(2)” in *Klaus Vogel* (2015) 211 m.nr. 118.

¹⁶⁰⁷ See part 4.5 and Rust “Article 3(2)” in *Klaus Vogel* (2015) 211 m.nr. 118. Avery Jones et al (1984) *BTR* 41 add to this that treaties will thus have to be amended more frequently if the static approach were to be followed.

¹⁶⁰⁸ Baker *Double Taxation Conventions* para E.25.

¹⁶⁰⁹ Eskinazi “Interpretation - South Africa” in *Cahiers Vol. 78a* (1993) 553.

¹⁶¹⁰ *Baldwins (South Africa) Ltd v CIR* (1961) 24 SATC 270.

¹⁶¹¹ Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.11 n 120 and see also para 9.3 n 14, which deals with this issue from an international perspective.

¹⁶¹² Art II(3).

¹⁶¹³ Income Tax Act 31 of 1941.

¹⁶¹⁴ S 33(2).

to the DTA.¹⁶¹⁵ The argument was that the meaning of “public company” should instead derive from the company laws of the UK (or the Union of South Africa).¹⁶¹⁶

Hoexter JA disagreed with this argument. For the reasons discussed in part 8.7.3.1, he held that the context did not require that the meaning in the 1941 ITA be rejected. He stated the following:

“I can find nothing ...which shows clearly that the term ‘public company’ cannot have the meaning which has been assigned to it in our Income Tax Act.... *On the contrary there is at least one very good reason why no other meaning should be assigned to it, and that is that otherwise the legislature of the United Kingdom could, by altering its definition of ‘public company’, alter the incidence of a Union tax in the Union. Such a possibility could never have entered the minds of the two contracting Governments.*”¹⁶¹⁷

As indicated above, Du Toit and Hattingh argue based on *Baldwins* that South African courts have adopted the static approach.¹⁶¹⁸ In support of their argument they note that the AD

“refused to apply an amended domestic definition of the term in the United Kingdom since this domestic definition postdated the conclusion of the convention and, if followed through in the convention, would allow the United Kingdom the opportunity to unilaterally alter the allocation of tax relief from a South African tax under the convention.”¹⁶¹⁹

However, it is not clear that one can make this deduction from *Baldwins*. It seems that the concern of the AD was mainly aimed at the possibility that the *treaty partner* could by amending its legislation force South Africa to give an exemption from NRST. There is no indication that the same concern would apply if *South Africa* were to amend its own legislation, for example to extend the circumstances under which South Africa would give exemption. It is also important to note that the court was making this statement not whilst deciding which of two possible meanings, one existing at the time of conclusion of the DTA

¹⁶¹⁵ *Baldwins (South Africa) Ltd v CIR* (1961) 24 SATC 270 272.

¹⁶¹⁶ 273 and 281.

¹⁶¹⁷ 281 (emphasis added).

¹⁶¹⁸ Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.11. Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 7.7.2 also understands this case to support a static approach.

¹⁶¹⁹ Para 9.11 n 120. There is no mention in the judgment of *Baldwins (South Africa) Ltd v CIR* (1961) 24 SATC 270 of any change in the definition of “public company” in either s 33 of the 1941 ITA, or the company law legislation of the treaty partner (the UK) in the period after signature of the DTA and before or during the years of assessment that were at issue in that case. The same applies to *ITC 789* (1954) 19 SATC 434, discussed next in the main text.

and one under an amendment made after conclusion of the DTA, should be proposed for purposes of Article 3(2).

*ITC 789*¹⁶²⁰ is also worth mentioning here. This decision was referred to by the AD in *Baldwins* and the AD was thus well aware of it.¹⁶²¹ In *ITC 789* the tax court was interpreting this same exemption from NRST. The exemption from NRST applied to “any amount ... which, *under the law of the Union relating to the taxation of income of private companies*, is apportionable ... to a public company”.¹⁶²² Changes were made after signature of the DTA to the provisions of the 1941 ITA relating to the taxation of the income of private companies. The taxpayer conceded that these changes would be covered by the DTA and the court expressly agreed with this view.¹⁶²³ The phrase in the DTA highlighted in the quote is very similar to the phrase used in Article 3(2) before the 1995 amendment.¹⁶²⁴ Based on the similarities in wording it may be tentatively proposed that the judgment serves as support for the ambulatory approach in Article 3(2).

8.3 Choosing between domestic meanings

It is not unusual for an expression to have more than one meaning. This may also be the case in the domestic law of a country that is party to a DTA in respect of an undefined treaty term. It should also be noted that Article 3(2) does not require the existence of a definition in the domestic law, but merely a “meaning”.¹⁶²⁵

An important issue if more than one meaning exists, is which domestic meaning should be put forward for purposes of the general *renvoi* clause. This issue is particularly important to this study since the expression “beneficial owner” is used in numerous South African

¹⁶²⁰ *ITC 789* (1954) 19 SATC 434.

¹⁶²¹ *Baldwins (South Africa) Ltd v CIR* (1961) 24 SATC 270 281. The AD pointed out that in *ITC 789* (1954) 19 SATC 434 437 the court had accepted, with reference to the general *renvoi* clause, that the definition of “public company” in the 1941 ITA should apply to give meaning to the term in the 1946 South Africa/UK DTA, but that the application of the domestic definition was not disputed in that case.

¹⁶²² Article VI of the 1946 South Africa/UK DTA (emphasis added).

¹⁶²³ *ITC 789* (1954) 19 SATC 434 436-437, although the amendment might not have been relevant in any event.

¹⁶²⁴ The relevant part of the 1963 version of Art 3(2) read: “which it has *under the laws of that Contracting State relating to the taxes*” (emphasis added). In the 1977 version this phrase read: “which it has *under the law of that State concerning the taxes*” (emphasis added). According to Avery Jones et al (1984) *BTR* 19 this change in the English text is unlikely to signify a change in meaning.

¹⁶²⁵ Kandev (2007) *Can Tax J* 44-45, including his discussion of *Canada (Attorney General) v Kubicek Estate* 1997 CanLII 5515. See also Pijl (1997) *BFIT* 543; Van Weeghel *The Improper Use of Tax Treaties* 68; Du Toit *Beneficial Ownership of Royalties* 173; Baker *Double Taxation Conventions* E.22; Kemmeren “Preface to Articles 10 to 12” in *Klaus Vogel* (2015) 208.

cases¹⁶²⁶ and legislation, including in the ITA. In the latter Act it is used with regard to both a tax on dividends and CGT.¹⁶²⁷

The only preference that Article 3(2) states is for a meaning under the tax laws over a meaning under other laws.¹⁶²⁸ Kandeve puts forward a number of arguments regarding the domestic meaning that is to be put forward as a domestic meaning under a general *renvoi* clause (“the proposed domestic meaning”). He argues that, if the term is used in the part of the domestic tax legislation that imposes the tax, the levying of which is restricted under the DTA (“the restricted tax”), the meaning of the term under that part (as opposed to other parts) is likely to be the proposed domestic meaning.¹⁶²⁹ If the term is only used in unrelated parts in the domestic tax legislation, it does not seem to preclude the operation of the general *renvoi* clause.¹⁶³⁰ In this case Kandeve tentatively proposes that the meaning that applies to the act in general, rather than any special meanings that may be applicable only to a part of the act that is not relevant to the restricted tax, will be the proposed domestic meaning.¹⁶³¹ He argues that, when determining the proposed domestic meaning, domestic rules of interpretation apply. This includes the domestic context, including the charging provisions relating to the restricted tax. This will be the case even though these provisions may not use the treaty term. Kandeve explains as follows his views with regard to the manner in which the Canadian ITA employs the term “beneficial owner”:

“For example ... the term “beneficial owner” and its variants “beneficial ownership” and “beneficially owned” are used in the [Canadian ITA], but not in the context of the provisions in part XIII [section 212] that charge non-residents to tax on Canadian-source dividends, interest, and royalties. ... Yet, in determining the domestic meaning of this term under article 3(2),

¹⁶²⁶ Ch 3. Domestic meanings can arguably be found in case law, according to Olivier & Honiball *International Tax* 300. Rust “Article 3(2)” in *Klaus Vogel* (2015) 208 m.nr. 113 argues as follows:

“The law of the State applying the treaty referred to by Article 3(2) ... could, if only the English version of the [OECD MTC] were authoritative, **include case law**. The French version ... excludes an interpretation of this type, however; ‘law’ in the sense of Article 3(2) ... therefore includes only legislative and administrative laws and other abstract-general rules subordinate to them (decrees, etc.). However, Article 3(2) ... does not require that there be a definition in the domestic legislation but only that the meaning of the term in question can be derived from it. So the case law can give the meaning to a term used in domestic law” (emphasis in the original, footnotes omitted).

¹⁶²⁷ Ch 9.

¹⁶²⁸ The phrase at the end of the clause (“any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State”) was only added when the 1995 amendments were made, but it seems unlikely that treaty provisions based on earlier versions of the provision will be interpreted differently. See also para 13(1) of the Commentary to Art 3 (added in 1995).

¹⁶²⁹ Kandeve (2007) *Can Tax J* 66. See also Engelen *Interpretation of Tax Treaties* 487; Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 7.3.2.

¹⁶³⁰ Although, as Kandeve (2007) *Can Tax J* 58 points out, Engelen *Interpretation of Tax Treaties* 486 disagrees.

¹⁶³¹ Kandeve (2007) *Can Tax J* 67.

“beneficial ownership” may reasonably be interpreted only in the context and in light of the purpose of section 212. It would be meaningless to do otherwise. Since the [Canadian ITA] does not provide a special meaning for “beneficial ownership” and since section 212 does not use this concept, there is a strong presumption that no special meaning that is different from the general private-law meaning of this term should be used.”¹⁶³²

Avery Jones proposes a different approach. Rather than identifying the “most appropriate” domestic meaning and thereafter applying the qualification “whether the context otherwise requires”, he proposes that each domestic meaning may individually be measured against that qualification.¹⁶³³

8.4 Selected other issues

A number of other issues relating to Article 3(2) need addressing in this study. The first issue is whether “term” in Article 3(2) includes a concept. The question may be put as follows: if an expression other than the treaty term is used in the domestic law, can the meaning of that expression be the proposed domestic meaning?

It is not unusual to have a divergence between the terms used in a DTA and the terms used in domestic legislation in respect of the restricted tax, as is evident from the following statement of the SCA:

“The ... DTA is based upon [the OECD MTC], which has served as the basis for similar agreements that exist between many countries. In interpreting its provisions, one must therefore not expect to find an exact correlation between the wording in the DTA and that used in the domestic taxing statute. Inevitably, they use wording of a wide nature, intended to encompass the various taxes generally found in the OECD member countries. In addition, because the double tax agreements are intended to encompass not only existing taxes, but also taxes which may come into existence at later dates (see article 2(2)), and bearing in mind the complex nature of taxation in the various member countries, *inevitably the wording in the DTA cannot be expected to match precisely that used in the domestic taxing statute.*”¹⁶³⁴

¹⁶³² Kandev (2007) *Can Tax J* 58 and 65 (emphasis in the original omitted).

¹⁶³³ Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 7.3.2.

¹⁶³⁴ *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA) para [18] (emphasis added).

A number of scholars argue against the word “term” in Article 3(2) including a concept.¹⁶³⁵ Other scholars, however, accept this possibility,¹⁶³⁶ as do some courts.¹⁶³⁷ Ward also supports this view. He gives as an example “alienation, disposal and disposition”, all being different expressions for the same concept.¹⁶³⁸ This example is relevant to a discussion in part 8.6.2 on the meaning of the treaty term “alienation”.

Another issue is whether domestic provisions that deem terms to have a particular meaning can be taken into account for purposes of Article 3(2). A number of scholars have come out in support of this view.¹⁶³⁹ There is also support for it in three judgments by the Dutch *Hoge Raad* on the meaning of “alienation” in Dutch DTAs. In these judgments a Dutch exit tax on substantial shareholding,¹⁶⁴⁰ which was a deemed alienation (“*vervreemding*”) under the Dutch income tax legislation, was considered. They involved an interpretation of provisions based on Article 13(5)¹⁶⁴¹ of the OECD MTC in three DTAs entered into by the Netherlands.¹⁶⁴² The court was primarily concerned with the question whether the levying of the exit tax constituted a treaty override.¹⁶⁴³ However, the court also referred to the general *renvoi* clauses found in all three the DTAs and held that the exit tax constituted an “alienation” under the treaties.¹⁶⁴⁴ Recently the view that deeming provisions in domestic law can be taken into account under a general *renvoi* clause was also accepted in *Martin*

¹⁶³⁵ See M Edwardes-Ker *Tax Treaty Interpretation* PhD thesis University of London (1994) 83-84 and the sources referred to by Pijl (1997) *BFIT* 542-543. In 1984 Avery Jones et al (1984) *BTR* 20-21 concluded that there was not enough authority to make conclusions in this regard.

¹⁶³⁶ Déry & Ward “Interpretation - Canada” in *Cahiers Vol. 78a* (1993) 277; Pijl (1997) *BFIT* 542; Wattel & Marres (2003) *Euro Tax* 71; Engelen *Interpretation of Tax Treaties* 448; Avery Jones “The Interaction between Tax Treaty Provisions and Domestic Law” in *Tax Treaties and Domestic Law* (2006) 133-134; Pötgens *Income from International Private Employment* 150; De Broe *International Tax Planning* 268; Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 7.2.1.

¹⁶³⁷ See the discussion in Kandev (2007) *Can Tax J* 56-57 and Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 7.2.1. For a recent example, see the UK case of *Martin Frederick Fowler v The Commissioners* [2016] UKFTT 0234 (TC) para 108.

¹⁶³⁸ Avery Jones (1986) *BFIT* 85 (opinion expressed by Sinclair). According to J Li & D Sandler “The Relationship Between Domestic Anti-Avoidance Legislation and Tax Treaties” (2007) 45 *Can Tax J* 891 n 67 a similar view was expressed by the Canadian Tax Foundation at a 1984 conference.

¹⁶³⁹ Pijl (1997) *BFIT* 543; De Broe *International Tax Planning* 285; Kandev (2007) *Can Tax J* 53-55.

¹⁶⁴⁰ For a summary of the main elements of the tax, see V Chand “Exit Charges for Migrating Individuals and Companies: Comparative and Tax Treaty Analysis” (2013) 67 *BFIT* 1 para 2.1.4.

¹⁶⁴¹ When the DTAs were concluded, this was Art 13(4) of the OECD MTC.

¹⁶⁴² *Decision by the Hoge Raad* (20 February 2009) 2701 BNB 2009/260 (regarding the DTA with Belgium), *Decision by the Hoge Raad* (20 February 2009) 43760 BNB 2009/261 (regarding the DTA with the US), *Decision by the Hoge Raad* (20 February 2009) 07/12314 BNB 2009/262 (regarding the DTA with the UK). See also the discussion of these cases by De Pietro (2015) *World Tax J* 83. These cases are also mentioned by Chand (2013) *BFIT* n 144 as confirmation that immediate exit taxes are “alienations”.

¹⁶⁴³ As discussed by Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 7.5.

¹⁶⁴⁴ *Decision by the Hoge Raad* (20 February 2009) 2701 BNB 2009/260 para 4.45.

Frederick Fowler v The Commissioners for Her Majesty's Revenue & Customs.¹⁶⁴⁵ This case concerned the interpretation of the 2002 South Africa/UK DTA and was decided by the UK First-Tier Tribunal Tax Chamber.¹⁶⁴⁶

This seems to be the preferable view. Arguably, deeming provisions do not differ all that much from definitions in legislation in the sense that both may extend the meaning of a term beyond the everyday meaning of the word.¹⁶⁴⁷ Allowing domestic definitions, but not deeming provisions, to be taken into account under Article 3(2) may accordingly in some cases be somewhat of an arbitrary distinction.

8.5 South African case law in which no reference was made to the general *renvoi* clause

As discussed previously, when South African courts interpret legislation, they usually accept that terms have their everyday meanings. Such an everyday meaning is often the same across borders and is thus neither “domestic”, nor “autonomous” as such.¹⁶⁴⁸ Possibly, for this reason the general *renvoi* clause is seldom referred to in South African case law on DTAs. Words having a technical or legal meaning may (but will not necessarily) be a different proposition. When it comes to these terms, reference to the general *renvoi* clause in the applicable DTA is more prevalent in local case law, as illustrated by the examples discussed under the next heading.

An example of where a court has determined the everyday meaning of a term in a DTA with no reference to the general *renvoi* clause, is *ITC 1735*,¹⁶⁴⁹ where the court interpreted a number of undefined terms in the South Africa/UK DTA. One of these was the term “professional services”. This expression was used in the ITA in an unrelated context.¹⁶⁵⁰ In considering the meaning of the treaty term, the court referred only to general dictionaries¹⁶⁵¹ and did not mention the fact that the expression was also used in the ITA.

¹⁶⁴⁵ *Martin Frederick Fowler v The Commissioners* [2016] UKFTT 0234 (TC).

¹⁶⁴⁶ Para 111.

¹⁶⁴⁷ As discussed in part 4.3.2. But note also De Broe's concern, mentioned in part 5.2.3, that domestic anti-avoidance provisions may go substantially beyond the “ordinary meaning” of an undefined treaty term and that this may be contrary to the Vienna rules.

¹⁶⁴⁸ Part 7.2.

¹⁶⁴⁹ *ITC 1735* (2002) 64 SATC 455, discussed in part 7.6.1.

¹⁶⁵⁰ S 18(1)(b)(i) of the ITA. The words “profession” and “professional” were used a number of times in the ITA too, in unrelated contexts.

¹⁶⁵¹ *ITC 1735* (2002) 64 SATC 455 para 12.5.1. The court also interpreted “athlete”, which was apparently not used in the ITA. The court again at para 12.6.1 gave it an everyday meaning as defined in general dictionaries

*ITC 1878*¹⁶⁵² is an example of where a technical domestic meaning was given to a term in a DTA, with no reference to the general *renvoi* clause. In this case, the court considered the South Africa/US DTA. As mentioned in part 7.5.4, one of the issues that arose was the interpretation of the following phrase in the DTA: “for a period or periods aggregating more than 183 days in any twelve-month period commencing or ending in the *taxable year* concerned”. The court consulted the Commentaries for an interpretation of this phrase. The Commentaries (and the OECD MTC) use the expression “fiscal year” instead of “taxable year”, but the South African tax court did not attach any importance to this. The term “fiscal year” is not defined in the OECD MTC and the OECD has proposed that its meaning should be determined in accordance with Article 3(2).¹⁶⁵³ Neither the term “taxable year”, nor the term “fiscal year” is used in the South African ITA. The court in *ITC 1878* accepted without explanation that the “fiscal year” of the non-resident company ran from 1 March to 28 February, which was what the court referred to as the “tax year” in South Africa.¹⁶⁵⁴ This, of course, is the “year of assessment” for individuals (but not necessarily companies).¹⁶⁵⁵ The following is noteworthy: firstly, the court used a domestic technical meaning for a *different term* (“year of assessment”) to give meaning to the treaty term (“taxable year”); secondly, it showed a preference for the meaning under the South African ITA rather than other possible domestic meanings.

and rejected the (technical) meaning proposed by a scholar. It is noteworthy that Rust “Article 3(2)” in *Klaus Vogel* (2015) 207 m.nr. 111 and Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 7.3.1 argue that Art 3(2) can only apply if the term is used in the domestic tax legislation relating to the taxes covered by the DTA, but for a different view, see Kandev (2007) *Can Tax J* 55; Baker *Double Taxation Conventions* E22. There is no indication in the judgment in *ITC 1735* (2002) 64 SATC 455 that this issue played a role when the meaning of “athlete” was considered.

In the same case, the court also had to decide the meaning of the undefined term “copyright” in the DTA. The term was at the time of application of the DTA defined in a number of provisions in the ITA, for example in the source rules of the ITA (s 9(1)(b), read with s 35(1)(a)(i)), where it was defined as “copyright as defined in the Copyright Act, 1978”. Although the court was clearly aware of the existence of this definition (having referred to it earlier in the judgment at para 11.1 with regard to a different issue), it did not refer to the definition when discussing the meaning of the term as used in the treaty. Instead, it simply referred at para 12.4 to the explanation given in a legal reference work as to what “copyright” entails. It should be noted that the legal reference work stated, as quoted in the judgment, that no comprehensive definition existed under the Copyright Act, 1978.

¹⁶⁵² *ITC 1878* (2015) 77 SATC 349.

¹⁶⁵³ OECD *The 183 Day Rule: Some Problems of Application and Interpretation* (1991) para 21. See also Pötgens *Income from International Private Employment* 563; BJ Arnold “Time Thresholds in Tax Treaties” (2008) 62 *BFIT* 218 224.

¹⁶⁵⁴ *ITC 1878* (2015) 77 SATC 349 para [47]. Pötgens *Income from International Private Employment* 564 also adopts this interpretation of “fiscal year” for South Africa.

¹⁶⁵⁵ See the definitions of “financial year” and “year of assessment” in s 1 of the ITA, read with s 5(1)(c) and (d).

8.6 South African case law in which reference was made to the general *renvoi* clause

8.6.1 General remarks

There are only a few South African cases in which reference was made to the general *renvoi* clause in a DTA.¹⁶⁵⁶ *ITC 789*¹⁶⁵⁷ and *Baldwins*¹⁶⁵⁸ were discussed in part 8.2 and those discussions need not be repeated here. The only case discussed below is the SCA's decision in *Tradehold*.¹⁶⁵⁹

What is noteworthy is that in all these cases the court used a definition of the treaty term (or another, comparable term) in the South African income tax legislation to give meaning to the undefined term in the DTA. Furthermore, these definitions either related to the restricted tax only; or applied to the entire income tax act and were used in the part of the act relating to the restricted tax. These cases thus support Kande's argument that, if a treaty term is used in the part of the domestic tax legislation that imposes the restricted tax, the meaning of the term under that part is likely to be the proposed domestic meaning.¹⁶⁶⁰

8.6.2 Reference to the general *renvoi* clause in *Tradehold*

8.6.2.1 Background

In *Tradehold*¹⁶⁶¹ the interpretation of Article 13(4), which is identical to what is now Article 13(5) of the OECD MTC, in the South Africa/Luxembourg DTA was considered.

According to South African CGT legislation at the time of the application of the treaty,¹⁶⁶² ceasing to be a South African resident was deemed to be a "disposal".¹⁶⁶³ This is an example of an "immediate exit tax"; in other words, a tax levied on taxpayers exiting the tax

¹⁶⁵⁶ *COT v Aktiebolaget Tetra Pak* (1966) 28 SATC 213, where the Rhodesian court mentions at 218 the general *renvoi* clause in the Rhodesia/Sweden DTA, is not discussed here since it does not add much with regard to an understanding of the general *renvoi* clause.

¹⁶⁵⁷ *ITC 789* (1954) 19 SATC 434 437. In this case it was never disputed, but the court nevertheless confirmed, that the meaning of the treaty term "public company" derived its meaning from the definition in the South African income tax legislation in accordance with the general *renvoi* clause. In *Baldwins (South Africa) Ltd v CIR* (1961) 24 SATC 270 281 the AD referred back to this case and acknowledged that this issue did not arise there. See also part 9.4.1.2.5, where a different aspect of *ITC 789* (1954) 19 SATC 434 is considered.

¹⁶⁵⁸ *Baldwins (South Africa) Ltd v CIR* (1961) 24 SATC 270.

¹⁶⁵⁹ *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA).

¹⁶⁶⁰ Part 8.3.

¹⁶⁶¹ *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA).

¹⁶⁶² When the treaty was signed and when it came into force, no CGT was yet in force in South Africa. In this regard, see n 1723 below.

¹⁶⁶³ Since the judgment in *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA), this deeming provision was moved from the Eighth Schedule to s 9H of the ITA.

jurisdiction of their countries of residence with no actual transfer of assets taking place at that stage.¹⁶⁶⁴

In *Tradehold* the taxpayer had ceased to be a South African resident as a result of a change in the definition of “resident” in the ITA.¹⁶⁶⁵ This triggered South African CGT in respect of shares held by the taxpayer. The South Africa/Luxembourg DTA gave exclusive taxing rights to the country of residence of the alienator (Luxembourg)¹⁶⁶⁶ in respect of gains from the “alienation” of these shares. The question that arose was whether the deemed disposal was an “alienation” as contemplated under the DTA: if it was, the DTA prohibited South Africa from levying CGT, but if it was not, the limitation in the DTA did not apply and South Africa could levy CGT.

The word “alienation” is used in Article 13 of the OECD MTC in order to indicate the event that gives rise to the gains covered by each sub-paragraph of Article 13.¹⁶⁶⁷ The most common dictionary meaning for the word “alienation” is “the transfer of ownership”.¹⁶⁶⁸ However, countries frequently include a definition for the term in their domestic CGT legislation. This definition will often give the term a meaning far removed from its dictionary meaning and may include events where no transfer of assets is involved.¹⁶⁶⁹ It is also common for domestic CGT legislation to use different, but comparable terms.¹⁶⁷⁰

The issue in *Tradehold*¹⁶⁷¹ was whether tax emigration (without any actual transfer of assets) could be regarded as an “alienation” for purposes of Article 13 of the OECD MTC if it is a trigger event for CGT under domestic legislation. As pointed out in part 8.4, there is support

¹⁶⁶⁴ Chand (2013) *BFIT* para 2.1.1.

¹⁶⁶⁵ Definition of “resident” in s 1 of the ITA.

¹⁶⁶⁶ BJ Arnold “International - Tax Treaty Case Law News” (2012) 66 *BFIT* 481 484 explains that, on the assumption that tax emigration may be regarded as an “alienation” in terms of Art 13 of the OECD MTC, countries would often in their domestic tax law deem such an “alienation” to take place immediately before the emigration. If this deeming is effective, it results in the taxation event taking place at a time when the person emigrating is still resident in that country, which would give that country the right to levy the tax. The South African ITA contained a similar timing provision in para 13(1)(g) of the Eighth Schedule at the time of the application of the DTA. However, this deeming provision did not have the desired result and much speculation followed as to why this might have been the case. See in this regard E Mazansky “South Africa’s Exit Charge Overridden by the Luxembourg-South Africa Income and Capital Tax Treaty (1998)” (2012) 66 *BFIT* 374 375; Arnold (2012) *BFIT* 484; LG Classen “The Exit Tax Consequences of the Migration of Companies from South Africa: *Commissioner for the South African Revenue Service v Tradehold Ltd*: Case Note” (2013) 25 *SA Merc LJ* 387 395-397; T Gutuza “Dual Residence and the Proviso: Where was Tradehold Resident?” (2014) 26 *SA Merc LJ* 543 552.

¹⁶⁶⁷ S Simontacchi *Taxation of Capital Gains under the OECD Model Convention: With Special Regard to Immovable Property* (2007) 175.

¹⁶⁶⁸ 175.

¹⁶⁶⁹ 178-179.

¹⁶⁷⁰ 175.

¹⁶⁷¹ *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA).

from the *Hoge Raad* for this view.¹⁶⁷² There is, however, also Canadian case law which, although not clear on this point, at least raises some doubts.¹⁶⁷³ There is support in scholarly contributions both against¹⁶⁷⁴ and for this view.¹⁶⁷⁵ The latter group of scholars refers to the Commentaries as support for their view.¹⁶⁷⁶

Turning to the meaning of “alienation” in South African domestic law, the trigger event for the levying of CGT is the “disposal” of an asset. For purposes of the part of the ITA that deals with the calculation of the amount that is subject to CGT (the Eighth Schedule to the ITA),¹⁶⁷⁷ the term “disposal” is defined to include an “event... which results in the ... transfer ... of an asset”.¹⁶⁷⁸ In addition certain events are expressly included, one of which is the “sale ... or any other *alienation* or transfer of ownership” of an asset.¹⁶⁷⁹ Apart from this definition, a number of events are also treated as “disposals”, which included at the time of the application of the treaty the ceasing of tax residency.¹⁶⁸⁰

Neither the Eighth Schedule, nor the ITA itself contains a definition of “alienation”. There is, however, case law on the meaning of the term “alienation” as used in South African insolvency legislation,¹⁶⁸¹ which corresponds with its dictionary meaning. Apart from this, other non-tax South African legislation also contains definitions for “alienate” and

¹⁶⁷² Chand (2013) *BFIT* n 145 refers to German case law that he submits also confirms this view.

¹⁶⁷³ See the discussion by Kandev (2007) *Can Tax J* 57-58.

¹⁶⁷⁴ L de Broe “The Tax Treatment of Transfer of Residence by Individuals - General Report” in *IFA Cahiers de Droit Fiscal International Vol. 87b* (2002) 19 65 and the other sources mentioned by Chand (2013) *BFIT* n 138. See also the reference to “M. Lang, Introduction to the Law of Double Taxation Conventions pp. 100-101 (Linde 2010)” by Arnold (2012) *BFIT* n 13.

¹⁶⁷⁵ Simontacchi *Taxation of Capital Gains* 182-184 argues that “alienation” should have a wide meaning, but that recourse to Art 3(2) may at times be needed. Arnold (2012) *BFIT* para 3 also argues in favour of the use of Art 3(2).

¹⁶⁷⁶ They refer either to paras 7-9, or to para 10, of the Commentary to Art 13. In respect of paras 7-9 of the Commentary, see *Decision by the Hoge Raad* (20 February 2009) 2701 BNB 2009/260 (discussed in part 8.4) paras 4.13 and 4.43-4.44; Simontacchi *Taxation of Capital Gains* 186-187; Arnold (2012) *BFIT* 483; Chand (2013) *BFIT* para 4.3.1. In respect of para 10 of the Commentary, see Simontacchi *Taxation of Capital Gains* 192-193; L Brillman “The Effect of Taxation on Business Mobility in the European Union: The Case of the Netherlands” (2015) 69 *BFIT* 442 446.

¹⁶⁷⁷ Although using the term “CGT” might create the wrong impression that one is referring to a tax separate from “normal tax” (the term used in the ITA for income tax), it is a common way of referring to the “taxable capital gain” that is calculated under the Eighth Schedule to the ITA. This taxable capital gain is included in the taxpayer’s “taxable income”, on which “normal tax” is levied (s 5 and the definition of “taxable income” in s 1, read with s 26A, of the ITA).

¹⁶⁷⁸ The definition of “disposal” in para 1, read with para 11(1), of the Eighth Schedule to the ITA.

¹⁶⁷⁹ Para 11(1)(a) of the Eighth Schedule to the ITA (emphasis added). To complete the definition of “disposal”, para 11(2) of the Eighth Schedule lists a number of events that are excluded from being a “disposal”.

¹⁶⁸⁰ Para 12 of the Eighth Schedule to the ITA.

¹⁶⁸¹ The court in *Cronje NO v Paul Els Investments (Pty) Ltd* 1982 (2) SA 179 (T) 188 defined it as “*die handelings waardeur eiendomsreg oorgedra word*”. This meaning was, in turn, based on an earlier decision by the AD in *Grobler v Trustee Estate De Beer* 1915 AD 265, where insolvency legislation was also considered.

“alienation” respectively.¹⁶⁸² None of these were mentioned in either the tax court¹⁶⁸³ or SCA judgments in *Tradehold*.

8.6.2.2 The court’s finding on the application of the general *renvoi* clause

The tax court,¹⁶⁸⁴ which made no reference to the general *renvoi* clause in the DTA, held that “alienation” included deemed disposals and stated the following:

“I am unable to see any reason why a deemed disposal of property should not be treated as an alienation of property for purposes of article 13(4) of the DTA. I agree in this regard with counsel for the appellant, who argued that it would be absurd if a taxpayer were to be protected in terms of art 13(4) from liability for tax resulting from a gain from an *actual* alienation of property, but not from a deemed alienation of property.”¹⁶⁸⁵

In the SCA judgment the court referred to two arguments made by the Commissioner in its averment that no “alienation”, as contemplated in the DTA, took place: firstly, since tax emigration was a “deemed” disposal under the South African ITA, it could not be regarded as an actual “disposal” (or “alienation”); and, secondly, “alienation” should have the meaning that it would have under South African law, which would not include tax emigration.¹⁶⁸⁶

In response, the SCA stated:

“The [South Africa/Luxembourg] DTA is based upon the [OECD MTC], which has served as the basis for similar agreements that exist between many countries. In interpreting its provisions, one must therefore not expect to find an exact correlation between the wording in the DTA and that used in the domestic taxing statute... [I]nvariably the wording in the DTA cannot be expected to match precisely that used in the domestic taxing statute. In *SIR v Downing* (supra) Corbett JA remarked ... :

‘The convention makes liberal use of what has been termed “international tax language” (see *Ostime* ...)’¹⁶⁸⁷ ...

¹⁶⁸² Examples include the definitions of “alienate”, with “alienation” having a “corresponding meaning”, in s 1(1) of the Alienation of Land Act 68 of 1981 and s 1 of the Property Time-Sharing Control Act 75 of 1983; the definition of “alienate” (but not of “alienation”) in s 1 of the Housing Development Schemes for Retired Persons Act 65 of 1988.

¹⁶⁸³ *ITC 1848* (2010) 73 SATC 170.

¹⁶⁸⁴ *ITC 1848* (2010) 73 SATC 170.

¹⁶⁸⁵ Paras [14] and [15]. These, and the next paragraph of the judgment, were quoted by the SCA in its judgment at para [10].

¹⁶⁸⁶ *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA) paras [11]-[13].

¹⁶⁸⁷ *Ostime v Australian Mutual Provident Society* [1960] AC 459.

Sub-article 2 [of Article 3] provides for a general rule of interpretation for terms used in the DTA that are not defined. ‘Alienation’ is not one of the defined terms and thus article 3(2) finds application...¹⁶⁸⁸

The court concluded that the term “alienation” as used in the DTA was not restricted to an actual alienation, but included deemed disposals.¹⁶⁸⁹

Although the SCA itself indicated in the last paragraph quoted above that the general *renvoi* clause “finds application”, this in itself does not mean that the domestic meaning of the word was given by the court to the treaty term. The court may have reasoned that the context required that a different meaning be adopted.¹⁶⁹⁰ Scholars have been divided on what the court has decided in this regard. Classen argues that a domestic meaning was given (although she thought that the facts perhaps warranted that the context required an alternative interpretation).¹⁶⁹¹ Du Plessis favours the view that the domestic meaning was not used since, on her reading of the judgment, the court held that the context required that the domestic meaning not be used.¹⁶⁹² Du Plessis gives as reason for her view the fact that the SCA referred (in the above-quoted passage) to the existence of an “international tax language”, which would suggest an autonomous meaning.¹⁶⁹³

The judgment of the SCA is certainly not very clear, but I argue that the court gave to the treaty term “alienation” the domestic meaning of “disposal” as defined in the Eighth Schedule to the ITA. The reasons for my view are twofold. Firstly, it should be noted that both the tax court and the SCA used the words “disposal” and “alienation” interchangeably. This appears from the statements from these judgments quoted earlier. Secondly, the only material to which they referred to for the treaty meaning is the Eighth Schedule. No dictionaries, case law, writings of scholars, or the Commentaries are referred to by the court

¹⁶⁸⁸ *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA) paras [18]-[19].

¹⁶⁸⁹ Para [25].

¹⁶⁹⁰ Alternatively, the SCA may have decided that no domestic meaning existed. However, given the fact that the meaning of the term has been considered by South African courts, this argument seems unlikely.

¹⁶⁹¹ Classen (2013) *SA Merc LJ* 398-399 indicates that the court “relied heavily” on Art 3(2). See also the following argument of M Seiler “Exit Taxation Arising from a Deemed Disposal of Shares” (2013) 67 *BFIT* 580 582-583:

“The SCA implicitly followed the ... approach, according to which the term ‘alienation’, as it is used in article 13 of the OECD Model, is a broad term. An ‘alienation’ is not conditional upon a change of ownership. Following this approach, it is argued that the term, outside its autonomous core meaning, has to be determined according to domestic law. Accordingly, exit taxes should be covered by article 13 of the OECD Model *if the domestic law of the states applying them attaches the same legal consequences* to exit cases as to alienations of the respective property” (emphasis added, footnotes omitted).

¹⁶⁹² Du Plessis *Critical Issues Regarding the OECD Model Tax Convention* 134-135. She does, however, include the possibility at n 958 of her contribution that the court used a domestic meaning.

¹⁶⁹³ 135. See also the reference to this by Seiler (2013) *BFIT* para 3.2.

with approval. This might be seen as an indication that neither an “everyday meaning” (for which general dictionaries would typically serve as guides),¹⁶⁹⁴ nor an autonomous technical meaning (for which legal dictionaries, foreign case law, scholarly writing and the Commentaries would typically serve as guides)¹⁶⁹⁵ was given by court, but rather a domestic technical meaning (derived from the definition in the ITA).

As for the reference to the “international tax language”, as noted in part 4.2, what is usually foreseen by using this phrase is a term that is not used in the domestic (tax) laws. In the case of “alienation”, however, a word that conveys the same concept (“disposal”) is used in the domestic tax law of one of the contracting parties. This may thus be an example of where the parties did not intend for the “common international understanding” (if one exists) to apply. Another indication that the court had not been looking for “the common *international* understanding” of the term, is the fact that no reference was made to foreign material on the meaning of the term, as explained above.

So why did the court refer to the “international tax language”? Immediately before using the phrase, the SCA explained that one cannot expect a DTA’s wording to match that of domestic tax legislation.¹⁶⁹⁶ It is possible that the court merely referred to the “international tax language” in order to bring across the point that the terms used in DTAs may be different from those used in domestic laws, rather than to advocate that an international “understanding” should be given to these terms. The court may thus be explaining that, when determining the domestic meaning of terms under Article 3(2) (to which the court referred in the very next paragraph), it is not surprising that the treaty and the domestic laws may use different terms for the same concept. This is thus a form of introduction to explain why the court is prepared to consider the meaning of “disposal” under South African law, whereas the treaty uses a different term, “alienation”.

If this reading of the judgment (that the court gave the domestic meaning of “disposal” under the Eighth Schedule to the treaty term “alienation”) is correct, the implication is, firstly, that the SCA was prepared to give the meaning that a different term (“disposal”) bears in domestic legislation to the treaty term (“alienation”). Another implication is that the SCA was prepared to import a meaning given under a deeming provision in the domestic legislation into the treaty term. In doing so, it rejected the non-tax meaning of the term proposed by the

¹⁶⁹⁴ Part 4.3.2.

¹⁶⁹⁵ Parts 4.2 and 4.3.2.

¹⁶⁹⁶ See the main text corresponding to n 1634 above.

Commissioner in favour of the meaning of the concept under the part of the ITA that deals with the restricted tax (CGT).

8.7 The meaning of the phrase “unless the context otherwise provides”

Article 3(2) provides that the proposed domestic meaning will apply to give meaning to a treaty term “unless the context otherwise provides”. In this part of the study the meaning of this phrase is considered. In part 9.6 the question will be asked whether this phrase will apply in the South African context.

8.7.1 The meaning of “context”

The first issue to consider is what “context” in Article 3(2) means.¹⁶⁹⁷ The Commentaries do not provide much guidance and merely state the following:

“The context is determined in particular by the intention of the Contracting States when signing the Convention as well as the meaning given to the term in question in the legislation of the other Contracting State (an implicit reference to the principle of reciprocity on which the Convention is based).¹⁶⁹⁸ The wording of the Article therefore allows the competent authorities some leeway.”¹⁶⁹⁹

The “context” foreseen in Article 31 of the VCLT, discussed in part 4.3.3, is clearly included.¹⁷⁰⁰ However, “context” in Article 3(2) is arguably not subject to the same restrictions that apply under that provision and materials also contemplated under Article 32 of the VCLT are thus included.¹⁷⁰¹ In fact, there is support for the view that “[a]ny relevant material that throws light on whether or not domestic law should not be used” be included.¹⁷⁰² This would include the Commentaries.¹⁷⁰³

¹⁶⁹⁷ For a summary of various views in this regard, see Van der Bruggen (2003) *Euro Tax* 143-144 and 147.

¹⁶⁹⁸ This is thus a nod towards the goal of common interpretation, as discussed in part 4.2.

¹⁶⁹⁹ Para 12 of the Commentary (1992) to Art 3.

¹⁷⁰⁰ Avery Jones et al (1984) *BTR* 104; Vogel & Prokisch “Interpretation - General Report” in *Cahiers Vol. 78a* (1993) 212 para 123; Edwardes-Ker *Tax Treaty Interpretation* 77; Danon *Switzerland’s Taxation of Trusts* 332; Baker *Double Taxation Conventions* para E.20; Rust “Article 3(2)” in *Klaus Vogel* (2015) 212 m.nr. 123. See also the sources listed by Van der Bruggen (2003) *Euro Tax* 143 n 19 and 147.

¹⁷⁰¹ Avery Jones et al (1984) *BTR* 18; Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 8.1. This was also the view recently expressed in the UK case of *Martin Frederick Fowler v The Commissioners* [2016] UKFTT 0234 (TC) para 119.

¹⁷⁰² Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 8.1.

¹⁷⁰³ Avery Jones et al (1984) *BTR* 92 and 100; Waters in Ward et al *Interpretation of Income Tax Treaties* 20; Ward et al *Interpretation of Income Tax Treaties* 31; De Broe *International Tax Planning* 285; Rust “Article 3(2)” in *Klaus Vogel* (2015) 212 m.nr. 123.

8.7.2 The views of scholars on “unless the context otherwise requires”

Scholars differ on when the circumstances exist to conclude that “the context otherwise requires”.¹⁷⁰⁴ They also differ on the importance to be given to a domestic meaning under Article 3(2).

On the one hand are those that argue that the domestic meaning should be used only “as a last resort”.¹⁷⁰⁵ Proponents of this view tend to focus on the importance of achieving the goals of common and uniform interpretation, which may not be achieved if a domestic meaning is given.

On the other hand are those who argue that the wording used in Article 3(2) suggests a different approach. They argue that the use of the words “shall”¹⁷⁰⁶ (instead of “may”) and “requires”¹⁷⁰⁷ indicates a preference for the domestic meaning that can only be dislodged if there are “reasonably strong” arguments to the contrary.¹⁷⁰⁸ Under this view, the proposed domestic meaning will always have to be determined,¹⁷⁰⁹ before comparing it to the “context” to determine whether or not it will apply to give meaning to the treaty term.

Article 3(2) is not the only provision in the OECD MTC that includes the qualification “unless the context otherwise requires”. It is also included in Article 3(1), which contains a list of definitions. It has been argued that the reasons that would be required to overthrow a definition of a term under Article 3(1) might have to be stronger than those required to overthrow a domestic meaning under Article 3(2). The basis for this argument is that it is far less certain that the treaty negotiators agreed upon the domestic meaning than they did on a

¹⁷⁰⁴ Avery Jones et al (1984) *BTR* 108; Kandev (2007) *Can Tax J* 68; Van Weeghel “Tax Treaties and Tax Avoidance - General Report” in *Cahiers Vol. 95a* (2010) 50-51.

¹⁷⁰⁵ See the sources listed by Avery Jones et al (1984) *BTR* 105-106; Edwardes-Ker *Tax Treaty Interpretation* 80-83, Danon *Switzerland’s Taxation of Trusts* 330 n 1788 and Kandev (2007) *Can Tax J* n 29.

¹⁷⁰⁶ Van der Bruggen (2003) *Euro Tax* 153; Kandev (2007) *Can Tax J* 38; Olivier & Honiball *International Tax* 544. This was also the view recently expressed in the UK case of *Martin Frederick Fowler v The Commissioners* [2016] UKFTT 0234 (TC) para 101.

¹⁷⁰⁷ Avery Jones et al (1984) *BTR* 108 proposes that it is a word “of some force”. But see Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 8.1 where the author simply argues that “a good reason” must exist not to use the domestic meaning.

¹⁷⁰⁸ Avery Jones et al (1984) *BTR* 108. Van der Bruggen (2003) *Euro Tax* 153 notes that “the discordance” must be “sufficiently clear”. Rust “Article 3(2)” in *Klaus Vogel* (2015) 212 m.nr. 123 notes that “weighty arguments” should be put forward if the domestic meaning is not used and see also 212 m.nr. 122. In *Martin Frederick Fowler v The Commissioners* [2016] UKFTT 0234 (TC) para 119 the court said that “a strong case” must exist for a different meaning. See also De Broe *International Tax Planning* 277; Kandev (2007) *Can Tax J* 68; as well as the sources listed by Edwardes-Ker *Tax Treaty Interpretation* 81-82 and Li & Sandler (2007) *Can Tax J* 908.

¹⁷⁰⁹ Edwardes-Ker *Tax Treaty Interpretation* 82; Rust “Article 3(2)” in *Klaus Vogel* (2015) 212 m.nr. 121; Baker *Double Taxation Conventions* para E.20.

definition in Article 3(1). If the ambulatory meaning applies, such a domestic meaning might not even have existed when the DTA was negotiated.¹⁷¹⁰

8.7.3 A South African perspective on “unless the context otherwise requires”

It is very common for definitions in South African legislation to provide that the definition will apply “unless the context indicates/requires¹⁷¹¹ otherwise”. One of the most well-known statements as to when the context may warrant a departure from a statutory definition is found in *Canca v Mount Frere Municipality*,¹⁷¹² where the court held as follows:

“The principle which emerges is that the statutory definition should prevail unless it appears that the Legislature intended otherwise and, in deciding whether the Legislature so intended, the Court has generally asked itself whether the application of the statutory definition would result in such *injustice or incongruity or absurdity* as to lead to the conclusion that the Legislature could never have intended the statutory definition to apply.”¹⁷¹³

The Constitutional Court subsequently took a similar view.¹⁷¹⁴

With regard to the phrase as used in the general *renvoi* clauses of South African DTAs, the cases of *Baldwins*¹⁷¹⁵ and *Tradehold*¹⁷¹⁶ are relevant.

8.7.3.1 “unless the context otherwise requires”: the view of the court in *Baldwins*

The most direct authority on the meaning of the phrase in South African general *renvoi* clauses is the 1961 case of *Baldwins*,¹⁷¹⁷ where the court considered this very issue. In that

¹⁷¹⁰ Avery Jones et al (1984) *BTR* 94.

¹⁷¹¹ Regarding the meaning of the word “require” in different contexts, see *Clutchco (Pty) Ltd v Davis* 2005 (3) SA 486 (SCA) paras [11]-[12].

¹⁷¹² *Canca v Mount Frere Municipality* 1984 (2) SA 830 (Tk).

¹⁷¹³ 832.

¹⁷¹⁴ In *Minister of Mineral Resources and others v Sishen Iron Ore Co (Pty) Ltd and another* 2014 (2) SA 603 (CC) para [59], having referring to the statement in *Canca v Mount Frere Municipality* 1984 (2) SA 830 (Tk), the court held as follows: “[W]e are obliged to give the phrase ... its statutorily defined meaning unless that meaning would lead to an *injustice or absurdity* not contemplated by the [legislature].” See also *SATAWU and another v Garvas and others* 2013 (1) SA 83 (CC) para 134. The definitions that were considered in these cases included the phrases “unless the context indicates otherwise” and “unless the context otherwise indicates” respectively.

¹⁷¹⁵ *Baldwins (South Africa) Ltd v CIR* (1961) 24 SATC 270.

¹⁷¹⁶ *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA).

¹⁷¹⁷ *Baldwins (South Africa) Ltd v CIR* (1961) 24 SATC 270, also discussed in part 8.2.

case, the court based its views on a decision of the Privy Council in respect of the interpretation of a definition in South African domestic legislation.¹⁷¹⁸

In part 8.7.1 it was pointed out that an argument is made that the reasons that would be required to overthrow a definition of a term under Article 3(1) (which also includes the phrase “unless the context otherwise requires”) might have to be stronger than those required to overthrow a domestic meaning under Article 3(2). If one takes this argument further, the reasons will have to be stronger to overthrow a statutory definition in domestic legislation than a domestic meaning under Article 3(2). However, the court in *Baldwins* made no such distinction since it interpreted the phrase “unless the context otherwise requires” in the DTA in the same manner in which the privy council had interpreted a similar phrase in a definition in South African legislation.¹⁷¹⁹ The AD also showed a strong preference for the use of a domestic meaning under Article 3(2), indicating that it will only depart from the domestic meaning if the context “clearly” shows otherwise, or if there are some other reasons “of weight”.¹⁷²⁰ As explained in part 8.2, in this case the taxpayer had argued against the use of the definition of “public company” in the 1941 ITA to evaluate a non-resident company. The taxpayer’s argument was based on the fact that this definition included categories of companies that could only apply to local, but not foreign, companies. This, the taxpayer argued, was an indication that it was not the intention of the parties that the definition in the 1941 ITA would apply.¹⁷²¹ The court, however, disagreed.

What is also noteworthy is that the court had no concerns with the fact that the meaning of the term would be different in the law of its treaty partner.

8.7.3.2 “unless the context otherwise requires”: the view of the court in *Tradehold*

Unfortunately *Tradehold*¹⁷²² does not throw much light on the phrase “unless the context otherwise requires”. As I argue in part 8.6.2.2, the SCA in *Tradehold* used a domestic meaning to give meaning to a treaty term and thus, by implication, held that the context did not require otherwise. The meaning of the phrase is, however, not addressed in the case and the following observations are thus made rather tentatively.

¹⁷¹⁸ *Baldwins (South Africa) Ltd v CIR* (1961) 24 SATC 270 281, where the court referred to the Privy Council’s judgment in *Govindasamy v Indian Immigration Trust Board Natal* 1918 AD 633.

¹⁷¹⁹ *Govindasamy v Indian Immigration Trust Board Natal* 1918 AD 633.

¹⁷²⁰ *Baldwins (South Africa) Ltd v CIR* (1961) 24 SATC 270 280-281.

¹⁷²¹ 272.

¹⁷²² *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA).

Of interest is the following statement by the court in that case:

“Article 13 is widely cast... It is reasonable to suppose that the parties to the DTA were aware of the provisions of the Eighth Schedule¹⁷²³ and must have intended article 13 to apply to capital gains of the kind provided in the Schedule... There is, moreover, no reason in principle why the parties to the DTA would have intended that article 13 should apply only to taxes on actual capital gains resulting from actual alienations of property.”¹⁷²⁴

This paragraph seems to indicate that the court accepted at the outset that a domestic meaning (the meaning in the Eighth Schedule to the ITA) would apply and that it was looking for a reason why this should not be the case. This might thus indicate a preference for the domestic meaning. How “strong” that reason should be, is, however, not apparent from this statement.

Since the *SCA Tradehold* did not consider either the Commentary to Article 13, or the meaning of the term “alienation” under the law of its treaty partner (Luxembourg), one can also deduct that these were not factors that were taken into account by the court in deciding whether the context otherwise requires.

8.8 Conclusion

Article 3(2) of the OECD MTC requires an interpreter of an undefined term in a DTA to use the domestic meaning of the term, unless the context otherwise requires. Although such an approach goes against the goals of common and uniform interpretation, it seems that it is warranted by the need for the DTA to link with domestic laws.

Since the redraft of Article 3(2) in 1995, it is clear that it is the domestic meaning at the time of application of the DTA that is the relevant meaning that should apply; in other words, that an ambulatory approach should be followed. With regard to clauses in DTAs based on the pre-1995 version, the position is less clear. There is possibly support in South African case law for the ambulatory approach.

Where more than one domestic meaning exists in the domestic tax legislation and the treaty term is used in the part of that legislation that imposes the restricted tax, the meaning of the term under that part (if compared with meanings in other parts of that legislation) is more

¹⁷²³ This is a somewhat surprising statement since the then South African Minister of Finance first announced the introduction of CGT in his budget speech on 23 February 2000, by which time the South Africa/Luxembourg DTA had already been signed. The actual provisions of the Eighth Schedule were only inserted by way of legislation (s 38 of the Taxation Laws Amendment Act 5 of 2001) after the DTA was already in force. See also Seiler (2013) *BFIT* heading 2.2.

¹⁷²⁴ *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA) para [24].

likely to be the most appropriate meaning for purposes of the general *renvoi* clause. This is, however, subject to the qualification that the context may require otherwise.

If the term used in the domestic law is comparable, but not identical to, the treaty term, the meaning of the comparable term can arguably be used as a domestic meaning for the treaty term. This argument is supported by the decision of the SCA in *Tradehold*.¹⁷²⁵

The domestic meaning will not apply if the context requires otherwise. The “context” here is not limited to the context contemplated under Article 31 of the VCLT and arguably includes the Commentaries. Internationally there is support for the argument that the context can only require otherwise if there are “reasonably strong arguments” to that effect. In South African case law, the AD in *Baldwins*¹⁷²⁶ showed a strong preference for the use of a domestic meaning under a general *renvoi* clause, indicating that it would only depart from it if the context “clearly” showed otherwise, or if there were some other reason “of weight”.¹⁷²⁷ The more recent judgment by the SCA in *Tradehold* does not indicate that South African courts have since then taken a different view.

¹⁷²⁵ *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA).

¹⁷²⁶ *Baldwins (South Africa) Ltd v CIR* (1961) 24 SATC 270.

¹⁷²⁷ 280-281.

CHAPTER 9

THE MEANING OF THE TERM “BENEFICIAL OWNER” IN SOUTH AFRICAN STATUTORY LAW AND THE APPLICATION OF A SOUTH AFRICAN MEANING UNDER THE GENERAL *REVOI* CLAUSE

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9.1 Introduction

In this chapter the meaning of “beneficial owner” in South African statutory law is considered with a view of identifying a meaning that may be proposed as a domestic meaning for purpose of the general *renvoi* clause.

In the previous chapter it was argued that a domestic meaning must be determined with reference to the domestic context, which would include the legislation that governs the tax that is restricted under the DTA. In the context of this study, this would be the part of the ITA that governs the taxation of dividends. The chapter thus commences with a brief overview of aspects relevant to the taxation of dividends in South African law. Thereafter the meaning of the term “beneficial owner” in South Africa statutory law is considered. The reason for restricting the analysis in the chapter to statutory law is that the use of the expression in South African case law was already considered in chapter 3.

Upon completion of the analysis of the meaning of the term in South Africa statutory law, a conclusion will be reached regarding the domestic meaning that is most likely to be proposed under the general *renvoi* clause. The question will then be asked whether the context requires that this proposed domestic meaning not be used when giving meaning to the treaty term “beneficial owner”.

9.2 Aspects relevant to the taxation of dividends in South African law

9.2.1 Dividends and their taxation

Currently¹⁷²⁸ the ITA makes a distinction between dividends declared by resident companies¹⁷²⁹ (which the ITA simply identifies as “dividends”)¹⁷³⁰ and dividends declared by non-resident companies¹⁷³¹ (which the ITA identifies as “foreign dividends”).¹⁷³² As a general rule dividends are exempt from normal tax.¹⁷³³ Foreign dividends, being not of a South African source,¹⁷³⁴ are only subject to normal tax in South Africa if they are received by, or accrues to, a South African resident.¹⁷³⁵ A number of exemptions apply with regard to such foreign dividends.¹⁷³⁶

The term “dividend” is defined in the ITA as follows:

“any amount transferred or applied by a company ... for the benefit or on behalf of any person in respect of any share in that company”.¹⁷³⁷

It is noteworthy that the term “beneficial owner” is not used either in the provisions dealing with the exemption of dividends or foreign dividends from normal tax, or in the definition of “dividend”.¹⁷³⁸

From a company law perspective, the board of directors of the company usually declares dividends,¹⁷³⁹ for which the comparable term in the 2008 Companies Act is

¹⁷²⁸ For an historical overview of taxes levied on dividends in the Union and Republic of South Africa, see J Hattingh “Corporate-Shareholder Taxation in South Africa: 1914 to 1961” in J Hattingh, J Roeleveld & C West (eds) *Income Tax in South Africa: The First 100 Years 1914 - 2014* (2016) 80; J Roeleveld “The Road to Dividend Withholding Tax in South African Income Tax Law” in J Hattingh, J Roeleveld & C West (eds) *Income Tax in South Africa: The First 100 Years 1914 - 2014* (2016) 111.

¹⁷²⁹ The taxation of “headquarter companies”, as defined in s 1 read with s 9I of the ITA, is not considered here.

¹⁷³⁰ See the definitions of “company”, “dividend” and “resident” in s 1 of the ITA.

¹⁷³¹ These are known as “foreign companies” in the ITA.

¹⁷³² See the definitions of “foreign company” and “foreign dividend” in s 1 of the ITA.

¹⁷³³ S 10(1)(k)(i) of the ITA. This general rule is subject to a number of exceptions.

¹⁷³⁴ S 9(4)(a) of the ITA.

¹⁷³⁵ The definition of “gross income” (especially para (k)) in s 1 of the ITA.

¹⁷³⁶ Ss 10B(2) and (3) of the ITA.

¹⁷³⁷ Definition of “dividend” in s 1 of the ITA, which is applicable to the ITA in general. S 64D also contains a definition of “dividend”, which only applies for purposes of the dividends tax.

¹⁷³⁸ This is in contrast with the definition of “dividend” considered in *SIR v Rosen* 1971 (1) SA 172 (A), discussed in part 9.4.1.2.9. That definition included a reference to a “shareholder” (which, as discussed in part 9.4.1.1, was a defined term that can be regarded as the forerunner to the current definition of “beneficial owner” in s 64D of the ITA).

¹⁷³⁹ Unless there is an existing legal obligation on the company, or if it is in pursuance of a court order. S 46(1)(a)(i) of the 2008 Companies Act.

“distributions”.¹⁷⁴⁰ The board may only declare dividends upon having reasonably concluded that, after having completed the distribution, the company’s assets will exceed its liabilities and the company will be able to pay its debts as they become due.¹⁷⁴¹ Upon the declaration of a dividend, a liability arises for the company.¹⁷⁴² This liability is satisfied when the company pays the dividend in accordance with the declaration. If dividends are paid contrary to the requirements set by the 2008 Companies Act, the directors may become personally liable¹⁷⁴³ and the recipient of the dividends may arguably also have to repay the dividends.¹⁷⁴⁴

9.2.2 The South African withholding tax regime in respect of dividends, interest and royalties

The ITA makes provision for a number of withholding taxes, including those on dividends, interest and royalties. The main difference between dividends tax and the withholding taxes on interest and royalties is that, whereas the latter only concerns payments to non-residents, dividends tax concerns payments to both residents and non-residents. The imposition of dividends tax thus serves two purposes. Similar to the imposition of the other two withholding taxes mentioned here, it addresses some of the problems experienced with the collection of taxes from non-residents.¹⁷⁴⁵ In addition, it also replaces the shareholder’s liability for normal tax on distributed company profits with a liability for a tax deemed more appropriate for this purpose in light of the problem of economic double taxation.

9.2.2.1 Dividends tax

Dividends tax, as a tax distinct from normal tax, is levied in terms of Part VIII of the ITA, in section 64D-64N. It became effective with regard to dividends paid after 1 April 2012, thereby replacing STC. Dividends tax is levied in respect of “dividends” (which includes here “foreign dividends”),¹⁷⁴⁶ either declared by a South African resident company,¹⁷⁴⁷ or by non-

¹⁷⁴⁰ Definition of “distribution” in s 1 of the 2008 Companies Act. That is not to say, however, that these terms have the same meanings.

¹⁷⁴¹ See s 46(1) of the 2008 Companies Act for a more complete list of requirements and s 4 for a comprehensive description of the “solvency and liquidity” test.

¹⁷⁴² Cassim et al *Contemporary Company Law* 282.

¹⁷⁴³ S 46(6) of the 2008 Companies Act.

¹⁷⁴⁴ Cassim et al *Contemporary Company Law* 287.

¹⁷⁴⁵ Olivier & Honiball *International Tax* 356.

¹⁷⁴⁶ The definition of “dividend” in s 64D cross-refers to the definitions of “dividend” and “foreign dividend” in s 1 and applies only for purposes of the dividends tax. Certain other payments may be deemed to be dividends, for example under s 64E(4) and 64EB(2).

¹⁷⁴⁷ S 64E excludes from dividends tax dividends declared by headquarter companies.

resident companies. In the latter case, liability only arises if the dividends do not constitute *in specie* dividends and if they are paid in respect of shares listed on a South African exchange¹⁷⁴⁸ and then only if they are paid to South African residents.¹⁷⁴⁹

Either the company paying the dividend,¹⁷⁵⁰ or a regulated intermediary withholds the dividends tax.¹⁷⁵¹ However, the liability for the tax lies with the “beneficial owner” of the dividend¹⁷⁵² (not being an *in specie* dividend).¹⁷⁵³ According to the authors of *Income Tax in South Africa* it is unclear whether the term “beneficial owner” refers to the share, or the dividend, or to both, but they consider the last option to be the correct one.¹⁷⁵⁴ The authors of *Silke on South African Income Tax* regard it as referring only to the dividend.¹⁷⁵⁵ This is the preferable view given that section 64EA(a) states that the liability for dividends tax lies with the “beneficial owner of the dividend”.

It seems that there can be only one “beneficial owner” in respect of a dividend,¹⁷⁵⁶ except for the possibility of joint holders who each shares in a certain proportion in dividends paid by a company.

The rate at which the tax is levied (20 per cent of the amount of the dividend)¹⁷⁵⁷ is reduced if a declaration by the beneficial owner is submitted by a prescribed date,¹⁷⁵⁸ stating that the dividend is subject to a reduced rate as a result of the application of a DTA.¹⁷⁵⁹

¹⁷⁴⁸ Para (b) of the definition of “dividend” in s 64D. See also the definition of “listed share” in s 1 of the ITA.

¹⁷⁴⁹ S 64F(j).

¹⁷⁵⁰ S 64G(1) of the ITA.

¹⁷⁵¹ In this case, the regulated intermediary will be paying the dividend that was declared by another person. See s 64H(1) of the ITA. The term “regulated intermediary” is defined in s 64D and includes, for example, a central securities depository participant. See also s 64I regarding dividends paid to insurers.

¹⁷⁵² Only in the limited circumstances foreseen in s 64J(7) may the company itself be held liable for dividends tax in respect of dividends other than *in specie* distributions.

¹⁷⁵³ S 64EA(a) of the ITA, read with s 64K(1). If the dividend constitutes a dividend *in specie*, s 64EA(b) provides that the liability lies with the resident company that declared and paid the dividend. For this reason *in specie* distributions are not addressed in this study. Any reference to dividends thus excludes dividends to the extent that they constitute *in specie* dividends.

¹⁷⁵⁴ Clegg & Stretch *Income Tax in South Africa* para 12.17.2.

¹⁷⁵⁵ AP de Koker & RC Williams *Silke on South African Income Tax* (2017) para 9.43 where the authors state that “[t]he scheme of the dividends tax is concerned with beneficial ownership of the *dividend*, not beneficial ownership of the share in question” (emphasis added).

¹⁷⁵⁶ S 64EA(a) provides that “any beneficial owner” is liable for dividends tax, thus apparently not excluding the possibility of more than one “beneficial owner”. Other provisions, such as the exemptions from dividends tax in s 64F, though, refer to “the beneficial owner”. This excludes the possibility of more than one “beneficial owner”. Du Toit *Beneficial Ownership of Royalties* 200 argues that there can also only be one beneficial owner in a treaty context.

¹⁷⁵⁷ S 64E(1), as it will read once the Draft Rates and Monetary Amounts and Amendment of Revenues Laws Bill 2017 (published on 22 February 2017) has been promulgated.

A number of exemptions apply in which case no liability for dividends tax arises. These exemptions apply if a declaration by the beneficial owner, confirming that the dividend is exempt, is submitted by the prescribed date.¹⁷⁶⁰ These exemptions are listed in the ITA and apply only to the extent that the beneficial owner meets one of the exemptions set out in this list.¹⁷⁶¹ One such criterion is if the beneficial owner is a South African resident company.¹⁷⁶² This prevents the cascading effect if dividends were to be taxed as they go up the chain in a group of companies.

9.2.2.2 Withholding taxes on interest and royalties

Since this study only considers Article 10 of the OECD MTC, the withholding taxes on royalties¹⁷⁶³ and interest¹⁷⁶⁴ are not considered in any detail. These taxes are levied at a rate of 15 per cent of either the amount of the royalty, or the interest. The liability only arises if these amounts were paid to, or for the benefit of, any “foreign person”,¹⁷⁶⁵ and only to the extent that these amounts are received or accrued from a source within South Africa.¹⁷⁶⁶ The liability for the taxes lies with the afore-mentioned foreign person.¹⁷⁶⁷ The withholding tax rate will be reduced if a declaration by this foreign person is submitted in which it is stated that the royalty or interest is subject to a reduced rate of tax as a result of the application of a DTA.¹⁷⁶⁸

¹⁷⁵⁸ S 64G(3) provides that this date will either be a date determined by the company (withholding the dividends tax), or the date of payment of the dividend (as to which, see s 64E(2)). However, see the possibility of a refund, mentioned at s 64L and 64M.

¹⁷⁵⁹ S 64G(3) and 64H(3) of the ITA and see also the reference to the written undertaking in those sections.

¹⁷⁶⁰ S 64G(2)(a) and 64H(2)(a) of the ITA. The requirements regarding a written undertaking and the prescribed date are the same as at ns 1758 and 1759 above. However, no such declaration is required if the dividend is paid by the company to a beneficial owner that forms part of the same group of companies (defined in s 41) as that company (which is restricted to a “resident” company), or if the company paid the dividend to a regulated intermediary (s 64G(2)(b) and (c)). It is also not required if an intermediary pays the dividend to another intermediary (s 64H(2)(b)).

¹⁷⁶¹ S 64F of the ITA.

¹⁷⁶² S 64F(a) of the ITA.

¹⁷⁶³ Part IVA (s 49A-49H) of the ITA.

¹⁷⁶⁴ Part IVB (s 50A-50H) of the ITA.

¹⁷⁶⁵ A “foreign person” is defined in ss 49A and 50A respectively as “any person that is not a resident”.

¹⁷⁶⁶ Ss 49B and 50B respectively.

¹⁷⁶⁷ Ss 49C and 50C respectively.

¹⁷⁶⁸ Ss 49E(3) and 50E(3) respectively.

9.3 The use of the expression “beneficial owner” and equivalents in statutory law other than the ITA

9.3.1 Overview

The term “beneficial owner” has been used in a number of repealed South African acts and are still being used in a number of acts and regulations.¹⁷⁶⁹ These are not of much relevance to this study since they do not define the term and thus do not contribute much in addition to the meanings already considered in chapter 3. They are therefore not considered further in this study.

Only one national South African act other than the ITA, the Financial Intelligence Centre Act,¹⁷⁷⁰ currently includes a definition of the term “beneficial owner”. The 2008 Companies Act includes a definition of “beneficial interest”, which may be relevant for the reasons explained under that discussion. There is also spatial planning and land use management by-laws of several municipalities that contain a definition of the term “beneficial owner”. These three definitions are considered next, starting with the definition in the 2008 Companies Act.

9.3.2 The definition of “beneficial interest” in the 2008 Companies Act

Company law legislation is perhaps the most probable of all the different kinds of non-tax legislation to give a useable meaning to the term “beneficial owner” for purposes of dividends tax.¹⁷⁷¹ The term “beneficial owner” was used in the 1973 Companies Act¹⁷⁷² and

¹⁷⁶⁹ These include the Small Business Deregulation Act (Ciskei) 27 of 1984 (s 1); the South African Reserve Bank Act 90 of 1989 (s 22); the Exchange Control Amnesty and Amendment of Taxation Laws Act 12 of 2003 (definitions of “foreign bearer instrument” and “held” in s 1); the Broadbank Infraco Act 33 of 2007 (definition of “Infraco shares” in s 1); the South African Airways Act 5 of 2007 (definition of “SAA shares” in s 1); the South African Express Act 34 of 2007 (definition of “SAX shares” in s 1) and the Financial Markets Act 19 of 2012 (s 35). The term “beneficial ownership” is also used in several acts and regulations, including in the Securities Transfer Tax Act 25 of 2007. The use of that term in the definition of “transfer” in s 1 of that Act is discussed by Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 11. It may also be noted that the expression “beneficial owner” is often used in South African case law dealing with the provisions of the Admiralty Jurisdiction Regulation Act 105 of 1983, particularly concerning the definition of “associated ship” in s 3(7). Although a previous draft of this Act contained the term “beneficial owner” (as discussed by Wallis *The Associated Ship* 76-78), the term is not included in the Admiralty Jurisdiction Regulation Act. The definition of “associated ship” is now primarily concerned with that of “control” instead of “beneficial ownership”, as confirmed in *Dole Fresh Fruit International Ltd v MV Kapetan Leonidas and another* 1995 (3) SA 112 (A) 122 and see also *Zygos Corporation v Salen Rederierna AB* 1985 (2) SA 486 (C) 489.

¹⁷⁷⁰ Financial Intelligence Centre Act 38 of 2001.

¹⁷⁷¹ Kandeve (2007) *Can Tax J* 45 similarly argues that, when giving a domestic meaning under the general *renvoi* clause where the tax legislation itself does not provide a definition (or one can perhaps add, if the tax law definition is not acceptable), it is the meaning in a commercial or accounting sense that is likely to be used, if the term is used “in a commercial context” in the income tax legislation. It is also noteworthy that the definition

is currently used in a regulation to the 2008 Companies Act.¹⁷⁷³ The 2008 Companies Act itself, however, does not employ this term.¹⁷⁷⁴ Instead its drafters opted for the term “beneficial interest”, which is defined in the Act. This definition corresponds closely to the definition of “beneficial ownership” under the repealed Uncertificated Securities Tax Act.¹⁷⁷⁵ This confirms that not too much emphasis should be placed here on the different terminology (that is “beneficial interest” rather than “beneficial owner”) in the context of the general *renvoi* clause.¹⁷⁷⁶

The term “beneficial interest” is defined in the 2008 Companies Act as follows:

“‘beneficial interest’, when used in relation to a company’s securities, means the right or entitlement of a person, through ownership, agreement, relationship or otherwise, alone or together with another person to -

- (a) receive or participate in any distribution in respect of the company’s securities;
- (b) exercise or cause to be exercised, in the ordinary course, any or all of the rights attaching to the company’s securities; or
- (c) dispose or direct the disposition of the company’s securities, or any part of a distribution in respect of the securities,

but does not include any interest held by a person in a unit trust or collective investment scheme in terms of the Collective Investment Schemes Act, 2002 (Act No. 45 of 2002)”.¹⁷⁷⁷

of “shareholder” in s 1 of the Tax Administration Act 28 of 2011 refers to the person holding the “beneficial interest” in a company, although that definition does not expressly cross-refer to the definition of “beneficial interest” in the 2008 Companies Act.

¹⁷⁷² It was used in s 440G of the Companies Act 61 of 1973 (which was inserted by s 4 of the Companies Amendment Act 78 of 1989), before its repeal by s 20 of the Companies Amendment Act 37 of 1999.

¹⁷⁷³ The regulation is quoted in Regulation 92 (GN R351 of 2011).

¹⁷⁷⁴ It does, however, employ the term “beneficial holder of securities”. See, e.g. the definition of “distribution” in s 1, as well as s 3(3), of the 2008 Companies Act. Delpont et al *Henochsberg on the Companies Act 71 of 2008* 30 regard this as being equivalent to the notion of a “beneficial owner” under case law, the meaning of which was mentioned in part 3.4.

¹⁷⁷⁵ Uncertificated Securities Tax Act 31 of 1998. This act was repealed by s 11 of the Securities Transfer Tax Act, 2007. The repealed act levied under s 2(1) uncertificated securities tax in respect of “every change in *beneficial ownership*” in securities.

¹⁷⁷⁶ The definition in s 1 of the Uncertificated Securities Tax Act, 1998 read:

“‘beneficial ownership’, in relation to a security, includes any one or more of the following:

- (a) the right or entitlement to receive any dividend or interest payable in respect of that security; or
- (b) the right to exercise or cause to be exercised in the ordinary course of events, any or all of the voting, conversion, redemption or other rights attaching to such security; Provided that where a company cancels or redeems its own securities, that company is deemed to have acquired the beneficial ownership in those securities.”

This definition also shows similarities with the definition of “beneficial interest” in the South African Reserve Bank Act, but less so with the definition of “beneficial interest” in s 1 of the Ship Registration Act 58 of 1998.

¹⁷⁷⁷ Definition of “beneficial owner” in s 1 of the 2008 Companies Act.

The term is especially (but not only)¹⁷⁷⁸ relevant for provisions in the 2008 Companies Act that set disclosure requirements for the holders of “beneficial interests” in securities.

A comparable definition of “beneficial interest” was included in 1999 in the 1973 Companies Act.¹⁷⁷⁹ At the time of the introduction of that definition the Explanatory Memorandum to the bill¹⁷⁸⁰ noted that the large volumes of shares in listed companies¹⁷⁸¹ registered in the names of nominees created the following problems:

“[I]nsider trading becomes impossible to detect; minority shareholders are unable to detect a change of controlling shareholder and could be prejudiced if a new controlling shareholder is an asset-stripper or, at least, someone in whom they don’t have confidence; the board and shareholders ought to be able to be fore-warned of a hostile takeover; competition legislation is virtually impossible to administer; a company itself does not know who a large percentage of its shareholders is and communication with all shareholders is virtually impossible.”¹⁷⁸²

Section 56(1) of the 2008 Companies Act provides that a company’s securities may be “held by, and registered in the name of, one person for the beneficial interest of another person”. This confirms that the practice of shares held by a nominee as agent for another, as described in part 3.4, lives on in the Act.¹⁷⁸³ However, the definition “beneficial interest” goes further than that. As discussed in part 3.4, under case law the “beneficial owner” is usually regarded as the person who is the holder of the bundle of personal rights that encompass the share conjunctively. The definition quoted above, however, foresees the possibility that someone may hold a “beneficial interest” in a share by virtue of the fact that such person holds only one of these rights.¹⁷⁸⁴ The notion of a person having a “beneficial interest” in the 2008

¹⁷⁷⁸ See the list compiled by Cassim et al *Contemporary Company Law* 253 of other circumstances under which this definition may be relevant.

¹⁷⁷⁹ Introduced in s 140A of the 1973 Companies Act by s 16 of the Companies Amendment Act (1999). Unlike the definition in the 2008 Companies Act, that definition only applied for purposes of that section.

¹⁷⁸⁰ Companies Amendment Bill 17D of 1999.

¹⁷⁸¹ S 140A of the 1973 Companies Act only applied in respect of listed securities, as indicated by the definition of “security” in that section.

¹⁷⁸² The bill also notes that placing obligations on nominees to identify “beneficial shareholders is thus essential in the maintenance of free, fair and acceptably regulated securities markets... South Africa’s obligations in international markets and the growing trend towards disclosure in these markets also compel legislative support for the principle of transparency of shareholdings.”

¹⁷⁸³ Although some of the terminology has changed. The 2008 Companies Act, for example, no longer employs the term “member” in respect of profit companies in the same manner as had the 1973 Companies Act. See in this regard the definition of “member” in s 1 of the 2008 Companies Act. The implication is that a shareholder whose name appears in the company’s register is no longer referred to as a “member”. According to Rachlitz (2013) *Stell LR* 409, especially n 27, the term “shareholder” (defined in s 1 of the 2008 Companies Act) is the equivalent under the 2008 Companies Act of a “member” under the 1973 Companies Act. See also Cassim et al *Contemporary Company Law* 242.

¹⁷⁸⁴ Delport et al *Henochsberg on the Companies Act 71 of 2008* 220.

Companies Act thus overlaps with, but is wider than the “beneficial owner” of shares as often understood in case law.¹⁷⁸⁵ It is also clear that more than one person can have a beneficial interest in the same security.

Section 56(2) of the 2008 Companies Act extends the meaning of the holder of a “beneficial interest” even further. It deems that, if any one of a list of circumstances is present, a person (X) will have a beneficial interest in securities of a public company if another person (Y) has a beneficial interest in that security. One example is if X is the holding company of Y.

The question whether the definition of “beneficial interest” in the 2008 Companies Act can be used to give meaning to the treaty term “beneficial owner” under the general *renvoi* clause is considered next. Du Plessis argues against this since the definition relates to a beneficial interest in a security, rather than a beneficial interest in a dividend.¹⁷⁸⁶ Du Toit and Hattingh similarly argue against the use of the company law definition. They argue that this definition does not “concern persons that hold the beneficial interest in personal payment rights in respect of securities (e.g. dividends)”.¹⁷⁸⁷

Given the potential importance of the meaning in company law legislation, it is worth pursuing the question whether the definition can nevertheless serve as a proposed domestic meaning, perhaps with a few minor adjustments. The question is whether one can argue that the beneficial owner of a dividend is the person who has a “beneficial interest” in the shares in respect of which the dividends were paid. The major problem is that a “beneficial interest”

¹⁷⁸⁵ Rachlitz (2013) *Stell LR* 412-413.

¹⁷⁸⁶ Du Plessis *Critical Issues Regarding the OECD Model Tax Convention* 256. Apart from the arguments discussed in the main text, Du Plessis points out (but does not attach much weight to) the fact that the 2008 Companies Act uses different terminology (“beneficial interest” instead of “beneficial owner”). It was argued in part 8.4 that the use of different terminology is not an insurmountable hurdle to the application of a domestic meaning under Article 3(2). See also the argument in the main text corresponding to n 1776 above regarding the different terminology in this case. Du Plessis also refers to the problem if a static approach is followed in the case of general *renvoi* clauses based on the pre-1995 version of Article 3(2) in DTAs concluded before the 2008 Companies Act came into effect. As mentioned in the main text above, the 1973 Companies Act contained in s 140A a comparable definition of “beneficial interest”, which was inserted in 1999. That, however, does not answer Du Plessis’s concern since DTAs concluded after 1999 would have included the post-1995 version of Article 3(2). Her concern therefore remains valid although, as discussed in part 8.2, it is not clear that South African case law supports the static approach. Lastly, Du Plessis also argues that the 2008 Companies Act itself provides that the definition applies for purposes of that Act only. Where the Act does not apply (for example, where no securities as defined in that Act are involved) the definition cannot apply; or if it does, it will be difficult to do so “sensibly”.

¹⁷⁸⁷ See also Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.12. They do, however, argue that the introduction of “the new regulatory framework for person[s] having a beneficial interest in a security may be the impetus for further development of this part of the law by South African courts. Though it remains to be seen whether such developments may impact the meaning of beneficial ownership of dividends, interest or royalties under the country’s double tax conventions because of the absence of a clear legal bridge between these two areas of the law.”

in a share refers to any of a number of “beneficial interests” that a person can have in the share, including rights and entitlements unrelated to dividends. A person may thus have a beneficial interest in a share (such as being able to direct the disposal of the share), yet have no rights relating to dividends.

The company law definition will thus have to be severely “rewritten” to make it fit the context of dividends tax, so that only a person with rights or entitlements relating to distributions (that meet the definition of “dividends” for purposes of dividends tax) in respect of shares are taken into account. That in itself will be a difficult exercise since it raises questions as to how close the relationship between the person’s particular right and the dividends have to be. For example, will someone who is entitled to cause another to vote in a specific way with regard to the appointment of directors be included, bearing in mind that it is usually the board of directors who decides whether and how much dividends are to be declared?¹⁷⁸⁸ The definition of “beneficial interest” in the 2008 Companies Act is clearly not aimed at answering this type of question since its object is not to identify persons with a beneficial interest in shares relating to dividends *only*.¹⁷⁸⁹

Therefore, it cannot be used to give meaning to the term “beneficial owner” for purposes of the general *renvoi* clause. In light of this conclusion, it is also not necessary to consider the applicability of section 56(2) of the 2008 Companies Act.

9.3.3 The definition of “beneficial owner” in the Financial Intelligence Centre Act

A 2017 act¹⁷⁹⁰ provides for the introduction of a definition of “beneficial owner” into the Financial Intelligence Centre Act.¹⁷⁹¹ This act places compliance obligations on financial institutions and other businesses regarded as being vulnerable to money laundering and the financing of terrorism.

South Africa is a member of FATF, an inter-governmental body who has the objects of setting standards and promoting measures for combating money laundering and terrorist

¹⁷⁸⁸ As discussed in part 9.2.1.

¹⁷⁸⁹ Even if one would be able to limit the definition to a person who has a beneficial interest in a share relating to dividends only, it may still result in more than one person being simultaneously regarded as a “beneficial owner” in respect of the same dividend. See, e.g. the argument made by Rachlitz (2013) *Stell LR* 412-413 that the person whose name appears in the register (but who is not the owner of the share) also holds a “beneficial interest” in the share by virtue of the words “exercise ... any or all of the rights attaching to the company’s securities” in sub-paragraph (b) of the definition. As pointed out in part 9.2.2.1, this goes against what is contemplated under the dividends tax.

¹⁷⁹⁰ Clause 1(d) of the Financial Intelligence Centre Amendment Act 1 of 2017.

¹⁷⁹¹ Financial Intelligence Centre Act 38 of 2001.

financing.¹⁷⁹² FATF has brought out a number of recommendations,¹⁷⁹³ of which Recommendation 24,¹⁷⁹⁴ together with its interpretation note¹⁷⁹⁵ and a set of guidelines produced by FATF,¹⁷⁹⁶ are particularly likely to have influenced the drafting of the South African definition of “beneficial owner” in the Financial Intelligence Centre Act.

FATF has pointed out that companies are “an attractive way to disguise and convert the proceeds of crime before introducing them into the financial system”.¹⁷⁹⁷ Information on beneficial ownership can reduce the misuse of corporate vehicles for this purpose, by

“identifying *those natural persons who may be responsible for the underlying activity of concern*, or who may have relevant information to further an investigation. This allows the authorities to ‘follow the money’ in financial investigations involving suspect accounts/assets held by corporate vehicles. In particular, beneficial ownership information can also help locate a given person’s assets within a jurisdiction.”¹⁷⁹⁸

Recommendation 24 requires countries to ensure that information on “beneficial ownership” and control of legal persons is obtainable.¹⁷⁹⁹ In the Glossary to the FATF Recommendations, “beneficial owner” is defined as follows:

“*Beneficial owner refers to the 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.*”¹⁸⁰⁰

¹⁷⁹² <http://www.fatf-gafi.org/about/> (accessed on 9-07-2017).

¹⁷⁹³ FATF *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation the FATF Recommendations* (2012).

¹⁷⁹⁴ *FATF Recommendations* 22. Note also Recommendation 25.

¹⁷⁹⁵ *FATF Recommendations* 86-91.

¹⁷⁹⁶ FATF *FATF Guidance Transparency and Beneficial Ownership* (2014).

¹⁷⁹⁷ Para 1.

¹⁷⁹⁸ Para 2 (emphasis added, footnotes omitted).

¹⁷⁹⁹ Recommendation 24 (entitled “Transparency and beneficial ownership of legal persons”) reads as follows: “Countries should take measures to prevent the misuse of legal persons for money laundering or terrorist financing. Countries should ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities. In particular, countries that have legal persons that are able to issue bearer shares or bearer share warrants, or which allow nominee shareholders or nominee directors, should take effective measures to ensure that they are not misused for money laundering or terrorist financing. Countries should consider measures to facilitate access to beneficial ownership and control information by financial institutions and [Designated Non-Financial Business or Professions] ...”

¹⁸⁰⁰ *FATF Recommendations* 113 (emphasis added, footnotes omitted) and see also Oguttu *Offshore Tax Avoidance* 567. With regard to the phrase “ultimate effective control”, the Glossary at *FATF Recommendations* 113 n 52 explains that this refers “to situations in which ownership/control is exercised through a chain of ownership or by means of control other than direct control.” *FATF Guidance Transparency and Beneficial Ownership* paras 15-16 provide further clarification:

“[T]he FATF definition focuses on the *natural* (not legal) *persons* who actually own and take advantage of capital or assets of the legal person; as well as on those who really exert effective control over it (whether or

The definition in the South African legislation reads as follows:

“‘beneficial owner’, in respect of a legal person, means a natural person who, independently or together with another person, directly or indirectly—

(a) owns the legal person; or

(b) exercises effective control of the legal person”.¹⁸⁰¹

The chances are slim that this definition will provide a domestic meaning for the treaty term “beneficial owner” for purposes of the general *renvoi* clause.¹⁸⁰² The first reason is that the definition relates to the beneficial owner of a legal person, rather than a dividend. Secondly, it limits the “beneficial owner” to a natural person, which is in line with FATF’s concern that natural persons who are engaged in criminal activities may use companies to disguise and convert the proceeds of their crimes. However, such a definition does not fit within the context of the dividends tax provisions, where it is clearly contemplated that the “beneficial owner” may be a legal person.¹⁸⁰³

9.3.4 The definition of “beneficial owner” in spatial planning and land use management by-laws

Spatial planning and land use management by-laws of several municipalities include the following definition of “beneficial owner”:

“‘beneficial owner’ means where specific property rights and equity in the property lawfully belongs to a person even though dominium or formal title of the property has not been registered or transferred.”¹⁸⁰⁴

not they occupy formal positions within that legal person), rather than just the (natural or legal) persons who are legally (on paper) entitled to do so. For example, if a company is legally owned by a second company (according to its corporate registration information), the beneficial owners are actually the *natural persons* who are behind that second company or ultimate holding company in the chain of ownership and who are controlling it. Likewise, persons listed in the corporate registration information as holding controlling positions within the company, but who are actually acting on behalf of someone else, cannot be considered beneficial owners because they are ultimately being used by someone else to exercise effective control over the company” (emphasis added).

¹⁸⁰¹ S 1 of the Financial Intelligence Centre Act 38 of 2001.

¹⁸⁰² For a similar view in respect of Belgium anti-money laundering legislation, see De Broe *International Tax Planning* 668 n 1000.

¹⁸⁰³ To give but one example: as mentioned in part 9.2.2.1, the ITA provides for an exemption from dividends tax for resident companies. Had the beneficial owner been limited to natural persons, such a limitation would be unnecessary. For a similar reason para 12.6 of the Commentary (2014) to Art 10 does not regard the FATF definition as appropriate for purposes of Art 10, as discussed by Vallada “Beneficial Ownership” in *Update 2014* (2015) 46-47. See also the argument raised in *Prévost Car Inc. v The Queen* 2008 TCC 231 para [26].

¹⁸⁰⁴ The definitions of “owner” in both the Spatial Planning and Land Use Management Act 16 of 2013 and the provincial Western Cape Land Use Planning Act 3 of 2014 include the following reference to “beneficial owner”: “‘owner’ means the person registered in a deeds registry as the owner of land or who is the *beneficial*

It is highly unlikely that this definition will provide a suitable definition for purposes of the general *renvoi* clause since property here does not include dividends.¹⁸⁰⁵

9.4 The definition of “beneficial owner” in the ITA

In this next part of the chapter the meaning of the term “beneficial owner” in the ITA is considered. Currently the term is used only in two parts of the ITA. It is used in a provision in the Eighth Schedule to the ITA, which grants original “beneficial owners”, who dispose of their long-term insurance policies, exemption from CGT.¹⁸⁰⁶ More important is the definition of “beneficial owner” in the part of the ITA that deals with dividends tax. This definition is considered next.¹⁸⁰⁷

The current definition of “beneficial owner” devolved from the definition of “shareholder”,¹⁸⁰⁸ which was first included in the 1941 ITA and remained part of South African income tax legislation until its deletion in 2011.¹⁸⁰⁹ This repealed definition is considered first, before turning to the current definition of “beneficial owner”. The wording of the two definitions contains important similarities and a discussion of the former definition may thus be useful in interpreting the current one.

owner in law”. The definitions of “applicant” and “owner” in the spatial planning and land use management by-laws of several municipalities include similar wording.

¹⁸⁰⁵ For example, the by-law of the Fetakgomo Local Municipality (which also includes a definition of “beneficial owner”) defines “property” as meaning “any erf, erven, lot, plot or stand, portion or part of land in relation to specific land use rights and conditions thereto in terms of the approved and including promulgated Land Use Scheme of the municipality”.

¹⁸⁰⁶ Para 55 of the Eighth Schedule to the ITA.

¹⁸⁰⁷ S 64EB of the ITA extends the definition of “beneficial owner” by deeming certain persons to be “beneficial owners”. These deeming provisions are anti-avoidance measures aimed at combatting avoidance structures that use the fact that certain persons are under s 64F exempt from dividends tax. Since the persons mentioned in s 64F would usually not include a non-resident direct recipient within the scope of this study, these anti-avoidance measures are not considered in this study. It is therefore also not necessary to consider whether these deeming provisions will apply in a treaty context.

¹⁸⁰⁸ Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.11 n 110 also ask whether the definition of “beneficial owner” “seek[s] to perpetuate the definition of ‘shareholder’”.

¹⁸⁰⁹ It was deleted by s 7(1)(zO) of the Taxation Laws Amendment Act 24 of 2011. The Taxation Laws Amendment Act 31 of 2013 replaced most references to “shareholder” in the ITA with the phrase “holder of shares” or a variant thereof. An additional definition of “shareholder” was also included in s 41 of the ITA by s 34 of the Revenue Laws Amendment Act 74 of 2002. This additional definition only applied to the part of the Act dealing with the restructuring of company groups (Part III of Ch 2 of the ITA) and was deleted by the Taxation Laws Amendment Act 43 of 2014. Since this definition was very similar to the general one that applied to the entire ITA and did not outlast the general definition for a substantial period, it will not be addressed in this study. To this may be added that, of the two definitions, the definition that applied to the ITA as a whole is more likely to be relevant for purposes of the general *renvoi* clause, as argued in part 8.3.

9.4.1 The repealed definition of “shareholder”

9.4.1.1 The definition of “shareholder” as forerunner to the definition of “beneficial owner”

As mentioned above, a definition of “shareholder” first appeared in the 1941 ITA. Under section 37 of this Act, the taxable income¹⁸¹⁰ of private companies was attributed to, and taxed in the hands of, their shareholders,¹⁸¹¹ much like partnerships are currently taxed.¹⁸¹² The term “shareholder” was defined in section 33(4) and read:

“‘shareholder’ in relation to any company means the registered shareholder in respect of any share, except that where some person other than the registered shareholder is *entitled*, whether by virtue of any provision in the memorandum or articles of association of the company or under the terms of any agreement or contract, or otherwise, *to all or part of the benefit of the rights of participation in the profits or income attaching to the shares* so registered, such other person, to the extent that he is entitled to such benefits, shall also be deemed to be a shareholder. In making such determination the Commissioner shall have regard, *inter alia*, to ... (d) the terms of any agreement or contract between the registered shareholder and the company or any other person.”¹⁸¹³

The definition thus included both persons whose names appeared in the company’s register and persons who were entitled to the benefit of the rights of participation in the profits of the company, the so-called “deemed shareholders”.¹⁸¹⁴ The definition of “shareholder” was amended numerous times over the ensuing years. However, the core part of the definition remained relatively unchanged.¹⁸¹⁵

The portion of the taxable income of the private company to be included in the shareholder’s taxable income under the regime described above was established under section 36. The

¹⁸¹⁰ As well as income subject to super tax.

¹⁸¹¹ It was included in the shareholder’s taxable income and income subject to super tax.

¹⁸¹² Ss 7(g) and 36 of the 1941 ITA, subject to certain exemptions in s 39. For an overview of this regime, see *Bell’s Trust v CIR* (1948) 15 SATC 255 262-263; AS Silke *The Taxation of Private Companies An Exposition of the Working of the Special Provisions Relating to Private Companies Contained in the Income Tax Act and Provincial Tax Ordinances* (1950) 3-6; Hattingh “Corporate-Shareholder Taxation” in *Income Tax: The First 100 Years* (2016) 103-105.

¹⁸¹³ Emphasis added.

¹⁸¹⁴ See, e.g. *SIR v Rosen* 1971 (1) SA 172 (A) 186.

¹⁸¹⁵ Before its deletion paragraph (a) of the definition of “shareholder” read as follows:

“in relation to any company referred to in paragraph (a), (b) or (d) of the definition of ‘company’ in this section [1], [shareholder] means the registered shareholder in respect of any share, except that where some person other than the registered shareholder is entitled, whether in terms of any agreement or contract or otherwise, to all or part of the benefit of the rights attaching to the share so registered, that other person shall, to the extent that such other person is entitled to such benefit, also be deemed to be a shareholder”.

portion was determined according to the “extent of the *rights* of each person who was a shareholder ... on the specified date to participate, directly or indirectly ... in the profits or income”.¹⁸¹⁶ As explained in *Bell’s Trust*,¹⁸¹⁷ this formulation goes against company law since no shareholder is entitled to participate in undistributed profits of the company. The AD explained that “in the case of a registered shareholder *who holds his shares for his own benefit alone*, it is manifest that he must be deemed to have the right to participate in undistributed profits” in the scheme of the 1941 ITA.¹⁸¹⁸

The Explanatory Memorandum that accompanied the bill¹⁸¹⁹ that gave rise to the deletion of the definition of “shareholder” explains the reason for the deletion as follows:

“The shareholder definition focuses on both the share register *and beneficial ownership*. This duality creates confusion because the person named in the share register is not necessarily the beneficial owner of the share (for example, a regulated intermediary). Consistent with the overall philosophy of the Income Tax Act, the focus should solely be on the beneficial owner of the shares. It is ... accordingly proposed that the shareholder definition be deleted. The focus should always be on the beneficial owner of the share (that is, ‘the holder’ or ‘the person who holds the shares’), not the registered owner.”¹⁸²⁰

At least to the drafters of this memorandum the second part of the definition of “shareholder” (that is the part dealing with the deemed shareholder) was thus a reference to beneficial ownership. (However, it should be noted that, as will transpire from the discussion below, this part of the definition was *not* limited to the beneficial owner of a share.) This link between the definitions of “shareholder” and “beneficial owner” is strengthened by the similarities in the wording of the two definitions.¹⁸²¹ It will be recalled that the current definition refers to “the person *entitled* to the *benefit* of the dividend attaching to a share”. It would have been noted, too, that both definitions were introduced with regard to provisions

¹⁸¹⁶ Emphasis added. See also s 37(a), which reads:

“The amount of the taxable income of a private company ... shall be apportioned ... among those persons who were shareholders of the company on the specified date, according to the *rights* of each such shareholder to participate in the profits or income of the company as determined in accordance with the provisions of section thirty-six...” (emphasis added).

See also the discussion of this distinction in *Bell’s Trust v CIR* (1948) 15 SATC 255 265.

¹⁸¹⁷ See, e.g. *Bell’s Trust v CIR* (1948) 15 SATC 255.

¹⁸¹⁸ 266 (emphasis added).

¹⁸¹⁹ Taxation Laws Amendment Bill 19 of 2011.

¹⁸²⁰ Emphasis added.

¹⁸²¹ See also *Davis Tax Committee’s Interim Report on Action Plan 6* 66-67, where reference is made to this definition of “shareholder” in the context of its discussion of the definition of “beneficial owner”.

dealing with the taxation of company profits (although, of course, the methods of taxation differed substantially).

As a concluding remark it should be noted that no indication was given as to why the term “beneficial owner” was chosen for the dividends tax. The term “shareholder” was presumably discarded due to its association with the person whose name appears in the company’s register.¹⁸²² The term “beneficial owner” was nevertheless an unexpected choice, given the association in the area of company law of the term with the holder of the bundle of personal rights that comprise the *share* conjunctively.¹⁸²³ Dividends tax, however, is concerned with the “beneficial owner” of dividends, not all the personal rights that comprise the *share* conjunctively. It is thus closer to the holder of the “beneficial interest” in a share as far as it relates to dividends.¹⁸²⁴ One possible reason for choosing the term “beneficial owner” (but this is pure speculation) is that it was to provide a link between the terminology used for purposes of dividends tax and the articles in South African DTAs dealing with the taxation of dividends. If so, it signalled the legislator’s intent that the term in South African DTAs should have the domestic meaning under the ITA. Counting against this argument is the fact that the provisions dealing with the withholding taxes on interest and royalties were not similarly amended, bearing in mind the project carried out in 2012 to bring these three withholding taxes more in line with one another.¹⁸²⁵ As pointed out in part 9.2.2.2, these provisions do not include the term “beneficial owner”.

9.4.1.2 Case law on the meaning of “shareholder”

The definition of “shareholder” in the ITA was discussed in a number of South African cases.¹⁸²⁶ These cases are discussed in chronological order except for a number of cases dealing with trusts, which are grouped together at the end of the discussion.

¹⁸²² For the position under the 2008 Companies Act, see n 1783 above.

¹⁸²³ Part 3.4.

¹⁸²⁴ Part 9.3.3.

¹⁸²⁵ In the Explanatory Memorandum to the Taxation Laws Amendment Bill 34 of 2012 it was pointed out at 113 that many of the then differences between the withholding taxes relating to dividends, interest and royalties arose “due to the dates in which these provisions were enacted”. It was also said that these differences complicated administration and compliance. In order to ensure better uniformity it was proposed that the provisions dealing with these withholding taxes “be unified to the extent possible”. It was also said that “[i]n the main, these changes will require adjustments to the interest and royalty withholding regimes because the rules around the recently enacted Dividends Tax have been well-debated and settled.”

¹⁸²⁶ Only the cases most relevant to this study are discussed here. Cases not discussed in this study include *ITC 530* (1942) 12 SATC 443, *ITC 636* (1947) 15 SATC 120 and *Brodie v SIR* 1974 (4) SA 704 (A).

9.4.1.2.1 *ITC 535*

*ITC 535*¹⁸²⁷ concerned a verbal agreement for the sale of shares to the seller's children. The shares were transferred to the purchasers and registered in their names. The parties agreed that the purchase price of the shares (calculated as a set amount per share) was to be paid out of dividends due to the purchasers in respect of the shares. It is not stated what would have happened, had no dividends been declared by the company.

The issue that arose was whether the portion of the taxable income of the company attributable to the sold shares after the sale should have been attributed to the seller or the purchasers respectively under the 1941 ITA. The Commissioner argued in favour of the former since the sale agreement left the seller "in full enjoyment of the rights of the income of the shares" until the entire purchase price was paid.¹⁸²⁸

The court stressed that it regarded the transaction as "bona fide" and "genuine" and approached the issue by considering the definition of "shareholder".¹⁸²⁹ Although the court did not agree that the expression "in full enjoyment" was "quite accurate", it held that the definition did not require that the person should have a "right" of participation. Instead having the "benefit" of the right of participation would suffice, such as in this case where the seller would be paid out of the dividends received.¹⁸³⁰

9.4.1.2.2 *Snider v Commissioner for Inland Revenue*

In *Snider v Commissioner for Inland Revenue* ("*Snider*")¹⁸³¹ the taxpayer (Snider) had donated shares in a private company to his wife and children.¹⁸³² The judgment dealt with the issue of whether Snider had a usufruct in respect of these shares in favour of himself.¹⁸³³ Based on the view that he had, the Commissioner continued to view Snider as a "shareholder" in respect of these shares for purposes of section 37 of the 1941 ITA.

¹⁸²⁷ *ITC 535* (1942) 13 SATC 98.

¹⁸²⁸ 99.

¹⁸²⁹ Since the seller had not sold all of his shares, he remained a registered shareholder and thus a "shareholder". Arguably the court should have therefore focused on the application of s 36, rather than on the definition of "shareholder". This point was made in *Hulett v Commissioner for Inland Revenue* 1946 NPD 47 56 (discussed in part 9.4.1.2.3) on the facts of that case. However, as pointed out in part 9.4.1.1, s 36 of the 1941 Act did not include the word "benefit" and the apportionment was to be made according to each shareholder's "right" to participate. One wonders how the difference in wording would have affected the outcome in this matter, had s 36 been considered.

¹⁸³⁰ *ITC 535* (1942) 13 SATC 98 99.

¹⁸³¹ *Snider v Commissioner for Inland Revenue* 1945 WLD 250.

¹⁸³² The company had previously taken over most of Snider's revenue producing assets.

¹⁸³³ *Snider v CIR* 1945 WLD 250 251.

In its interpretation of the documentation, the court found that Snider did not have a usufruct over the shares, but only a “right to claim a usufruct” in future.¹⁸³⁴ The court also indicated that, in order to determine whether Snider was a “shareholder”, one had to decide whether he was “entitled to the dividends”.¹⁸³⁵ The court placed emphasis on the word “entitled” in the definition of “shareholder” and since Snider “could not in law claim any interest whatsoever in that portion of the profit of the company” attributable to the donated shares, he was not a “shareholder” in the relevant year.¹⁸³⁶

9.4.1.2.3 *Hulett v Commissioner for Inland Revenue*

The case of *Hulett v Commissioner for Inland Revenue* (“*Hulett*”)¹⁸³⁷ is an interesting one. In this case, the taxpayer had transferred his farm and others assets to a company that was formed for this specific purpose in return for the issue of shares in the company. He subsequently donated most of the shares in this company to his wife and children and these shares were transferred to and registered in their names. The taxpayer became managing director for life of the company in terms of the company’s articles of association, had special veto rights with respect to increases in the capital of the company and alterations of the articles and borrowed large sums of money from it. He also had a casting vote which meant that he controlled the company for as long as there was only one other director, but not if the maximum number of six directors were appointed.

The Commissioner included under section 37 of the 1941 ITA all the undistributed profits of the company in the taxpayer’s taxable income. Despite evidence led by the taxpayer that there was no agreement between the taxpayer and his children that any of the “income of the company” should be allocated to him, the Special Court held in favour of the Commissioner. The court referred to the “extent of the control which [the taxpayer] has reserved to himself ..., coupled with the fact that the children have not exercised such rights as might in some degree limit that control”¹⁸³⁸ and “the actual course of the treatment of the company’s profits”.¹⁸³⁹ Although not stated in the judgment, it seems clear that the Commissioner was

¹⁸³⁴ 256.

¹⁸³⁵ 254.

¹⁸³⁶ 255. Cameron et al *Honoré’s South African Law of Trusts* 448 questions the correctness of this decision.

¹⁸³⁷ *Hulett v CIR* 1946 NPD 47.

¹⁸³⁸ The High Court’s view of the facts, as expressed at 54 and 58, was that the control of the company rested with the shareholders, who could have appointed additional directors. Such additional directors would have largely neutralised the taxpayer’s casting vote, as explained in the main text.

¹⁸³⁹ 52-53 (emphasis added).

concerned that the company was formed, and the various transactions entered into, in order to reduce the taxpayer's income tax liability.

Since a few shares in the company were still registered in the taxpayer's name, he was a "shareholder" of the company. The issue was thus not whether the taxpayer was a "shareholder", but rather which portion of the company's profits should be attributed to him under section 36 of the 1941 ITA.¹⁸⁴⁰

The court held that the "rights" of each shareholder to participate in the income of the company as determined under section 36 referred to "legal rights". These "legal rights" were to be determined from the company's articles of association and other relevant documents.¹⁸⁴¹

The court indicated further that the inquiry should be whether the taxpayer would have been able to claim the portion of the undistributed profits had the company distributed those profits on the specified date.¹⁸⁴² The fact that the taxpayer could by virtue of his powers under the company's articles in future participate in the company's profits,¹⁸⁴³ was not relevant. What was relevant was that he had not, in fact, used his control to participate in the profits.¹⁸⁴⁴ Based on this analysis of the meaning of the word "rights", the court found against the Commissioner.

The court also at various places in its judgment emphasised that there was no argument of a sham being present. The court pointed out the following:

"I must repeat that other considerations would have applied if the commissioner, in making his original assessment or before the Special Court, had proceeded on the basis that the company's incorporation or the transactions of the company or of the taxpayer were not what they purport to be but were in truth a sham. In that case the enquiry before the Special Court would have been as to the true facts... Other considerations also would have applied had it been possible for the commissioner to invoke [the GAAR in] section 90. It is common cause that he could not

¹⁸⁴⁰ 56. See also the remark by the court at 55 that "section 36 is the operative section and the Commissioner's determination under that section will automatically settle who the shareholders, as defined in section 33(4), really are". But compare *Bell's Trust v CIR* (1948) 15 SATC 255 264-265, where the court set out the following steps for the apportionment of the taxable income of private companies to their shareholders: firstly, ascertainment of the "specified date"; secondly, *identification of the shareholders*; and thirdly, determination of the extent of the rights of each shareholder to participate in the profits of the company.

¹⁸⁴¹ *Hulett v CIR* 1946 NPD 47 57.

¹⁸⁴² 57-58, but see *Bell's Trust v CIR* (1948) 15 SATC 255 266 (discussed in part 9.4.1.2.7) for criticism of this test.

¹⁸⁴³ The court listed the following examples of how the taxpayer could have participated in the company's profits: by ensuring that the company forego repayment of the loans made to him or by donations made to him.

¹⁸⁴⁴ *Hulett v CIR* 1946 NPD 47 57.

have done so because the transactions in question were entered into prior to the enactment of Act No. 31 of 1941.”¹⁸⁴⁵

9.4.1.2.4 ITC 695

In *ITC 695*¹⁸⁴⁶ the taxpayer had entered into an agreement to purchase shares from the registered shareholder in a private company. Having failed to honour this agreement, judgment was handed down against the taxpayer for payment of the purchase price. However, it seems that, at the relevant date, the shares had not yet been ceded to the purchaser. The question that arose was whether the seller was a “shareholder” as defined in the 1941 ITA to which the profits of the company could be attributed under section 37 of the 1941 ITA.

The court agreed that the purchaser was a “shareholder” since he was “liable for the risk of the shares, and similarly was *entitled to any income or profits* that might be made on the shares”, despite not having taken transfer of the shares. It also held that, at the relevant date, the taxpayer “was entitled to the [company’s] profits accruing for the year”.¹⁸⁴⁷

9.4.1.2.5 ITC 789

*ITC 789*¹⁸⁴⁸ was discussed in part 8.2. One of the companies involved in this case was a UK resident company, referred to as “A Company” in the judgment. This company had two classes of shares in issue. One of the classes was listed and owned by the general public, whilst the other class (the ordinary shares) was owned in its entirety by B Company. B Company’s share capital was structured similarly to that of A Company, with its ordinary shares being owned entirely by C Company. All of the shares of C Company were listed and held by the general public.

¹⁸⁴⁵ 58. At 54 the court also stated:

“[N]o attack has been made, either before the Special Court or before us, upon the validity of the company’s incorporation, or upon the validity of the transactions preceding incorporation or of the subsequent transactions of the company and the taxpayer. We must take it, therefore, that all these transactions are what they purport to be. Thus the case must be decided upon the basis that the taxpayer validly [entered into the various agreements].” See also 57 where the court held that it was “relieved of the necessity of enquiring whether these documents are not in truth a mere sham and whether the taxpayer’s legal rights are not in truth much more extensive than the documents suggest, for the Commissioner has not attacked them on this ground, ... nor has the Special Court so dealt with them”.

¹⁸⁴⁶ *ITC 695* (1950) 17 SATC 84. See also the reference to this case by De Koker & Williams *Silke on South African Income Tax* para 9.2 n 8.

¹⁸⁴⁷ *ITC 695* (1950) 17 SATC 84 85 (emphasis added). See also the statement at 85 that the taxpayer was “entitled to the proportion of the profits of the company which belonged to the ... shares”.

¹⁸⁴⁸ *ITC 789* (1954) 19 SATC 434.

The issue that arose was whether A Company could be regarded as a “public company” as defined in section 33 of the 1941 ITA. The definition of “public company” included at the time of the application of the facts companies in respect of which the general public was “substantially interested *as shareholders* in every class of the shares issued by the company”.¹⁸⁴⁹

The court rejected the argument that the public could be deemed to be “shareholders” of A Company by virtue of the fact that “dividends on the ordinary shares of [A Company] ultimately – via the B Company – reach those members of the general public who hold shares in the C Company”.¹⁸⁵⁰ The court contrasted the then definition of “public company” with a version prior to the amendment. The phrase “as shareholders” did not appear in the previous version of the definition of “public company”. In case law on this previous version it had been held that “interest” was wide enough to “embrace an indirect pecuniary interest”, including an indirect shareholding.¹⁸⁵¹

9.4.1.2.6 ITC 1378

*ITC 1378*¹⁸⁵² concerned the cession of the taxpayer’s right¹⁸⁵³ to receive dividends in respect of shares held in a private company for a specified period. The question that arose was whether dividends declared during this period had accrued to the taxpayer. The court, having found that a valid cession had taken place that resulted in a right having vested in the cessionary, held that the dividends did not accrue to the taxpayer.¹⁸⁵⁴

The court then stated:

“In view of the conclusion which I have reached above, it is not necessary for me to reach a final decision on the interesting and *compelling* argument which was advanced that, in any event, by virtue of the terms of the [cession], the [cessionary] is, under the definition of ‘shareholder’ in s 1 of the Income Tax Act, for purposes of the Act, deemed to be a shareholder

¹⁸⁴⁹ S 33(2)(b)(i) of the 1941 ITA (emphasis added).

¹⁸⁵⁰ *ITC 789* (1954) 19 SATC 434 439-440. The court held that this was true under both the definition of “shareholder” in s 33(4) of the 1941 ITA and the “ordinary natural meaning” of that word.

¹⁸⁵¹ 440.

¹⁸⁵² *ITC 1378* (1983) 45 SATC 230. See also the reference to this case by De Koker & Williams *Silke on South African Income Tax* para 9.2 n 8.

¹⁸⁵³ The questions whether this was a right, as opposed to a mere *spes*, and whether such a *spes* was capable of being ceded, were debated in the judgment at 232-233. The court at 233-234 disagreed that this was a *spes* (regarding it instead as a contingent right), but held that, even if it was a *spes*, a cession of a *spes* was permissible.

¹⁸⁵⁴ *ITC 1378* (1983) 45 SATC 230 234.

of [the company] and that the dividends accrue to the [cessionary] directly or through [the taxpayer] as a conduit. The definition is wide enough, it was submitted, to *include a person having an unregistered equitable interest in shares in a company.*¹⁸⁵⁵

9.4.1.2.7 *Bell's Trust v Commissioner for Inland Revenue*

In *Bell's Trust v Commissioner for Inland Revenue* (“*Bell's Trust*”)¹⁸⁵⁶ a trust was the registered shareholder of a private company. The trust deed provided that the trustees were to pay to the beneficiaries, or their descendants upon their death, the dividends that accrued on these shares. Any minor’s portion of the dividends was to be retained by the trustees until such time as the minor had reached majority. The issue that the court had to resolve was which portion of the undistributed taxable income of the company had to be attributed to the major beneficiaries under section 37 of the 1941 ITA.

The court considered the definition of “shareholder” in the 1941 ITA, explaining that where a registered shareholder was a “mere nominee” for the “real owner”, both of these were “shareholders”.¹⁸⁵⁷ On the facts, the court regarded both the trust and the major children as “shareholders”. In respect of the children, the reason given by the court was “because they [were] entitled to part of the benefit of rights of participation in the profits or income” attaching to the shares as provided in the definition of “shareholder”.¹⁸⁵⁸

The court then proceeded to determine the portion that had to be apportioned to them under section 36, which depended on the trust and major children’s “rights of participation”. It pointed out that under company law shareholders had no right to participate in the undistributed profits of a company. It disagreed with the test formulated in *Hulett*.¹⁸⁵⁹ As will be recalled, the test in *Hulett* was whether a shareholder could have claimed his share of the undistributed profits, had the company distributed these.¹⁸⁶⁰

The court pointed out that the major children had a right under the trust deed to participate in distributed profits only. With regard to undistributed profits, the trustees were not “mere nominees” in respect of the shares, but held them “not only on behalf of the [beneficiaries]

¹⁸⁵⁵ 235 (emphasis added).

¹⁸⁵⁶ *Bell's Trust v CIR* (1948) 15 SATC 255. See also the reference to this case by De Koker & Williams *Silke on South African Income Tax* para 9.2 n 8.

¹⁸⁵⁷ *Bell's Trust v CIR* (1948) 15 SATC 255 265.

¹⁸⁵⁸ 265.

¹⁸⁵⁹ *Hulett v CIR* 1946 NPD 47.

¹⁸⁶⁰ As mentioned in part 9.4.1.2.3.

but also on behalf of future unascertained beneficiaries”.¹⁸⁶¹ None of the undistributed profits could thus be apportioned to the major beneficiaries.

9.4.1.2.8 *Gundelfinger v Commissioner for Inland Revenue*

In *Gundelfinger v Commissioner for Inland Revenue* (“*Gundelfinger*”)¹⁸⁶² the AD also considered a testamentary trust. The beneficiaries of this trust were each entitled to receive a portion of dividends distributed in respect of shares in private companies owned by the trust. The question was whether any of the undistributed profits of these private companies could be apportioned to the beneficiaries under section 37 of the 1941 ITA.

The court pointed out that the facts differed from those of *Bell’s Trust*, where it was provided in the will that, upon the death of a beneficiary, his descendants will become entitled to his share of the trust income. No similar provision was included in this case. The court held that the undistributed profits could be apportioned to the beneficiaries and stated as follows:

“This *is* a case ‘where the registered shareholder holds shares as a mere nominee for persons who are in existence’... [T]he [trust beneficiary]’s rights vested immediately upon the establishment of the trust. If he were to die, his estate would benefit... The uncertainty in the case was not *whether* the appellant would receive the benefit, but *when* he would receive it.”¹⁸⁶³

9.4.1.2.9 *Secretary for Inland Revenue v Rosen*

Before discussing the case of *Rosen*,¹⁸⁶⁴ it may be prudent to mention the much older case of *Armstrong v Commissioner for Inland Revenue* (“*Armstrong*”).¹⁸⁶⁵ *Armstrong* was decided

¹⁸⁶¹ *Bell’s Trust v CIR* (1948) 15 SATC 255 267.

¹⁸⁶² *Gundelfinger v Commissioner for Inland Revenue* 1957 (2) SA 412 (A). See also the reference to this case by De Koker & Williams *Silke on South African Income Tax* para 9.2 n 8.

¹⁸⁶³ *Gundelfinger v CIR* 1957 (2) SA 412 (A) 419 (emphasis in the original).

¹⁸⁶⁴ *SIR v Rosen* 1971 (1) SA 172 (A).

¹⁸⁶⁵ *Armstrong v CIR* (1938) 10 SATC 1. The court in *SIR v Rosen* 1971 (1) SA 172 (A) also referred to an even earlier case, *ITC 136* (1928) 4 SATC 203. This case concerned (the husband of) a beneficiary in two estates administered in the Union of South Africa. These estates had received interest (and other income), which they had distributed to the beneficiaries. The question was whether parts of these distributions were exempt, being “interest received by or accruing to any person ...” under s 10(h) of the income tax legislation at the time. The court held at 208-209 as follows:

“It was true that the capital in the estates under which appellant’s wife benefited was under the control of the executors or trustees, but the income was clearly the income of the usufructuaries or beneficiaries... There was nothing in sec 10(h) as amended to indicate that the capital from which the income was derived must belong to or be under the absolute control of the taxpayer. If the trustees or executors in these estates invested a large portion of the capital which was under their administration in shares of dividend-paying limited liability companies carrying on business in South Africa, then the dividends received on these shares would be included in the income which was divided amongst the beneficiaries and the latter would surely be entitled to claim exemption from normal tax on the portion of their income represented by these dividends owing to the

before the definition of “shareholder” was introduced and dealt with a provision under the 1925 income tax legislation.¹⁸⁶⁶ This provision exempted “dividends ... received or accrued from any company” from normal tax. At that time, “dividends” was an undefined term. Furthermore, the exemption was silent on who the recipient of the dividend had to be.¹⁸⁶⁷

Mrs Armstrong was a beneficiary of a trust under which she would receive a stipulated amount each year. The trust received dividends and other amounts and paid the stipulated amount over to Mrs Armstrong. The question was whether parts of the amounts distributed to Mrs Armstrong could be exempt from normal tax by virtue of the above-mentioned exemption.

The court in *Armstrong* held in this regard:

“[T]he scheme of the Act [is] clearly ...that income derived from companies should, in the hands of the true recipients of it, be free of the tax which has already been deducted at the source. ... In my view, however, the idea was to free moneys derived from a source which has already paid the tax from being again subject to the tax... And the clear intention of the Act can only be effectively and generally carried out by exempting the person ultimately receiving such moneys. In the simple case I am now examining, namely, that of a trio comprising a company, the intervening trustee, and the beneficiary, it is manifest that in the truest sense the beneficiary derives his income from the company, for that income fluctuates with the fortunes of the company and the trustee can neither increase nor diminish it, *he is a mere ‘conduit pipe.’* This leads on to the firm conclusion that *the true test of exemption of the person beneficially entitled to the income is not the right to sue the company but the derivation of that income.*”¹⁸⁶⁸

The AD’s decision was thus to a large degree dependant on its view of the policy considerations underlying the exemption.¹⁸⁶⁹

companies already having paid normal tax thereon...For Income Tax purposes income should retain its identity until it reached the party in whose hands it is taxable and it should not be affected by the mere fact of its having passed through the hands of intermediaries, such as executors or trustees, in whose hands it was not taxable and who were merely acting as representatives of beneficiaries, usufructuaries, or clients...”

¹⁸⁶⁶ Income Tax Act 40 of 1925.

¹⁸⁶⁷ In the court *a quo* the court had read into this section the words “by the taxpayer”. The AD was, however, not prepared to do so, as discussed in *Armstrong v CIR* (1938) 10 SATC 1 6.

¹⁸⁶⁸ *Armstrong v CIR* (1938) 10 SATC 1 6-7 (emphasis added).

¹⁸⁶⁹ In *Commissioner of Taxes v R* (1966) 28 SATC 115 119 the court summarised the finding in *Armstrong v CIR* (1938) 10 SATC 1 as follows, emphasising the reliance placed on the policy of the income tax legislation: “*Armstrong’s* case was concerned with whether or not moneys which a beneficiary received and which were derived from dividends should be taxed in view of the fact that the dividends themselves had already been taxed in the hands of the company and that the clear policy of the Act, as it existed at that time, was that dividends should not be taxed twice.” See also *SIR v Rosen* 1971 (1) SA 172 (A) 187-188.

Turning now to *Rosen*, in this case a testamentary trust had received dividends in respect of shares of which it was the owner. Mrs Rosen had the right to receive a specified amount of money from the trust. One of the questions was whether at least a part of the amounts she had so received were “dividends” in her hands and thus qualified for exemption from normal tax.¹⁸⁷⁰ Under the (1962) ITA as it read at the time, a “dividend” was defined as “any amount distributed by a company ... to its *shareholders*”.¹⁸⁷¹ The definition of “shareholder” had remained virtually unchanged from the 1941 ITA¹⁸⁷² and the Commissioner argued that Mrs Rosen did not qualify as a “shareholder”.

The court disagreed.¹⁸⁷³ In a number of the AD’s statements are worth repeating here and I will come back to them in part 9.4.2.3. The courts confirmed that the definition of “shareholder” embraced the conduit principle and that the registered shareholder is a “mere conduit-pipe for passing the dividends on to the deemed shareholder, the *true* recipient”.¹⁸⁷⁴ This conduit pipe is “mostly apposite to trust cases”.¹⁸⁷⁵ As authority for its statements the court referred to *Armstrong*.¹⁸⁷⁶

The court then held:

“It follows that in my view the conduit principle operates for the purpose of [the exemption] when the beneficiary of the dividends *is a deemed shareholder as defined in the Act, i.e.*

‘entitled to all or part of the benefit of the rights of participation in the profits or income attaching to the shares’

registered in the trustees’ name. It is that crucial phrase that can render a trustee under a trust agreement a mere conduit-pipe in our present Act. *Mr. O’Donovan [for the Commissioner] contended, and this was his main argument, that for such a conduit-pipe to exist the beneficiary’s legal entitlement under the trust deed had to vest in him not merely a personal right of action against the trustee to secure the payment of trust income, but a jus in personam ad rem acquirendam, i.e. the right to receive from the trustee the whole or part of specific dividends or dividends on specified shares.*

That, however, puts too narrow a construction on the above crucial phrase in the definition of ‘shareholder’. It would virtually limit its applicability to the comparatively rare case where the

¹⁸⁷⁰ S 10(1)(k)(ii) of the ITA, as it read then, exempted from normal tax “dividends received by or accrued to or in favour of any person ...”.

¹⁸⁷¹ S 1 (emphasis added).

¹⁸⁷² As confirmed by the court in *SIR v Rosen* 1971 (1) SA 172 (A) 185.

¹⁸⁷³ 186.

¹⁸⁷⁴ 186 (emphasis added).

¹⁸⁷⁵ 186.

¹⁸⁷⁶ 187-188.

beneficiary is entitled to receive from the trustee the very dividend cheque issued to him by the company. *I think that its wording is manifestly wider than that. It is obviously wide enough and must have been intended to include the more usual case where the dividends vest in ownership in the trustee who is subjected to the beneficiary's mere personal right to receive his share of them ...* The beneficiary therefore had merely a *jus in personam* against the trustees for securing the payments to him, and not a *jus in personam ad rem acquirendam* in any sense. Notwithstanding that, the beneficiary's legal entitlement can still fall within the wide ambit of being

‘entitled to all or part of the benefit of the rights of participation in the profits or income attaching to the shares’

registered in the trustee's name, as was held in *Bell's Trust v C.I.R.*¹⁸⁷⁷

*It is unnecessary to decide in the present appeal what limitations, if any, should be placed on the wide language of that phrase, and to what extent it applies to cases other than trust cases. It suffices to say that the trust deed may itself entitle or oblige the trustee to administer the dividends in such a way that he is not a mere conduit-pipe for passing them on to the beneficiary, that in his hands their source as dividends can no longer be identified or they otherwise lose their character and identity as dividends, and that the beneficiary is thus entitled to receive mere trust income in contradistinction to the benefit of the dividend rights in terms of the above crucial phrase.*¹⁸⁷⁸

9.4.2 The definition of “beneficial owner” for purposes of dividends tax

The definition of “shareholder” included right up to its deletion the reference to the person “entitled ... to all or part of the *benefit*”. The current definition of “beneficial owner” also refers to a person “entitled to the *benefit*” of a dividend. Below the meanings of the words “benefit” and “entitled to” in unrelated contexts are briefly discussed before making a few observations following from the cases discussed above. These discussions may assist with an understanding as to how the definition of “beneficial owner” will be interpreted in the case of conduit company treaty shopping.

¹⁸⁷⁷ *Bell's Trust v CIR* (1948) 15 SATC 255, discussed in part 9.4.1.2.7.

¹⁸⁷⁸ *SIR v Rosen* 1971 (1) SA 172 (A) 189-190 (emphasis added).

9.4.2.1 The meaning of “benefit”

In a case concerning the interpretation of the expression “beneficially interested” in customs legislation,¹⁸⁷⁹ the SCA in *EBN Trading (Pty) Ltd v Commissioner of Customs and Excise* (“*EBN Trading*”)¹⁸⁸⁰ had to determine whether a company that argued that it was only a “financier” in respect of imported goods was “beneficially interested” in the goods. The court was referred to case law on the meaning of the expression,¹⁸⁸¹ but turned to the *Shorter Oxford English Dictionary* and noted that that dictionary gave the following meaning for “benefit”: “advantage, profit, ... pecuniary profit”.¹⁸⁸²

In the much earlier case of *Schutz and De Jager v Edelstein*¹⁸⁸³ the court considered the meaning of the term “benefit” in a provision contained in insolvency legislation. The defendant in this case had published a notice of intention to surrender his estate as insolvent and the *curator bonis* had endeavoured to arrange a common-law compromise with all his creditors. Under this compromise, the creditors were to accept reduced repayment of their claims. The plaintiffs, being creditors of the defendant, subsequently entered into an agreement with him in terms of which they agreed not to have him sequestered. In return he would repay their debts in full under revised time periods.

The question that arose was whether the plaintiffs had received a “benefit” as consideration for refraining from instituting sequestration proceedings. If so, the agreement would be void. The court held that the “ordinary meaning” of the word “benefit” is “advantage” or “profit”. It further held that in the context of the legislation it referred to a “benefit or advantage which other creditors do not get.”¹⁸⁸⁴

Lastly, for purposes of labour legislation, a South African court has held that employee “benefits” include not only those rights to which an employee may be entitled under a contract, but also a practice.¹⁸⁸⁵

¹⁸⁷⁹ The definition of “importer” in s 1 of the Customs and Excise Act 91 of 1964.

¹⁸⁸⁰ *EBN Trading (Pty) Ltd v Commissioner of Customs and Excise* 2001 (2) SA 1210 (SCA).

¹⁸⁸¹ Para [25].

¹⁸⁸² Para [24]. See also *National Railways of Zimbabwe Contributory Pension Fund v Edy* 1988 (2) ZLR 157 (SC) 161 where the court also quoted that dictionary with regard to the meaning of “benefit”.

¹⁸⁸³ *Schutz and De Jager v Edelstein* 1942 CPD 126.

¹⁸⁸⁴ 132-133.

¹⁸⁸⁵ In *Apollo Tyres SA (Pty) Ltd v Commission for Conciliation, Mediation & Arbitration and others* (2013) 34 ILJ 1120 (LAC) the court considered the meaning of the word “benefits” in the definition of an “unfair labour practice” in labour legislation, which defines it to mean “any unfair act or omission that arises between an employer and an employee involving - (a) unfair conduct by the employer relating to ... the provision of

It is thus clear that the word “benefit” potentially has a very wide meaning, referring to an “advantage” or “profit”.

9.4.2.2 The meaning of “entitled to”

When the expression “entitled to” is considered, Du Toit and Hattingh state that this expression “could suggest that there must exist a contractual nexus in the sense of an ‘entitlement’ to the dividend, though that is ... not clear.”¹⁸⁸⁶

There are several South African judgments in which the meaning of the words “entitled to” was considered. In *Burger v Commissioner for Inland Revenue* (“*Burger*”)¹⁸⁸⁷ a testator provided in his will that his administrators should set aside an amount that was to be used to care for Miss Burger in their discretion. The question was whether she became “entitled to” this amount, which would have had succession duty consequences.¹⁸⁸⁸ The court held that she was not entitled “in the legal sense”. It quoted UK case law which interpreted the word “entitled” in comparable legislation to mean having “a right to sue for and recover such property”.¹⁸⁸⁹

In *S v Marais* (“*Marais*”)¹⁸⁹⁰ legislation provided that articles seized by the state had to be forfeited to the state if the person, from whom it was seized, was not “entitled to” the article. The majority of the AD held that this referred to a person “legally entitled thereto”, who

benefits to an employee.” In this case, the employer had initiated an early retirement scheme (subject to management’s discretion) for some of its employees, but refused one of its employees (Hoosen) entry into the scheme. The court held at para 50:

“In my view, the better approach would be to interpret the term ‘benefit’ to include a right or entitlement to which the employee is entitled (*ex contractu* or *ex lege* including rights judicially created) as well as an advantage or privilege which has been offered or granted to an employee in terms of a policy or practice subject to the employer’s discretion. In my judgment ‘benefit’ in s 186(2)(a) of the Act means existing advantages or privileges to which an employee is entitled as a right or granted in terms of a policy or practice subject to the employer’s discretion.”

¹⁸⁸⁶ Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.6.3.

¹⁸⁸⁷ *Burger v Commissioner for Inland Revenue* 1956 (1) SA 534 (W).

¹⁸⁸⁸ The relevant legislative provision read:

“A succession shall be deemed to have accrued whenever any person has become *entitled to*, or to any interest in, any property ... (a) By virtue of any disposition made by any predecessor who has died...” (emphasis added). The comparable English legislation compared in this case referred to a person becoming “beneficially entitled to any property or the income thereof”.

¹⁸⁸⁹ *Burger v CIR* 1956 (1) SA 534 (W) 536. The Commissioner also argued that Burger had acquired an “interest” in the fund and became entitled to the income therefrom. The court did not agree with this since payment of any amounts to her was left to the discretion of the administrators.

¹⁸⁹⁰ *S v Marais* 1982 (3) SA 988 (A).

“would have to show that he could succeed in claiming the [seized article] in a civil action in a court of law”.¹⁸⁹¹

One has to remember that the object in case of the definition of “beneficial owner” in the ITA is a “benefit”. One should thus take note of a number of cases in which wider meanings were attached to the words “entitled to”. Perhaps most in point is *Snider*,¹⁸⁹² discussed in in part 9.4.1.2.2. In that case, the court attributed to the words “entitled to” in s 36 of the 1941 ITA the meaning of having in law a claim to an “interest” in the company’s profits.

In *Pretorius v Commissioner of Inland Revenue* (“*Pretorius*”)¹⁸⁹³ the court interpreted transfer duty legislation which provided for an exemption from duty where trust property was transferred by trustees to “the persons *entitled thereto*” under the trust deed. The court quoted from the *Oxford English Dictionary* which ascribed the following meaning to “entitle”:

“To furnish (a person) with a ‘title’ to an estate. Hence gen to give (a person or thing) a rightful claim to a possession, privilege, designation, mode of treatment etc.”¹⁸⁹⁴

The dictionary meaning quoted by the court is wide and not limited to where a person has a subjective right to sue for delivery of particular goods. This is indicated by the reference to someone having a “right” to a “privilege, designation, [or] mode of treatment”.

It is thus not clear that “entitled” will necessarily refer to someone being able to institute a claim in court for payment of the *dividend*. It may also refer to a person who has a claim to somehow *benefit* from the dividend. The case of *Armstrong*¹⁸⁹⁵ also confirms this.

9.4.2.3 Observations on the meaning of the definition of “beneficial owner” for purposes of this study

A number of observations regarding the definition of “beneficial owner” in the ITA that may be relevant in the context of conduit company treaty shopping can be made following the discussions above. All of these observations are made somewhat tentatively since none of the cases dealt with conduit company treaty shopping.

¹⁸⁹¹ 1004. But see the criticism by the minority per Viljoen AJ at 1013, who held that this fails to distinguish between “entitled to” and being “entitled to recover”.

¹⁸⁹² *Snider v CIR* 1945 WLD 250.

¹⁸⁹³ *Pretorius v Commissioner of Inland Revenue* 1986 (1) SA 223 (A).

¹⁸⁹⁴ 248.

¹⁸⁹⁵ *Armstrong v CIR* (1938) 10 SATC 1. See especially the last sentence of the paragraph quoted from that case in the main text corresponding to n 1868 above.

The first is that a “beneficial owner” is not limited to the holder of a share in the company.¹⁸⁹⁶ This was confirmed in *ITC 535*¹⁸⁹⁷ and *ITC 695*;¹⁸⁹⁸ *ITC 1378*¹⁸⁹⁹ also leaves open this possibility. The meaning is thus not to be confused with the “beneficial owner” of shares as often understood under South African case law in respect of companies.¹⁹⁰⁰ Instead, it is more comparable with a holder of a “beneficial interest” in shares relating to dividend rights, as defined in the 2008 Companies Act.¹⁹⁰¹

The words “entitled to” means “having a rightful claim to”, but it is important to note that the object of the entitlement is a “benefit”. The question is thus whether the direct recipient “has a rightful claim” to a “benefit”, not the dividend itself.¹⁹⁰² Related to this is the observation that a “beneficial owner” is not limited to a person who has a claim (enforced through the registered shareholder, if necessary) against the company in respect of declared dividends. In *ITC 535*¹⁹⁰³ the court held that, if a direct recipient is obliged to transfer to another person dividends that such direct recipient had received, that other person will be the “shareholder” and, likely now, the “beneficial owner”. This was the case even though that other person did not have a right against the company and the nature of the on-payment was not a dividend. The decision in *Rosen*¹⁹⁰⁴ is also relevant here. There the court stated that a trust beneficiary can in certain circumstances be regarded as a “shareholder” (and, probably, also now a “beneficial owner”), despite not having a right against the company. However, the court expressly refrained from deciding whether this finding will also apply to non-trust cases¹⁹⁰⁵ and one should not disregard the fact that the decision was influenced by the earlier case of *Armstrong*,¹⁹⁰⁶ which did not concern the definition of “shareholder”.

The word “benefit” can have a wide meaning, such as an “advantage”. According to Du Toit and Hattingh the definition of “beneficial owner” in the ITA “centres on ‘benefits’ alone”.

¹⁸⁹⁶ De Koker & Williams *Silke on South African Income Tax* para 9.43 agree. Olivier & Honiball *International Tax* 103 notes that the beneficial owner is not “necessarily the registered owner” of the share.

¹⁸⁹⁷ *ITC 535* (1942) 13 SATC 98, discussed in part 9.4.1.2.1.

¹⁸⁹⁸ *ITC 695* (1950) 17 SATC 84, discussed in part 9.4.1.2.4. See also the reference to this case by De Koker & Williams *Silke on South African Income Tax* para 9.2 n 8.

¹⁸⁹⁹ *ITC 1378* (1983) 45 SATC 230, discussed in part 9.4.1.2.6. See also the reference to this case by De Koker & Williams *Silke on South African Income Tax* para 9.2 n 8.

¹⁹⁰⁰ See part 3.4.

¹⁹⁰¹ Discussed in part 9.3.2.

¹⁹⁰² See also Kruger (2012) *BTCLQ* 14.

¹⁹⁰³ *ITC 535* (1942) 13 SATC 98, discussed in part 9.4.1.2.1.

¹⁹⁰⁴ *SIR v Rosen* 1971 (1) SA 172 (A), discussed in part 9.4.1.2.9.

¹⁹⁰⁵ 189-190.

¹⁹⁰⁶ *Armstrong v CIR* (1938) 10 SATC 1, discussed in part 9.4.1.2.9.

They note that this approach was discarded in *Prévost*.¹⁹⁰⁷ The problem with an approach that focuses on whether a person has benefitted, such as the one possibly followed in *Indofood (CA)*,¹⁹⁰⁸ was also pointed out in part 6.3.4.4.

It is, however, important to read the word “benefit” in the context in which it appears. SARS recognises that not everyone that “benefits from the holding of shares by another will necessarily be the beneficial owner of a dividend.”¹⁹⁰⁹ The question is thus what limitations can be imposed on the word “benefit”?

The court in *Rosen*¹⁹¹⁰ expressly left open this question, but *ITC 789*¹⁹¹¹ imposes an important limitation. According to *ITC 789*, in the case of a group of companies, the ultimate shareholders were not “shareholders” in lower-tier companies despite the argument they were entitled to the “benefit” of dividends received by the lower-tier companies. It is therefore also likely that they will not now be “beneficial owners” of dividends received by lower-tier companies. The view expressed by the court in a very different context in *The Princess Estate and Gold Mining Co Ltd*¹⁹¹² is also noteworthy. There the AD held that a sole shareholder does not hold a “beneficial interest” in the company’s assets for purposes of stamp duty legislation. The questions whether a shareholder has a “beneficial interest” in a dividend received by a company and whether a shareholder is “entitled” to “benefit” from a dividend received by a company are clearly not the same, but are also not that much different. A person who can “benefit” from dividends in many cases would have an “interest” in the dividends.¹⁹¹³

What these cases show is that, in the context of conduit company treaty shopping involving *entity conduits*,¹⁹¹⁴ the ultimate recipients are unlikely to be regarded as the beneficial owners of dividends received by the direct recipient merely by virtue of their shareholding in the direct recipient. The fact that there is possibly a tax avoidance motive should not affect this

¹⁹⁰⁷ Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.11. See the statement by the FCA in *Prévost Car Inc. v Canada* 2009 FCA 57 (CanLII) para [15], referred to in part 6.5.3.

¹⁹⁰⁸ *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] STC 1195.

¹⁹⁰⁹ Para 3.2.1 of South African Revenue Service *SARS’ Comprehensive Guide to Dividends Tax* (2015) available at <http://www.sars.gov.za/AllDocs/OpsDocs/Guides/LAPD-IT-G19%20-%20Comprehensive%20Guide%20to%20Dividends%20Tax%20-%20External%20Guide.pdf> (accessed on 19-07-2016).

¹⁹¹⁰ *SIR v Rosen* 1971 (1) SA 172 (A) 190, discussed in this context in part 9.4.1.2.9.

¹⁹¹¹ *ITC 789* (1954) 19 SATC 434, discussed in this context in part 9.4.1.2.5.

¹⁹¹² *The Princess Estate and Gold Mining Co. Ltd. v The Registrar of Mining Titles* 1911 TPD 1066 1077, discussed in part 3.4.

¹⁹¹³ See also the case of *EBN Trading (Pty) Ltd v Commissioner of Customs and Excise* 2001 (2) SA 1210 (SCA), mentioned in part 9.4.2.1.

¹⁹¹⁴ See the meaning of “entity conduits” in part 2.2.

deduction. Here one should keep in mind the conclusion in part 7.4 that, even when faced with tax avoidance, South African courts generally analyse transactions with regard to the legal rights of each party. It is true that the word “benefit” has a wider meaning than the word “right”, but the cases mentioned above serve as precedent for it not being wide enough to include indirect shareholding.

*Hulett*¹⁹¹⁵ may also be relevant here, although the court there did not consider whether the taxpayer was entitled to the “benefit of the rights of participation” and thus a “shareholder”. Instead, the court considered whether the taxpayer had the “right” to participate in the company’s profits had the company distributed these profits. The court accepted that, unless transactions are regarded as shams or unless anti-avoidance provisions apply, the taxpayer could not be regarded as having a right to participate in the profits of the company merely because of the tax benefits sought in this manner. It seems unlikely that the court would have reached a different conclusion had it been necessary to show that the taxpayer was also a “shareholder” (in respect of the shares that he had donated to his children). He would still not be “entitled” to the benefit of the right to participate in the company’s profits. Here it is also important to keep in mind that in that case evidence was lead (and it seems, accepted) that the shareholders (his children) were not obliged to pass on any dividends received. The issue in this case thus simply centred on the taxpayer’s relationship with the company, not with his relationship with the direct recipients of the dividends (the children).

Turning to conduit company treaty shopping involving *income* conduits¹⁹¹⁶ it is much more difficult to make deductions. The case of *Rosen* may be helpful despite the AD’s statement that its finding was limited to cases involving trusts.¹⁹¹⁷ In the case of a vested income beneficiary of a trust, it cannot be said to the trust beneficiary is “entitled to” “dividends” declared by a company. This is due to the interposition of a person (the trustee) who is neither an agent, nor a nominee between the trustee and the company declaring the dividend.¹⁹¹⁸ The court in *Rosen* justifies treating the trust beneficiary nevertheless as a “shareholder” by focusing on the term “benefit”. When considering this issue the AD referred back to *Armstrong*.¹⁹¹⁹ In *Armstrong* the court noted that “in the truest sense the beneficiary derives

¹⁹¹⁵ *Hulett v CIR* 1946 NPD 47, discussed in part 9.4.1.2.3.

¹⁹¹⁶ See the meaning of “income conduits” in part 2.2.

¹⁹¹⁷ For a discussion of this case from a point of view of beneficial ownership with regard to trusts, see Du Plessis *Critical Issues Regarding the OECD Model Tax Convention* 282-283.

¹⁹¹⁸ See part 3.3, in particular the main text corresponding to n 408 above.

¹⁹¹⁹ *Armstrong v CIR* (1938) 10 SATC 1, discussed in part 9.4.1.2.9.

his income from the company, *for that income fluctuates with the fortunes of the company* and the trustee can neither increase nor diminish it, he is a mere ‘conduit pipe.’ This leads on to the firm conclusion that the *true test* of ... the person beneficially entitled to the income is not the right to sue the company but the *derivation of that income.*” To paraphrase, the beneficiary can be said to be entitled to the “benefit” of the dividends because, failing the declaration of dividends by the company to the direct recipient (the trustee), such beneficiary has no right against the trustee.

Unfortunately the facts given in *ITC 535* are too scarce to confidently make deductions from this case. However, if the purchasers were only obliged to pay for the shares to the extent that they received dividends, the case reinforces the idea that the ultimate recipient (the seller) is entitled to the “benefit” of the dividend because, failing the declaration of dividends by the company to the direct recipient (the purchasers), he had no right against the purchasers.

What the discussion above shows, is that the definition of “beneficial owner” is unlikely to be of much assistance in combatting conduit treaty shopping involving, firstly, entity conduits. Secondly, when it comes to income conduits, the guidelines from trust cases such as *Rosen* suggest that the manner in which the definition is interpreted may not be all that different from the meaning given in *Prévost*.¹⁹²⁰ Accordingly, under the South African definition of “beneficial owner”, in the case of conduit company treaty shopping it is arguable that the beneficial owner is the direct recipient, unless such direct recipient is an agent or has a legal obligation to transfer funds to another person and that obligation only arises if and to the extent that such direct recipient receives the dividend. This is dependent on the legal rights created by the parties and under other applicable legal rules.

Furthermore, the decision in *Prévost (FCA)*¹⁹²¹ shows that, where courts can reconcile the international meaning of beneficial ownership with its domestic meaning, they will be inclined to do so, rather than choosing between the two.¹⁹²² In this way the two meanings can influence each other. This reinforces the conclusion that, despite the apparent wide nature of the definition of “beneficial owner” in the ITA, it is unlikely to be interpreted in this manner.

¹⁹²⁰ Part 6.6.3.2.

¹⁹²¹ *Prévost Car Inc. v Canada* 2009 FCA 57 (CanLII).

¹⁹²² See the conclusion in part 6.7.

9.5 The proposed domestic meaning of “beneficial owner” for purposes of the general *renvoi* clause in South African DTAs

The most appropriate domestic meaning to be put forward for purposes of the general *renvoi* clause in interpreting the article pertaining to dividends in South African DTAs in the context of conduit company treaty shopping is considered next. One has to bear in mind, though, that the context may require that this domestic meaning not be used. This follow-up question is considered under the next heading.

Article 3(2) of the OECD MTC provides that the meaning of the term in the “applicable tax laws” takes precedence over other meanings of the term. The best starting point is thus the use of the term in the ITA. As mentioned in part 9.4, the term “beneficial owner” is currently used in only two parts of the ITA. It is used in a provision in the Eighth Schedule to the ITA, which grants original “beneficial owners”, who dispose of their long-term insurance policies, exemption from CGT. The provision reads as follows:

“(1) A person must disregard any capital gain or capital loss determined in respect of a disposal that resulted in the receipt by or an accrual to that person of an amount - (a) in respect of a policy, where that person - (i) is the original *beneficial owner* or one of the original *beneficial owners* of the policy”.¹⁹²³

However, no definition is given as to who the “beneficial owner” of the policy is and it is unlikely to be of much assistance in giving meaning to the treaty term.¹⁹²⁴ As indicated in part 8.3, where more than one meaning exists under tax law and the treaty term is used in the part of the domestic legislation that imposes the restricted tax, the meaning of the term under that part is likely to be the most appropriate meaning.¹⁹²⁵ For this reason, it is proposed that the definition of “beneficial owner” under the part of the ITA dealing with dividends tax is the appropriate domestic meaning to be put forward.

Du Toit and Hattingh argue that this definition in the ITA cannot apply in the case of DTAs that were concluded before the inclusion of the definition in the ITA and which contain a pre-

¹⁹²³ Para 55(1)(a)(i) (emphasis added). The term “beneficial owner” is also used in the rest of sub-paragraph (a).

¹⁹²⁴ The Sixth Schedule to the ITA, before amendment by the Income Tax Act 65 of 1973, contained the following definition of the term “owner”: “in relation to an insurance policy, means the person in whom the rights conferred by the policy are vested as *beneficial owner*...”

¹⁹²⁵ See also part 8.6.1.

1995 version of Article 3(2). They argue that there is support in South African case law for the static approach in such cases.¹⁹²⁶

In reply to this argument, it has been argued in part 8.2 that it is not clear that South African courts adhere to a static approach. Even if they do, the possibility exists that the term “shareholder”, as previously defined in the ITA, is a comparable term to that of “beneficial owner”.¹⁹²⁷ As will be recalled, there is an argument that a meaning given to a different, yet comparable, term in domestic legislation may be used for purposes of the general *renvoi* clause.¹⁹²⁸ There is admittedly the problem that under the repealed definition of “shareholder” both the person whose name appeared in the company’s register and the deemed shareholder (the person entitled to the benefit of the rights of participation in the company’s profits) were “shareholders”. As indicated in part 9.2.2.1, it seems unlikely that the dividends tax provisions foresee more than one beneficial owner in respect of the same dividends.¹⁹²⁹ The definition would thus have to be read restrictively, arguably to be limited to the deemed shareholder. This is in line with the definition of a dividend, being an amount applied “for the benefit of or on behalf of” a person.

Should the context require that the definition in the ITA not be used, the possibility cannot be excluded that another domestic meaning may be used, which should then again be “tested” against the context.¹⁹³⁰ Using the meanings in South African statutory law has already been argued against in part 9.3. The question remains whether the analysis in chapter 3, of the manner in which the expression “beneficial owner” is used by South African courts, will provide a possible meaning.

It is noteworthy that in *Prévost (TCC)*¹⁹³¹ the court’s understanding of aspects of Canadian civil and common law strongly influenced the domestic meaning given by the court.¹⁹³² It is doubtful that the analysis in chapter 3 can serve a similar purpose. The use of the expression

¹⁹²⁶ Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.11.

¹⁹²⁷ See the discussion in part 9.4.1.1.

¹⁹²⁸ As discussed in part 8.4.

¹⁹²⁹ Other consequential changes will also have to be read in if the repealed definition of “shareholder” is to be used as a comparable term for “beneficial owner”. For example, since an amendment made by the Revenue Law Amendment Act 45 of 2003, the definition of “shareholder” referred not only to the person entitled to the benefit of participating in the profits of the company, but also the capital and from later on, also any of the rights attaching to the share. The same problems than those pointed out in part 9.3.2 may arise with regard to more than one person holding a “beneficial interest” as contemplated in the 2008 Companies Act in respect of the same share.

¹⁹³⁰ See Avery Jones’s view, referred to in part 8.3.

¹⁹³¹ *Prévost Car Inc. v The Queen* 2008 TCC 231.

¹⁹³² Part 6.5.2 and see also the discussion in part 6.6.3.2.

in South African law is too imprecise and too varied. An overview of the findings in chapter 3 illustrates this. The expression is sometimes used in South African case law to refer to the person who is the holder of the property and whose ownership attributes, especially those relating to use and enjoyment, have not been curtailed.¹⁹³³ Therefore, one can possibly argue that it will refer to a direct recipient whose ownership attributes (possibly limited to use and enjoyment) in respect of the dividends have not been curtailed. However, it has been argued earlier that it is extremely difficult to find a workable solution for “ownership attributes” when it comes to payment rights.¹⁹³⁴

The expression is also sometimes used in South Africa case law to refer to someone who has an “interest” in property.¹⁹³⁵ In the context of conduit company treaty shopping, it can thus refer to the ultimate recipient who may not have any rights to the dividend, but who has an “interest” in the dividend. However, not enough guidelines have been given in case law regarding what type of “interest” may suffice. For example, it was shown that the “interest” that a shareholder has in a company’s assets may be recognised to have consequences in law, but that this will depend on the context in which it is considered.¹⁹³⁶

Lastly, there is South African case law that uses the expression “beneficial owner” to refer to the person who is the real owner, following an application of the simulation and piercing of the corporate veil measures.¹⁹³⁷ However, that does not provide an alternative meaning as such.

The conclusion is that, should the definition of “beneficial owner” in the ITA not pass muster (in the sense that the context requires that it not be used), it is unlikely that any other domestic meaning will.

¹⁹³³ Part 3.5.2.1.

¹⁹³⁴ Part 6.6.3.2.

¹⁹³⁵ Part 3.5.3.

¹⁹³⁶ Part 3.4.

¹⁹³⁷ Part 3.5.2.2.

9.6 Whether the context requires that the domestic meaning not be used

What remains to be done, is to decide whether the context requires that the definition of “beneficial owner” in the ITA not be used to give meaning to the treaty term “beneficial owner”. Little guidance is given by foreign courts on this issue. Garibay, who analysed case law from several countries, concludes:

“It is only rarely that the courts adopted a step-by-step analysis, whereby they have identified the possible domestic meaning, discovered the existence of alternative meanings, found which is the ‘context’ of a specific undefined term and assessed which meaning better suits that ‘context’. More often than not, the courts have simply ‘jumped’ to a meaning, which could be the domestic law meaning, the international meaning or the dictionary meaning, without stating the reasons for selecting such an approach. In many cases, the domestic law meaning and the international tax meaning are similar, and the ‘context’ would not require the application of a different meaning, but the reasoning is not included in the decisions.”¹⁹³⁸

As pointed out in part 2.4,¹⁹³⁹ the majority of authors internationally argue that a domestic meaning for beneficial ownership should never be used. However, it is worth pointing out that not all scholars agree with this view.¹⁹⁴⁰ I question whether one can ever argue in the abstract, without considering a particular domestic meaning of the term “beneficial owner”, that the “context” requires that it not be used. The reason for this is that enquiry in each case is whether the context shows that the contracting states intended for the particular domestic meaning not to apply.¹⁹⁴¹

My discussion will, unfortunately, suffer from the same criticism. I have reached the conclusion in part 9.5 that, in the context of conduit company treaty shopping, the existing case law is too limited to make deductions with regard to income conduits especially. My discussion will thus necessarily not be able to evaluate the domestic meaning in light of the context.

¹⁹³⁸ Garibay (2011) *BFIT* heading 1.

¹⁹³⁹ See also part 5.2.3.

¹⁹⁴⁰ See, for example, Fraser & Oliver (2007) *BTR* 44, where one of the authors argues that, in the case of DTAs entered into by the UK, the meaning under UK common law should be used. See also further sources of this contrary view mentioned by Danon *Switzerland’s Taxation of Trusts* 330 and Li *Beneficial Ownership in Tax Treaties* 198.

¹⁹⁴¹ See also para 12 of the Commentary (1992) to Art 3. But see Oliver (2001) *BTR* 46 who argues that the phrase requires one to ask: “Did the drafters of the OECD Model in using the term beneficial owner in Articles 10, 11 and 12 intend that its meaning be obtained through a reference to domestic law?” (Emphasis added.)

If one turns to the views of South African scholars with regard to whether the definition of “beneficial owner” in the ITA will apply to give meaning to the term in South African DTAs, there are both support for and against such view. The authors of *Silke on South African Income Tax* argue in favour of the use of the definition for purposes of the general *renvoi* clause.¹⁹⁴² Opposed to this view are Oguttu, Du Toit and Hattingh, Olivier and Honiball and Du Plessis.¹⁹⁴³ Their arguments are addressed below, together with other reasons for why the context may require that a proposed domestic meaning not be applied to undefined treaty terms. Some of these arguments have been raised with regard to the term “beneficial owner” specifically, whilst others have been raised more generally with regard to undefined treaty terms.

Before considering these arguments, it may be recalled that the “context” is arguably a wide concept that may include the Commentaries.¹⁹⁴⁴ It may also be recalled that scholars have given diverse importance to the use of a domestic meaning under Article 3(2), ranging from it being “a last resort” to it being the default choice that can only be departed from if there are “reasonably strong” arguments to the contrary.¹⁹⁴⁵ From a South African perspective, the AD’s view in *Baldwins*¹⁹⁴⁶ arguably falls on the side of the latter. Here it is important to note that in *Baldwins* the court had considered the qualification “unless the context otherwise requires” with reference to case law on the meaning of the phrase in a definition in domestic legislation. According to the court’s approach, it is as if the contracting parties had expressly agreed that the undefined treaty term would have the meaning as defined in the South African legislation. The only exception is if the context “clearly” provides otherwise or if there are

¹⁹⁴² De Koker & Williams *Silke on South African Income Tax* para 9.43 remark:

“As regards the effect of the Canadian courts’ interpretation of beneficial ownership [in *Prévost Car Inc. v The Queen* 2008 TCC 231 and *Velcro Canada Inc. v the Queen* 2012 TCC 57 (CanLII)], the South African courts have frequently pointed out that the decisions of the courts of other countries must be cautiously approached owing to the difference in the basis of taxation applicable in foreign countries. In the South African context, the term ‘beneficial owner’ is a statutorily defined term (in s 64D) and our courts will first have regard to the plain meaning of the words used in the context of South African law and will not regard them as the tip of an English law iceberg. The decisions in *Prévost* and *Velcro* may be most valuable and may very well influence South African courts” (footnote omitted).

¹⁹⁴³ Oguttu *Offshore Tax Avoidance* 570-571; Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) paras 9.3 and 9.11; Olivier & Honiball *International Tax* 548; Du Plessis *Critical Issues Regarding the OECD Model Tax Convention* 255. Cilliers “Anti-Avoidance” in *Silke on International Tax* (2010) para 46.38 states that South African courts will “probably in principle be prepared to adopt an ‘international tax meaning’” and bases his argument on South African case law recognising “international tax language”.

¹⁹⁴⁴ Part 8.7.1.

¹⁹⁴⁵ Part 8.7.2.

¹⁹⁴⁶ *Baldwins (South Africa) Ltd v CIR* (1961) 24 SATC 270, discussed in this context in part 8.7.3.1.

reasons “of weight”. The position of the SCA in *Tradehold*¹⁹⁴⁷ is less clear, but probably does not support the “as a last resort” argument.

It is also important to bear in mind that Article 3(2) presupposes that treaty parties can have different meanings for the same treaty term.¹⁹⁴⁸ Du Toit, however, argues that where “beneficial owner” does not have a meaning in the domestic law of both the contracting parties, the general *renvoi* clause can almost never be applied.¹⁹⁴⁹ Avery Jones also argues that, if there is a domestic meaning in the one treaty country, the purpose of the term will usually be best served if a common interpretation for beneficial ownership is given.¹⁹⁵⁰

The Commentary to Article 3 includes in the “context” of Article 3(2) the meaning of the other contracting state.¹⁹⁵¹ Avery Jones says of this provision:

“The Commentary to Article 3 of the OECD Model may also have in mind the situation where *the purpose of the tax treaty would be served* by giving the term a common meaning, although there is a domestic law meaning of the term in one of the sates. The absence of a domestic law meaning in the other state would be context that might indicate that the domestic law meaning should not be used in the first state”.¹⁹⁵²

However, Pijl argues that the Commentary is unclear and does not explain the consequences should the other contracting party not define a term. He concludes that “invoking this element ... is not likely to succeed” in displacing a domestic meaning.¹⁹⁵³

There is thus no automatic disqualification of a domestic meaning if the treaty partner does not have a domestic meaning. The OECD in a 2010 report acknowledged this possibility in respect of the beneficial ownership requirement in the following statement:

“Because the term ‘beneficial owner’ is not defined in the Model, it ordinarily would be given the meaning that it has under the law of the State applying the Convention, unless the context otherwise requires. Accordingly, a Contracting State might consider itself entitled to decide

¹⁹⁴⁷ *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA), discussed in this context in part 8.7.3.2.

¹⁹⁴⁸ Parts 4.5 and 8.1.

¹⁹⁴⁹ Du Toit *Beneficial Ownership of Royalties* 177. See also Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.3.

¹⁹⁵⁰ Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 8.2.4.2.2.

¹⁹⁵¹ Paragraph 12 of the Commentary (1992) to Art 3 provides:

“However, paragraph 2 specifies that this applies only if the context does not require an alternative interpretation. The context is determined in particular by the intention of the Contracting States when signing the Convention *as well as the meaning given to the term in question in the legislation of the other Contracting State (an implicit reference to the principle of reciprocity on which the Convention is based)*. The wording of the Article therefore allows the competent authorities some leeway” (emphasis added).

¹⁹⁵² Avery Jones “Treaty Interpretation” in *Global Tax Treaty Commentaries* (2015) para 8.1 (emphasis added).

¹⁹⁵³ Pijl (2000) *BFIT* 260.

effectively the question with respect to CIVs investing in that State, *even if the country of residence would take the opposite view.*”¹⁹⁵⁴

Keeping all of the above in mind, I turn to the first consideration. Many scholars argue that, if the Commentaries adopt a meaning that differs from the domestic meaning of an undefined treaty term, it is an indication that the domestic meaning should not be used.¹⁹⁵⁵ (The Commentaries can thus feature twice in the interpretation of an undefined treaty term: as part of the “context” in determining whether a proposed domestic meaning will not be used to give meaning to the treaty term; and, if that domestic meaning is not used, in giving meaning to the treaty term under the Vienna rules.)¹⁹⁵⁶ The reason given for this view is that the meaning in the Commentaries is likely the meaning that was intended by the contracting countries when the treaty was negotiated (rather than the domestic meaning).¹⁹⁵⁷ Ward et al adopt a somewhat more cautious approach, arguing that “in most cases” the domestic meaning will have to give way. De Broe agrees that the context would provide otherwise if there is a meaning in the Commentaries, provided that such meaning is “clear”.¹⁹⁵⁸

With regard to the beneficial ownership requirement, it was also pointed out in part 2.5 that it is commonly understood that the Commentaries themselves prescribe the use of an international meaning. Many scholars agree that, in light of the argument above and due to the fact that an explanation of beneficial ownership is given in the Commentaries, that explanation should trump any domestic meaning.¹⁹⁵⁹ Whether case law supports the conclusion that the meaning in the Commentaries is clear enough to serve that purpose, is, however, doubtful as shown by the diverse outcomes mentioned in part 6.7.

Pistone also points out that in a country where the Commentaries are not given much weight by the courts, the possibility of a domestic meaning of beneficial ownership being applied,

¹⁹⁵⁴ *The Granting of Treaty Benefits with respect to the Income of CIVs Report* para 31. See also *Report of the Informal Consultative Group on the Taxation of CIVs* para 34 (pointed out by Jiménez (2010) *World Tax J* 56 n 97). Therefore, if the one state has a domestic meaning, but not the other state and the latter adopts an international meaning, it does not automatically disqualifies the former state from using its domestic meaning.

¹⁹⁵⁵ Garibay (2011) *BFIT* headings 1 and 3.3.

¹⁹⁵⁶ As discussed in part 4.4.1.

¹⁹⁵⁷ See the discussion in part 4.4 and De Broe *International Tax Planning* 655. See also Ward et al *Interpretation of Income Tax Treaties* 31. Kandeve (2007) *Can Tax J* 50 and 53 seems to support this view, but not necessarily if one of the treaty partners is not a member of the OECD.

¹⁹⁵⁸ De Broe *International Tax Planning* 671.

¹⁹⁵⁹ Waters, referred to in Ward et al *Interpretation of Income Tax Treaties* 20 and Ward et al *Interpretation of Income Tax Treaties* 31; De Broe *International Tax Planning* 671.

increases.¹⁹⁶⁰ The use of the Commentaries by South Africa courts was discussed in part 7.5.6. It was concluded there that reference by South African courts to the Commentaries is unpredictable; and that, although the courts admit to the value of the Commentaries, they have no qualms about not adhering to the Commentaries.

Whether the fact that the Commentaries has a meaning for beneficial ownership will result in the South African domestic meaning not applying, will thus depend, first of all, on whether the South African court will refer to the Commentaries. Secondly, it will depend on which of the two arguments the court find more convincing: that the contracting states intended for the (unclear) meaning in the Commentaries to apply, or that the contracting states would have had the domestic meaning in mind when concluding the DTA. As explained in part 4.5, it is sometimes argued that treaty negotiators may have a domestic meaning in mind when negotiating a treaty. This may especially be the case when it comes to the South African definition of the term “beneficial owner”, bearing in mind that the definition is used in the part of the ITA dealing with the dividends tax.¹⁹⁶¹ The definition is thus likely to be very much in the minds of the South African treaty negotiators when negotiating when South Africa will be prepared to grant a reduction in the rate of dividends tax. It should also be pointed out here that Kandeve is of the view that, if there is an exhaustive definition in the domestic law that is used in the context of levying the restricted tax, there is a strong argument that the context does not require otherwise and that the domestic meaning should be used.¹⁹⁶²

Another argument sometimes raised is that “context” should also include foreign case law. (Similar to the role of the Commentaries, case law may thus not only be taken into account to determine the international meaning of an undefined treaty term, but also to determine whether a domestic meaning should not apply.)¹⁹⁶³ Oguttu argues with reference to the decision in *Indofood (CA)*¹⁹⁶⁴ that an international meaning be given to the treaty term “beneficial owner” instead of the domestic definition in the ITA.¹⁹⁶⁵ Du Toit and Hattingh argue in this regard that section 233 of the Constitution requires “that regard must be had to the international law position” which means that foreign case law on DTAs should be taken

¹⁹⁶⁰ P Pistone “Italy: Beneficial Ownership as Anti-Abuse Provision in International Taxation” in M Lang, P Pistone, J Schuch, C Staringer & A Storck (eds) *Beneficial Ownership: Recent Trends* (2013) 175.

¹⁹⁶¹ Part 9.2.2.1.

¹⁹⁶² Kandeve (2007) *Can Tax J* 69.

¹⁹⁶³ Part 7.6.3.1.2.

¹⁹⁶⁴ *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] STC 1195.

¹⁹⁶⁵ Oguttu *Offshore Tax Avoidance* 570-571.

into account.¹⁹⁶⁶ It was indicated in part 7.2 that it is not clear that this is what section 233 of the Constitution prescribes. It is nevertheless agreed that foreign case law may be of assistance. It is important to keep in mind that one is not at this stage of the enquiry attempting to give an international meaning to the treaty term, but rather to determine whether the context requires that the proposed domestic meaning not be used.

Arguably most of the cases discussed in chapter 6 apply an international meaning. Leaving aside the decisions in the *Prévost*¹⁹⁶⁷ (where the TCC arguably adopted a domestic meaning, which the FCA found to be similar to the international meaning), none of those cases mentions the general *renvoi* clauses despite the fact that each of the applicable DTAs included such a clause. These cases thus provide no explanation for the manner in which the courts considered this issue (if at all). That might be explained by virtue of the fact that the cases were all civil-law jurisdictions and there was simply no domestic meaning.¹⁹⁶⁸ In conclusion it can be said that foreign case law does not give clear guidance on whether the context requires that a domestic meaning of beneficial ownership not be used in a treaty context.

Another consideration is whether the treaty term forms part of the “international tax language”, discussed in part 4.2.¹⁹⁶⁹ It is sometime argued that, if so, the term should not be given a domestic meaning.¹⁹⁷⁰ Olivier and Honiball suggest that the reason for this approach is that the use of such language is an indication that the parties intended for the term to have its international meaning.¹⁹⁷¹ With regard to beneficial ownership, the argument is thus that it is part of the “international tax language” and should be given an international meaning. A related argument is that beneficial ownership “as an international tax term has its genesis” in the OECD MTC and that it should thus not have its domestic meaning.¹⁹⁷²

Although it may be argued that the employment of a term that forms part of the “international tax language” is an indication that it should have an international meaning, it does not follow that the parties could never have intended for the domestic meaning to be used. Otherwise, it

¹⁹⁶⁶ Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.13 (footnotes omitted).

¹⁹⁶⁷ *Prévost Car Inc. v The Queen* 2008 TCC 231 and *Prévost Car Inc. v Canada* 2009 FCA 57 (CanLII).

¹⁹⁶⁸ Part 6.7.

¹⁹⁶⁹ See also part 8.6.2.2.

¹⁹⁷⁰ Vogel & Prokisch “Interpretation - General Report” in *Cahiers Vol. 78a* (1993) 61-62. See also the sources quoted by Du Toit *Beneficial Ownership of Royalties* 173-174.

¹⁹⁷¹ Olivier & Honiball *International Tax* 544.

¹⁹⁷² Du Toit *Beneficial Ownership of Royalties* 177-178 and see n 238 above.

raises the OECD MTC (or the Commentaries, if that is the source of the “international tax language”) to the status of a treaty. Clearly, a contracting party is allowed to include in a DTA a definition of a treaty term¹⁹⁷³ that is at odds with the meaning as understood in “international tax language”. If this view is accepted, the possibility that a contracting party may introduce a domestic meaning under the general *renvoi* clause, which is at odds with that meaning, cannot be discarded out of hand. One is reminded of the meaning of “international tax language”, mentioned in part 4.2. According to that meaning, the “international tax language” is the “common international understanding” of treaty terms and, if contracting parties use such a term, they usually intend for it have this international meaning, “unless they prefer to give the term a special meaning, either by formulating a special definition of the term *or by using a term which has a clear relation to domestic law.*”¹⁹⁷⁴

It is also noteworthy that in a number of countries where a meaning is given to the term “beneficial owner” in domestic tax legislation (inserted after 1977), such as Italy,¹⁹⁷⁵ Brazil,¹⁹⁷⁶ the US¹⁹⁷⁷ and the Netherlands,¹⁹⁷⁸ there is at least some support for the domestic meaning to be applied although most of the support notably comes from the tax authorities in those countries.

A number of arguments regarding why the anti-abuse nature of the beneficial ownership requirement points to the context requiring otherwise was already dealt with in part 5.2.3. I mention another one here. It has been argued that if treaty benefits are to be granted in abusive situations under the domestic law meaning, the context may require that the domestic

¹⁹⁷³ See, for example, the inclusions in the definitions of “beneficial owner” in the New Zealand and Singapore DTAs, mentioned at n 17 above.

¹⁹⁷⁴ Prokisch, quoted in Du Toit *Beneficial Ownership of Royalties* 182.

¹⁹⁷⁵ As discussed by Avella (2015) *Euro Tax* 61-62.

¹⁹⁷⁶ As discussed by Rocha (2012) *BFIT* 358.

¹⁹⁷⁷ As discussed by Oliver et al (2000) *BFIT* 314; Danon *Switzerland's Taxation of Trusts* 329 and De Broe et al (2011) *BFIT* 388.

¹⁹⁷⁸ Wet op de dividendbelasting 1964 s 4(3). Collier (2011) *BTR* 698 translates this negative definition as follows:

“Under this legislation, a recipient of a dividend is not considered to be a beneficial owner when it has in conjunction with the dividend received (the proceeds) given a consideration as part of a series of structured transactions, and it is likely that the proceeds, either wholly or partially, have benefited another person who would have been subject to greater dividend withholding tax, and this person has directly or indirectly retained the same or a similar position in the underlying equity instruments. A structured transaction may also include a transaction through a regulated stock exchange.”

Pijl (2000) *BFIT* 259-260 argues that a previous version of the definition can apply in a treaty context, as does the Dutch tax authority, as pointed out by De Broe et al (2011) *BFIT* 388. Smit “Beneficial Ownership in Netherlands Case law” in *Beneficial Ownership* (2013) 74-75, however, regards the definition as a form of treaty override that should not be applied to give meaning to the term “beneficial owner” in Dutch DTAs. For similar reasoning, see Van Weeghel & De Boer (2006) *BFIT* 364.

meaning not be used.¹⁹⁷⁹ Garibay argues that this is supported by case law.¹⁹⁸⁰ Kandev explains why this may be the case. He argues that, in determining the domestic meaning of a term, it is the context in which the term is used in the domestic law that is relevant for determining the domestic meaning that may be given to the treaty term, not that of the treaty. Therefore, if the treaty term is used in domestic law in a context not aimed at countering abusive practices, the term should be interpreted in that manner. When deciding whether the context requires that the proposed domestic meaning not be used in interpreting the treaty, it is more likely that the finding will go against the domestic meaning being used.¹⁹⁸¹ Therefore, if the meaning of beneficial owner in the ITA does not address conduit company treaty shopping, but the international meaning does, the context may require that the domestic meaning not apply.

Lastly, Du Toit and Hattingh argue that it would be undesirable for the definition of “beneficial owner” in the ITA to be used in relation to dividends under the DTA, whilst other meanings are used in relation to interest and royalties under the same DTA.¹⁹⁸² As was noted earlier,¹⁹⁸³ the reference to “context” in Article 31(1) of the Vienna rules implies that if identical terms are used in a DTA they are presumed to have the same meaning unless a “very convincing argument” to the contrary is made. With reference to the general *renvoi* clause the same argument can be made.

I agree that this is a strong argument against the use of the domestic definition of “beneficial owner”. The follow up question would then be to ask whether the definition of “beneficial owner” in the ITA can also be used to give meaning to the treaty term “beneficial owner” in Articles 11 and 12 (the interest and royalty articles respectively). The meaning in such a case will, for example, read “the person entitled to the benefit of the *interest/royalty*”. It will be recalled that in *Baldwins*¹⁹⁸⁴ the AD was prepared to accept that the context does not require that a definition in local tax legislation not be used under the general *renvoi* clause merely because there were some categories listed in the definition that could not apply in the treaty context. There is, however, a difference between agreeing that some parts of a definition will not be applicable in a treaty context and replacing key words in a definition. This may be a

¹⁹⁷⁹ De Broe *International Tax Planning* 670.

¹⁹⁸⁰ Garibay (2011) *BFIT* heading 7.

¹⁹⁸¹ Kandev (2007) *Can Tax J* 63-65.

¹⁹⁸² Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.11. See also the argument of Oliver (2001) *BTR* 47 about the different usages of the term within Article 10.

¹⁹⁸³ Part 4.3.3.

¹⁹⁸⁴ *Baldwins (South Africa) Ltd v CIR* (1961) 24 SATC 270, discussed in parts 8.2 and 8.7.3.1.

step too far for a court to accept. Furthermore, the fact that the South African legislator has refrained from using the term “beneficial owner” in respect of the withholding taxes on interest and royalties may be an indication that it did not intend such an outcome.¹⁹⁸⁵

9.7 Conclusion

The ITA includes a definition of “beneficial owner” in the part of the ITA that deals with the withholding tax on dividends. Apart from the ITA, the term “beneficial owner” is only defined in one South African national act and the term “beneficial interest” in company legislation. It is unlikely that either of these two meanings can be used as a domestic meaning in terms of the general *renvoi* clause.

The current definition of “beneficial owner” in the ITA shows similarities with the repealed definition of “shareholder” that previously applied to that Act. The wide nature of these two definitions is reflected in the use of the words “entitled to” and “the benefit”.

An analysis of the case law on the definition of “shareholder” shows that, despite the wide formulation, courts have not interpreted the definition in this manner. It is thus arguable that the meaning given to the definition in the context of conduit company treaty shopping will show similarities with the meaning given in *Prévost (TCC)*.¹⁹⁸⁶ This definition is most likely the meaning that should be put forward under the general *renvoi* clause.

In the event that the domestic definition and the international meaning differ on a particular point, one has to consider whether the context requires that the domestic meaning not be used. This may very well be the case; otherwise, the meaning of “beneficial owner” will have different meanings in provisions based on Articles 10, 11 and 12 of the OECD MTC.

¹⁹⁸⁵ Part 9.4.1.1.

¹⁹⁸⁶ *Prévost Car Inc. v The Queen* 2008 TCC 231.

CHAPTER 10

CONCLUSION

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10.1 Research question

The question that this study aimed to address was how a South African court would interpret the term “beneficial owner” in provisions in South African DTAs based on Article 10(2) of the OECD MTC, in the context of conduit company treaty shopping.

10.2 Findings made in the study

In the first part of the study,¹⁹⁸⁷ the focus was on establishing an autonomous (international) meaning for the treaty term “beneficial owner”. At the conclusion of chapter 7 I reconsidered the findings made in previous chapters and proposed an international meaning for the term “beneficial owner” in provisions in South African DTAs based on Article 10(2) of the OECD MTC, in the context of conduit company treaty shopping.

A South African court must adhere to the Vienna rules when interpreting a DTA, as acknowledged by the SCA.¹⁹⁸⁸ This requires the court to determine the “ordinary meaning” of the treaty term “beneficial owner”, in light of the context and the purpose of the treaty.¹⁹⁸⁹ In cases such as *Natal JMPF*¹⁹⁹⁰ and *Bosch*,¹⁹⁹¹ the SCA, with regard to the interpretation of domestic legislation, adopted an approach in terms of which meaning cannot be given to text without a consideration of the context and purpose. These cases give equal importance to the literal meaning of the words and the context and purpose. This approach is allowed under the Vienna rules and is likely to be adopted when the beneficial ownership requirement in South

¹⁹⁸⁷ Chs 2 to 7.

¹⁹⁸⁸ Part 7.3.

¹⁹⁸⁹ Part 4.3.1.

¹⁹⁹⁰ *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA).

¹⁹⁹¹ *CSARS v Bosch* 2015 (2) SA 174 (SCA).

African DTAs is interpreted.¹⁹⁹² South African courts are furthermore inclined to give words in tax legislation a legal meaning and to analyse transactions based on the legal rights created by the parties, even if tax avoidance is suspected. They are likely to follow the same approach with regard to the interpretation of DTAs.¹⁹⁹³

Turning now to the “ordinary meaning” of the treaty term “beneficial owner”, South African courts often determine the “ordinary meaning” of treaty terms with reference to general dictionaries.¹⁹⁹⁴ It is also noteworthy that in *Prévost (TCC)*¹⁹⁹⁵ the court was referred to general English and French dictionaries regarding the meanings of “beneficial” and “owner” as separate words, after having been informed that there is no definition in English dictionaries for the phrase “beneficial owner”.¹⁹⁹⁶ The court, however, did not seem to attach much significance to these dictionary meanings. It was pointed out in part 4.3.2 that it is unlikely that the expression “beneficial owner” will have an everyday, man-in-the-street meaning that will be useful in this context. General dictionaries are thus unlikely to be useful.

The term is more likely to have a technical meaning. As mentioned in part 4.3.2, such a technical meaning may still be regarded as an “ordinary meaning” as contemplated in Article 31(1) of the VCLT. A possible source of such a meaning is a legal dictionary, for example *Black’s Law Dictionary*, from which this study quoted.¹⁹⁹⁷ South African courts have in the past referred to this legal dictionary when interpreting DTAs.¹⁹⁹⁸ However, the first part of the definition of “beneficial owner” in this dictionary focuses in on fragmented ownership recognised in the law of equity. Such a meaning will not assist in (civil-law) countries that do not allow for fragmented ownership and thus cannot serve as an international meaning.¹⁹⁹⁹ The rest of that definition deals with limited meanings under company and intellectual property law which are unlikely to be applicable beyond those narrow contexts. A Canadian law dictionary and a South African law and economics dictionary provide broader meanings,²⁰⁰⁰ but these meanings are not precise enough to serve as “ordinary meanings” in the context of conduit company treaty shopping.

¹⁹⁹² Parts 4.3.6 and 7.3.

¹⁹⁹³ Part 7.4.

¹⁹⁹⁴ Parts 4.3.2 and 7.6.1.

¹⁹⁹⁵ *Prévost Car Inc. v The Queen* 2008 TCC 231.

¹⁹⁹⁶ Part 6.5.2. However, see the meanings from subject dictionaries quoted in part 3.6.

¹⁹⁹⁷ Part 3.6.

¹⁹⁹⁸ Part 7.6.1.

¹⁹⁹⁹ Part 2.4.1. For a description of fragmented ownership under the law of equity, see part 3.2.3.4.

²⁰⁰⁰ Part 3.6.

Upon exhausting the usual avenues for ascertaining the “ordinary meanings” of the treaty term “beneficial owner”, South African courts will likely turn to other avenues. One possibility is that the “ordinary meaning” may be the meaning that the term has in common-law jurisdictions. This is understood by Du Toit to refer to the person whose ownership attributes outweigh all others. Du Toit makes a very convincing argument as to why a meaning in the common-law countries might have been the meaning that was originally intended when the term was included in the OECD MTC. The main problem, however, is that there is not wide support for the view that Du Toit’s meaning, or any other meaning, is shared amongst the common-law jurisdictions.²⁰⁰¹

Another possibility is the description of beneficial ownership in the Commentaries to Article 10. There is an argument that the Commentaries can be a source for the “ordinary meaning” of a treaty term as contemplated in Article 31(1).²⁰⁰² This is also a possibility when it comes to the ordinary meaning of “beneficial owner”. In this regard, the meaning in the 2014 Commentaries is likely to be relevant for all DTAs, even those entered into before 2014.²⁰⁰³

In making the argument that the meaning in the Commentaries may serve as the “ordinary meaning” I have not lost sight of the fact that the Commentaries have failed thus far to result in a uniform interpretation by either scholars²⁰⁰⁴ or foreign courts²⁰⁰⁵ and that the 2014 Commentaries may not fare much better.²⁰⁰⁶ Nor have I disregarded the argument that, where the Commentaries go beyond illustrating or explaining the text, the meaning should not be given simply because it is contained in the Commentaries.²⁰⁰⁷

I have also not ignored the fact that South African case law confirms that South African courts are not obliged to refer to the Commentaries. This case law also shows that reference to the Commentaries is inconsistent and that, even where the Commentaries have been referred to, they were not necessarily followed.²⁰⁰⁸

For all of these reasons one should be careful to rely only on the meaning in the Commentaries.²⁰⁰⁹ It is, however, difficult to divorce the meaning in the Commentaries from

²⁰⁰¹ Parts 2.4.1 and 3.2.3.4.

²⁰⁰² Part 4.4.1.

²⁰⁰³ Part 7.5.7.

²⁰⁰⁴ Part 2.4.

²⁰⁰⁵ Part 6.7.

²⁰⁰⁶ Part 2.6.

²⁰⁰⁷ Part 4.4.

²⁰⁰⁸ Part 7.6.

²⁰⁰⁹ Part 4.4.

the remaining possible sources on the “ordinary meaning”, the first being foreign scholarly writing.²⁰¹⁰ That is because scholarly writing often simply refers back to the Commentaries,²⁰¹¹ rather than providing an alternative meaning. Those scholars who do not look to the Commentaries for a meaning often use as their starting point the perceived purpose for which the beneficial ownership requirement was inserted in the OECD MTC in the first place. From this starting point they then work backwards to give a meaning to the beneficial ownership requirement that accords with this purpose. Whilst such an approach may pay due deference to the “context”, which would include the purpose for which the term was included,²⁰¹² one has to question whether it properly takes into account the “ordinary meaning” of the term as an integral element of the interpretation process.

According to one argument, foreign case law could also be a source of the ordinary meaning of undefined treaty terms.²⁰¹³ Of all the cases discussed in chapter 6, the decisions in the *Prévost* matter are likely to carry the most weight in South Africa.²⁰¹⁴ *Prévost (TCC)*²⁰¹⁵ is also the only of the judgments that takes the time to establish a meaning outside the Commentaries. The court considered both the civil and common law and the meaning given by the court is thus arguably a meaning that would be acceptable in both civil and common-law jurisdictions.²⁰¹⁶ The *Prévost* meaning can also be reconciled with (one way of reading) the 2014 Commentaries.²⁰¹⁷

Notably the *Prévost* meaning includes the possibility that the ultimate recipient may be the beneficial owner of a dividend received by the direct recipient despite not having any rights to the dividend itself. This is in line with the finding in chapter 3 that there is South African case law in which the expression “beneficial owner” was used to refer to someone who only has an interest in property, rather than any rights to such property.

One has to question though whether the “ordinary meaning” in *Prévost (TCC)* places enough emphasis on the anti-avoidance purpose of the beneficial ownership requirement and thus the “context” contemplated in Article 31(1).²⁰¹⁸ On the one hand, this meaning may catch

²⁰¹⁰ Part 4.2.

²⁰¹¹ Parts 2.4 and 7.6.3.1.2.

²⁰¹² Part 4.3.4.

²⁰¹³ Part 4.3.5.

²⁰¹⁴ Part 7.6.3.1.2.

²⁰¹⁵ *Prévost Car Inc. v The Queen* 2008 TCC 231.

²⁰¹⁶ Du Toit & Hattingh “Beneficial Ownership” in *Silke on International Tax* (2010) para 9.6.3.

²⁰¹⁷ Part 6.6.3.2.

²⁰¹⁸ Part 6.5.4.3.

financial arrangements despite the fact that there may be no intention to obtain the treaty benefits of a reduced withholding tax rate. On the other hand, and perhaps more problematic in the context of this study, this meaning may not be able to combat various forms of conduit company treaty shopping. As pointed out in chapter 2, despite the uncertainty regarding the initial purpose of inserting the beneficial ownership requirement, it has been accepted numerous times by scholars and courts to have an anti-avoidance purpose of combatting conduit company treaty shopping (beyond the agent/nominee scenarios). Since 2003, the Commentaries have also expressly stated this.²⁰¹⁹ (Although the Commentaries as a source to determine the purpose of a provision in a DTA is controversial, there is some scholarly support for such an argument).²⁰²⁰

Apart from the purpose of the beneficial ownership requirement itself, one must also consider the purpose of the treaty as a whole as contemplated in Article 31(1). The new purpose included in the MLC and proposed for the OECD MTC makes it clear that DTAs should not create opportunities for reduced taxation through treaty-shopping arrangements.²⁰²¹ In *Indofood (CA)*²⁰²² the court took the treaty purpose of eliminating tax evasion into account when giving meaning to the term “beneficial owner” although it possibly did not play a central role in that decision.²⁰²³

The narrow legal meaning in *Prévost* leaves plenty of room for treaty shopping to take place. It is also important to bear in mind that the TCC and FCA in *Prévost* seemingly accepted that there was no (main) tax avoidance purpose with the insertion of the direct recipient and that the court thus paid little attention to this purpose when giving meaning to the term. The problem is especially considerable in structures where the direct recipient forms part of a group of companies. In such a scenario ultimate recipients, by virtue of their control over direct recipients, may not be inclined to build in contractual safeguards to ensure that dividends are passed on. In these cases the narrow meaning in *Prévost* will not prevent such structures from accessing the treaty benefits.

The obvious way to overcome this shortcoming (if one restricts one’s quest to the beneficial ownership requirement) is to give the beneficial requirement an economic meaning. Such meaning may be based on, for example, the economic substance of the direct recipient, or

²⁰¹⁹ Part 2.3.4.

²⁰²⁰ Part 4.3.4.

²⁰²¹ Part 4.3.4.

²⁰²² *Indofood International Finance Ltd v JP Morgan Chase Bank NA* [2006] STC 1195.

²⁰²³ Part 6.3.4.4.

control of the ultimate recipient over the direct recipient, or on whether a person is the ultimate recipient in related transactions (however that may be defined), or on whether the sole purpose of inserting the direct recipient was to acquire the treaty benefit. However, if this is the case, there is a strong argument that one is allowing context and purpose to override the “ordinary meaning” of the term. This is not in accordance with how South African courts are likely to interpret DTAs under the Vienna rules, as explained above. That is because there is little indication that the “ordinary meaning” of the term supports such a meaning. It is true that in South African case law the expression is sometimes used in the context of shams and piercing of the corporate veil, both scenarios often associated with avoidance of tax rules.²⁰²⁴ However, these isolated examples are not sufficient to give beneficial ownership an “ordinary meaning” that allows for this consideration to be taken into account. Furthermore, despite the fact that the 2014 Commentaries refer to the anti-avoidance purpose of the beneficial ownership requirement, at least one way of reading the Commentaries is that they also only support the narrow legal meaning in *Prévost*, as explained above.

Also, if one considers the purpose of a DTA as a whole, preventing tax avoidance by way of treaty shopping is not a DTA’s only purpose. It must be remembered that South Africa has also opted to include in the MLC the object of developing economic relationships.²⁰²⁵ Legal certainty regarding tax liability is important to any investor²⁰²⁶ and the development of countries’ economic relationships would include increasing investment between residents of these countries. The Commentaries have also since 1977 noted the fostering of international trade and investment as a purpose of DTAs.²⁰²⁷ Therefore, a narrow legal meaning for the beneficial ownership requirement, which will catch some treaty shopping structures and which provide clarity on when it will be applied, will serve all the purposes of a DTA better than a wide economic meaning that may avoid more forms of treaty shopping, but which may discourage investment due to the uncertainty caused by such an approach.

I should also note that I do not agree that the mere existence of other anti-avoidance measures that may also be used to combat conduit company treaty shopping should mean that the beneficial ownership must be interpreted narrowly. I do, however, agree that anti-avoidance

²⁰²⁴ Part 3.5.2.2.

²⁰²⁵ Part 4.3.4.

²⁰²⁶ Part 2.2.

²⁰²⁷ Part 4.3.4.

measures have boundaries in the law within which they operate. That creates legal certainty. There may be areas where these boundaries overlap, so that more than one measure may be used to combat tax avoidance. But of course there may also be gaps between the boundaries. That means that any given anti-avoidance measure will be appropriate to deal with some forms of tax avoidance, but not others. It also means that there may be some forms of tax avoidance which may, as much as tax authorities regard them as inappropriate, not be caught. Here one should also pause to reflect that it has long been recognised by South African courts that an interpretative approach under which transactions are considered according to the legal rights created by the parties may create the possibility that the approach be (mis)used to ensure that the transaction falls within a favourable provision in tax legislation. In the *NWK*²⁰²⁸ judgment, the SCA (on one way of reading that judgment) took a stand against such an approach by attempting to extend the boundaries of the sham doctrine, but in subsequent decisions the SCA reconfirmed the boundaries of the doctrine in South African law. In these later judgments, the SCA also confirmed that an approach, which analyses transactions based on the legal rights created by the parties, is still valid in South African law.²⁰²⁹

I thus agree that the test in *Prévost* strikes the right balance between the “ordinary meaning” of the term and the context and purpose elements of Article 31(1) of the VCLT.

I should also consider whether my conclusion will be affected in the event that foreign case law and the Commentaries cannot be seen as sources for the “ordinary meaning” of the treaty term “beneficial owner” as contemplated under Article 31, but rather as supplementary aids under Article 32. In such an event, arguably the court will have to fall back on other “ordinary meanings”, possibly the meaning in legal dictionaries. The court may (and probably would) then turn to foreign case law and the Commentaries to determine whether they, firstly, confirm that meaning. If not, it may be an indication that another meaning is possible under Article 31, which can then be confirmed by the latter sources. But again, it is not clear that an alternative is readily available. More likely, foreign case law and the Commentaries will indicate that there is an ambiguity, which means that these sources can instead be used to determine the meaning. That brings one back to the *Prévost* meaning which accords to one way of reading the 2014 Commentaries.²⁰³⁰

²⁰²⁸ *CSARS v NWK Ltd* 2011 (2) SA 67 (SCA).

²⁰²⁹ Part 5.4.

²⁰³⁰ Part 4.3.5.

I thus propose that the international meaning, which a South African court should adopt for the term “beneficial owner” in articles in South African DTAs based on Article 10 of the OECD in the case of conduit company treaty shopping is the direct recipient, unless such direct recipient is, firstly, an agent or, secondly, has a legal obligation to transfer funds to another person and that obligation only arises if and to the extent that such direct recipient receives the dividend.²⁰³¹

Lastly, I acknowledge the limitations of this study, which focuses on conduit company treaty shopping only. The necessary implication of this scope is that in this study the direct recipient is always a company.²⁰³² I therefore cannot propose that this meaning will work in the problematic areas of direct recipients that are trusts (or trustees) or tax transparent entities. I pause, however, to reflect here that it is unlikely that one rule can serve both anti-avoidance and attribution purposes without having to make some adjustments depending on the circumstances in which it is used. One is already seeing this in the fact that the Commentaries are attempting to deal with beneficial ownership of CIVs separately and one would hope that further work would be done in other areas, such as trusts. It should also be noted that the 2014 Commentaries thought it necessary to expressly state that a trust (or trustee) can be a beneficial owner, recognising perhaps that one may otherwise find it difficult to fit a trust (or trustee) into the rest of the Commentary to Article 10.²⁰³³

In the remaining part of the study,²⁰³⁴ the general *renvoi* clause was considered to determine whether, instead of the international meaning, a domestic meaning would be given to the treaty term “beneficial owner”. The ITA includes a definition of “beneficial owner” in the part of the ITA that deals with the withholding tax on dividends. Apart from the ITA, the term “beneficial owner” is only defined in one other South African national act, namely the Financial Intelligence Centre Act,²⁰³⁵ and the term “beneficial interest” in company legislation. It is unlikely that either of these two meanings can be used as a domestic meaning in terms of the general *renvoi* clause.²⁰³⁶ Of all these meanings in the South African statutory law, the definition in the ITA is the most likely domestic meaning that will apply under the general *renvoi* clause.

²⁰³¹ Part 6.6.3.2.

²⁰³² Part 1.6.

²⁰³³ As pointed out in part 2.4.1.

²⁰³⁴ Chs 8 and 9.

²⁰³⁵ Financial Intelligence Centre Act 38 of 2001.

²⁰³⁶ Part 9.3.

The current definition of “beneficial owner” in the ITA shows similarities with the repealed definition of “shareholder” that previously applied to this Act. The wide nature of these two definitions is reflected in the use of the words “entitled to” and “the benefit”. An analysis of the case law on the definition of “shareholder” shows that, despite the wide formulation, courts have not interpreted the definition in this manner.²⁰³⁷ It is thus arguable that the meaning given to the definition in the context of conduit company treaty shopping will show similarities with the international meaning given above.

In the event that the domestic definition and the international meaning differ on a particular point, it is, however, likely that the context will require that the domestic meaning not be used.²⁰³⁸

10.3 Concluding remarks

In conclusion, the study proposes the following answers to the questions posed in part 1.4:

- a) With regard to the question whether the beneficial ownership requirement can be regarded as an anti-avoidance measure, research conducted during the past five years shows that it is not clear that when the term “beneficial owner” was introduced in the 1977 OECD MTC it was intended to combat conduit company treaty shopping other than through agents or nominees. However, the notion that it was intended as an anti-avoidance tool not necessarily limited to agent and nominee conduit structures has become engrained in scholarly writing and court judgments.²⁰³⁹ The OECD has also claimed as much, most clearly in the 2003 and 2014 Commentaries.²⁰⁴⁰ For these reasons it is unlikely that the beneficial ownership will shake off its image as an anti-avoidance measure aimed at combatting conduit company treaty shopping beyond the agent and nominee scenarios.
- b) When it comes to the question whether a legal or economic meaning should be given to the term “beneficial owner”, there is clear support in the 2003 and 2014 Commentaries

²⁰³⁷ Part 9.4.2.3.

²⁰³⁸ Part 9.6.

²⁰³⁹ Part 2.3.1.

²⁰⁴⁰ Part 2.3.4.

for both approaches.²⁰⁴¹ Case law and scholarly writing also support both,²⁰⁴² but it is proposed that a South African court is more likely to adopt a legal approach.²⁰⁴³

- c) The last question to consider is whether the term “beneficial owner” should have a domestic or international meaning. General *renvoi* clauses in DTAs provide that domestic meanings apply to give meaning to undefined treaty terms unless the context requires otherwise.²⁰⁴⁴ There is no settled meaning for the expression “beneficial owner” in South Africa case law.²⁰⁴⁵ South African legislation apart from the ITA does not provide a workable meaning either.²⁰⁴⁶ There is a definition of “beneficial owner” in the ITA that may be used for this purpose. Case law on the predecessor of this definition suggests that this meaning may in many aspects be similar to the international meaning.²⁰⁴⁷ However, should it differ on a particular point, it is likely that the context will provide that the domestic meaning should not apply.²⁰⁴⁸

The answers proposed above lead to the conclusion that the research question posed in part 1.4 may be answered as follows: A South Africa court, if faced with conduit company treaty shopping, is likely to regard the direct recipient of dividends as the beneficial owner of such dividends, as contemplated in provisions in South African DTAs based on Article 10 of the OECD MTC. The exceptions will be if the direct recipient is, firstly, an agent or, secondly, has a legal obligation to transfer funds to another person and that obligation only arises if and to the extent that such direct recipient receives the dividends.

This meaning is unlikely to provide much protection for the South African tax base against conduit company treaty shopping, especially where the direct recipient is part of a group of companies controlled by the ultimate recipient. It remains uncertain to what extent the definition of “beneficial owner” in the ITA may be interpreted more widely to provide better protection to the South African tax base. If such an interpretation is viable, the next hurdle to overcome is that the domestic meaning must apply in a treaty context. Therefore, should the South African legislator intend for this domestic meaning to apply in a treaty context, it is advisable that the South African legislation consider either entering into a position in respect

²⁰⁴¹ Parts 2.3.4, and 2.3.5 and 2.6.

²⁰⁴² Parts 2.4 and 6.7.

²⁰⁴³ Parts 7.6.3.1.2, 7.7 and 10.2.

²⁰⁴⁴ Part 4.5 and ch 8.

²⁰⁴⁵ Part 3.7.

²⁰⁴⁶ Part 9.3.

²⁰⁴⁷ Part 9.4.2.3.

²⁰⁴⁸ Part 9.6.

of the Commentaries to that effect or, preferably, include a provision in future DTAs that explicitly provides for this.

In addition, the South African legislator needs to consider other anti-avoidance measures to protect its tax base against conduit company treaty shopping. These may include the application of existing measures such as the South African GAAR in section 80A-L of the ITA,²⁰⁴⁹ piercing the corporate veil²⁰⁵⁰ and the PPT included in the MLC and the 2017 draft update to the OECD MTC.²⁰⁵¹ The South African legislation should possibly also consider adopting LOB clauses although there is little indication of this being feasible. Whether these measures can apply in a treaty context and whether they will be more effective than the beneficial ownership requirement in combatting conduit company treaty shopping, are questions for another day.

²⁰⁴⁹ Referred to in part 5.2.1.

²⁰⁵⁰ Considered in part 5.7.3.

²⁰⁵¹ Part 2.3.6.

ANNEXURE A: WORDING OF PARAGRAPH 12 OF THE COMMENTARIES TO ARTICLE 10 AFTER AMENDMENT IN 2003 AND 2014 AND THE PROPOSED AMENDMENTS IN 2017

Annexure overview:

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The wording of the Commentary to Article 10, following the amendments made in 2003

“12 The term ‘beneficial owner’ is not used in a narrow technical sense, rather, it should be understood in its context and in the light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.

12.1 Where an item of income is received by a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption merely on account of the status of the immediate recipient of the income as a resident of the other Contracting State. The immediate recipient of the income in this situation qualifies as a resident but no potential double taxation arises as a consequence of that status since the recipient is not treated as the owner of the income for tax purposes in the State of residence. 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.²⁰⁵²

- 12.2 Subject to other conditions imposed by the Article, the limitation of tax in the State of source remains available when an intermediary, such as an agent or nominee located in a Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State (the text of the Model was amended in 1995 to clarify this point, which has been the consistent position of all member countries). States which wish to make this more explicit are free to do so during bilateral negotiations.”

The wording of the Commentary to Article 10, following the amendments made in 2014

“12. The requirement of beneficial ownership was introduced in paragraph 2 of Article 10 to clarify the meaning of the words “paid ... to a resident” as they are used in paragraph 1 of the Article. It makes plain that the State of source is not obliged to give up taxing rights over dividend income merely because that income was paid direct to a resident of a State with which the State of source had concluded a convention.

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

The term “beneficial owner” is therefore not used in a narrow technical sense (such as the meaning that it has under the trust law of many common law countries¹), rather, it should be understood in its context, in particular in relation to the words ‘paid ... to a resident’, and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.

¹ For example, where the trustees of a discretionary trust do not distribute dividends earned during a given period, these trustees, acting in their capacity as such (or the trust, if recognised as a separate taxpayer), could constitute the beneficial owners of

²⁰⁵² Footnote omitted.

such income for the purposes of Article 10 even if they are not the beneficial owners under the relevant trust law.

- 12.2 Where an item of income is paid to a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption merely on account of the status of the direct recipient of the income as a resident of the other Contracting State. The direct recipient of the income in this situation qualifies as a resident but no potential double taxation arises as a consequence of that status since the recipient is not treated as the owner of the income for tax purposes in the State of residence.
- 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.²⁰⁵³
- 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

²⁰⁵³ Footnote omitted.

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 the 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.

- 12.5 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 below). 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. 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.
- 12.6 The above explanations concerning the meaning of ‘beneficial owner’ make it clear that the meaning given to this term in the context of the Article must be distinguished from the different meaning that has been given to that term in the context of other instruments¹ that concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of ‘beneficial owner’ cannot be applied in the context of the Article. Indeed, that meaning, which refers to natural persons (i.e. individuals), cannot be reconciled with the express wording of subparagraph 2 a), which refers to the situation where a company is the beneficial owner of a dividend. In the context of Article 10, the term ‘beneficial owner’ is intended to address difficulties arising from the use of the words ‘paid to’ in relation to dividends rather than difficulties related to the ownership of the shares of the company paying these dividends. For that reason, it would be

inappropriate, in the context of that Article, to consider a meaning developed in order to refer to the individuals who exercise ‘ultimate effective control over a legal person or arrangement.’

1 See, for example, Financial Action Task Force, *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation – The FATF Recommendations* (OECD FATF, Paris, 2012), which sets forth in detail the international anti-money laundering standard and which includes the following definition of beneficial owner (at page 110): “the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement.” Similarly, the 2001 report of the OECD Steering Group on Corporate Governance, *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes* (OECD, Paris, 2001), defines beneficial ownership as follows (at page 14):

‘In this Report, “beneficial ownership” refers to ultimate beneficial ownership or interest by a natural person. In some situations, uncovering the beneficial owner may involve piercing through various intermediary entities and/or individuals until the true owner who is a natural person is found. With respect to corporations, ownership is held by shareholders or members. In partnerships, interests are held by general and limited partners. In trusts and foundations, beneficial ownership refers to beneficiaries, which may also include the settlor or founder.’

12.7 Subject to other conditions imposed by the Article, the limitation of tax in the State of source remains available when an intermediary, such as an agent or nominee located in a Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State (the text of the Model was amended in 1995 and in 2014 to clarify this point, which has been the consistent position of all member countries).”

Proposed amendments to the wording of the Commentary to Article 10 set out in the 2017 draft update to the Commentaries:²⁰⁵⁴

- “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~~**22 to 48** of the Commentary on Article 1. Where the 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.
- 12.5 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~~ below). ***The provisions of Article 29 and the principles put forward.*** ~~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,~~ ***will apply to prevent abuses, including treaty shopping situations where the recipient is the beneficial owner of the dividends.*** ~~These include specific anti-abuse provisions in treaties, general anti-abuse rules and substance over form or economic substance approaches.~~

²⁰⁵⁴ Draft 2017 Update Part 2 D para 11.

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 *abuses, such as certain forms of* treaty shopping, *that are addressed by these provisions and principles* and must not, therefore, be considered as restricting in any way the application of other approaches to addressing such cases.

- 12.7 Subject to other conditions imposed by the Article *and the other provisions of the Convention*, the limitation of tax in the State of source remains available when an intermediary, such as an agent or nominee located in a Contracting State or in a third State, is interposed between the beneficiary and the payer but the beneficial owner is a resident of the other Contracting State (the text of the Model was amended in 1995 and in 2014 to clarify this point, which has been the consistent position of all member countries).”

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