

Taxation of the dividends to the foreign shareholder and the concept of beneficial owner

I. Introduction

The concept of “beneficial owner” lacking a consensus on its definition and interpretation yet, is a significant safety instrument that is frequently encountered in international taxation practice.

In Turkey where corporates with foreign partnerships are established, the problem of double taxation regarding the dividends distributed to shareholder is frequently encountered and at that stage, the concept of beneficial owner is of capital importance regarding the use of the reduced withholding tax to be applied on dividends proposed within the Double Taxation Treaties”.

While there is no explicit regulation on the definition of the beneficial owner in neither the local nor international legislation, any consistent judicial decision on the assessment of the aforementioned concept does not exist as well. Regarding the solution of possible controversies, in terms of the assessment of the legal nature of this concept existing in the DTTs in which Turkey is a party to, OECD Model Tax Convention and explanations within the commentary book concerning that treaty should be resorted to and benchmarks relating to the international judicial rulings should be considered.

II. Beneficial owner within the context of OECD Model Tax Convention

The concept of beneficial owner is included in the three articles of the OECD Model Convention titled as dividends, interest and royalties, however the model convention does not contain any clear wording on the definition of the concept.

Article 10 of the model convention regulates how the dividend income will be taxed.

Although the first clause of the provision indicates that the state in which the person receiving the dividend is resident has the authority for taxation, the country of origin where the dividend obtained is also authorized for taxation in the second clause of the article.

Taxation authority of the country of origin is restricted through the same article as well. Accordingly, provided to be the of the dividend distributed, if at least 25 % of the capital of the company paying the dividend is owned, it would be taxed at 5 % of the gross dividend amount in the country of origin.

As it is seen through the provision of the article, so as to be subject to the reduced rate (max 5 %) the person obtaining dividend should be meeting all of the requirements indicated below;

- to be resident in the other contracting state,
- standing as a company other than private companies,
- To be the beneficial owner of the dividend
- To possess at least 25 % of the capital of the company paying the dividend.

To sum up, despite the implications made upon the concept of beneficial owner, we are confined with commentaries since any clear expression is not available within the model convention regarding the concept of beneficial owner.

III. Assessment within the context of Corporate Tax Law and DTTs in which Turkey is party to

In terms of identifying the rate of income tax withholding to be applied on the dividend payment to the foreign shareholder, it is of significant importance to define the foreign shareholder's state of liability in Turkey.

The second clause of Article 3 within the Corporate Tax Law no.5520 contains a definition on non-residency.

The first clause under Article 30 of the CTL, it's regulated that a corporate tax deduction of 15 % will be applied over the income and revenue of the non-residents.

Within the 3rd clause of same article, it is ensured that a corporate tax withholding at a rate of 15 % will be applied over the dividend distributed to the non-resident shareholder.

However, in the taxation of the dividend to be distributed to foreign shareholder, it would be appropriate to search for the existence of a DTT signed between the contracting countries and having a role of being an important tool in the solution of the double taxation problem.

In that circumstance, concerning the dividend distribution to be performed by the resident company in Turkey with foreign capital to its foreign partners or individuals, provisions of the DTTs signed between Turkey and the concerned country, if any, should be looked at.

When the provisions relating to dividends contained in the treaties that Turkey is a party, it appears to be largely in line with the provisions existing under the OECD model.¹

IV. Opinion of the Turkish tax administration

There are rulings issued by the Administration at various dates on the taxation of the dividend distributed to the foreign shareholder.

Regarding the request of opinion on the rate of income tax withholding concerning the dividend to be paid to a company with 38,25 % of its capital resident in Spain, Revenue Administration's ruling dated 29.07.2011 contains explanations indicating that the Spanish resident company should prove it's fully amenable in Spain and being taxed in that country over its entire global income through a certificate of residency obtained from Spanish authorities for the implementation of the reduced rate proposed in the DTT signed between Turkey and Spain.²

¹ Batun, Mehmet (2016). Taxation of dividend income within the context of DTTs, Vergi Dünyası, Year 36, issue 422.

² Revenue Administration ruling dated 29.07.2011 and no. B.07.1.GİB.4.42.16.01-KVK-2/1377—59

Also, regarding the request of opinion on the rate of withholding concerning the dividend to be paid to a Japanese company in which it has 99,96 % of its shares, Revenue Administration's ruling dated 04.08.2017, it was indicated that the reduced rate contracted in the agreement shall be applied provided that the Japanese resident company obtaining the dividend is the beneficial owner of the dividend and holding at least 25 % of shares of the company paying the dividend, pertaining to the DTT signed between Turkey and Japan.³

Within the context of the rulings, despite it's seen that the taxation of dividends distributed to the shareholder resident abroad at reduced rate as per the provisions of DTT is dependent on the submission of the certificate of residence to be obtained from the authorities of the country of the company receiving the dividend; by the introduction of BEPS ("Base Erosion and Profit Shifting") Action Plan; additional information and documents related to the shareholder receiving dividend such as the balance sheet, annual report are requested along with the certificate of residence during the tax investigations initiated about the matter.

V. Beneficial owner within the context of international judicial rulings

The international judicial rulings that are of great importance during the detection of beneficial owner and addressing the economic and legal approach in the assessment on this concept are provided below:

Prevost ruling: During the course of events leading to this decision, all shares of Prevost resident in Canada were acquired by the Swedish resident Volvo and after a while whole shares were transferred to HoldCo resident in the Netherlands. Following that transfer, UK resident Henyls bought 49 % of HoldCo shares. According to the shareholding contract agreed between the parties, Volvo and Henyls agreed that at least 80 % of Prevost and HoldCo's annual earnings shall be distributed to the shareholders as dividend. Prevost paid the dividend to HoldCo with a 5 % tax deduction as per the tax treaty between the Netherlands and Canada and following that, HoldCo distributed the dividend it obtained from Prevost to Volvo and Henyl's. As a result of that, the Canadian Revenue Administration claimed that HoldCo is not the beneficial owner in terms of the dividend it has obtained.⁴

The Canadian Federal Court of Appeals detected the matters indicated below in its investigation and rejected the claims that HoldCo is not the beneficial owner:

- The relationship among HoldCo and shareholders is not the relationship of agency or representative,
- HoldCo is not a party to the shareholding contract,
- Any provision indicating that HoldCo is required to pay dividend to the shareholders does not exist in its corporate charter,
- Shareholders do not have the right for initiating legal proceeding against HoldCo in case it does not distribute dividend,
- HoldCo has the possession of the dividends so as to distribute them when it obtains them.

³ Revenue Administration ruling dated 04.08.2017 and no.62030549-125[30-2014/155]-235835

⁴ Özgenç, Ayhan Selçuk The concept of beneficial owner in tax treaties

Velcro ruling: In this case, Canadian resident Velcro Canada Inc (“**VCI**”) pays royalty to Velcro Holding BV (“**VHBV**”) resident in the Netherlands and VHBV transfers the 90 % of those royalties to Velcro Industries BV (“**VIBV**”) which is resident in the Netherlands Antilles.⁵

In the aforementioned matter, Canadian Revenue Administration claimed that the beneficial owner is the Antilles resident VIBV and reverse charge tax assessment was handled in the name of VCI.

Regarding the mentioned assessment, in the case filed by VCI, the Canadian Tax Court referred to the Prevost ruling above in its investigation and stressed on the 4 parameters for the detection of beneficial owner and indicated that VHBV has met all these parameters. Those parameters may be defined as follows:

1) Possession:

- The amount of payment subject to income to be deposited to the bank account of the company and all rights concerning that bank account should completely be owned by the company receiving the payment,
- Interest income derived through the amount in that bank account should belong to the company receiving the payment and the company has the full authority for the management of the funds held in the account.

2) Usage:

- The company receiving payment should have the authority to use the paid amount in line with its own will.

3) Risk:

- Concerning the paid amount deposited to its bank account, the company shall undertake the exchange rate risks and any wording indicating that it will share those risks should not exist in the contracts it signed.

4) Control:

- Many of the assessments made regarding “possession”, “risk” and “usage” are also valid for this criteria, the company receiving the payments has the authority over the paid amounts and thus has got the control over the aforementioned payments.

VI. Conclusion

Although the Turkish tax legislation does not contain any regulation in terms of the definition of beneficial owner, within the context of both the OECD Model Convention on Tax and the international judicial rulings, in the detection of the beneficial owner, it's apparent that the company receiving a dividend payment should have the full authority

⁵ Demir, Alper Cihad (2017) Who is the Beneficial Owner? How is it identified? Vergi Dünyası, Year 36, Issue 432.

over the paid dividend amount both legally and economically, For the entitlement of that authority, the parameters provided above should be taken into account.

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