German Advisory Group

Institute for Economic Research and Policy Consulting

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Shortcomings in the Tax Code regarding "Beneficial Owner"

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About the German Advisory Group

The German Advisory Group on Economic Reforms, which is active in Ukraine since 1994, advises the Ukrainian Government and other state authorities such as the National Bank of Ukraine on a wide range of economic policy issues and on financial sector development. Our analytical work is presented and discussed during regular meetings with high-level decision makers. The group is financed by the German Federal Ministry of Economics and Technology under the TRANSFORM programme and its successor.

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Shortcomings in the Tax Code regarding „Beneficial Owner“

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This policy briefing has been prepared upon request from the Ministry of Finance.

1. Problem setting

According art. 160. of the New Tax Code (NTC) e.g. dividends, interest, royalties received from Ukrainian origin by non residents are generally taxable in Ukraine, unless respective double taxation agreement foresees a different taxation.

For paying in art. 160.1. NTC outlined incomes abroad, art. 160.2. - 160.9. NTC foresees a withdrawal tax to be applied - meaning the Ukrainian payer has to act as tax agent for the recipient and withdraw this tax.

Reduced tax rates or exemption can be applied according respective Double Taxation Agreements if the recipient is the beneficial owner of respective income (art.103.2.), whereas according art. 103.4. NTC a respective certificate of residence has to be provided.

Since in the OECD model convention and also for example in the Ukrainian-German double taxation agreement (DTA) a “beneficial owner” is not defined, it is likely that for definition of a beneficial owner art. 103.3 NTC will be applied.

According art. 103.3 NTC 2nd sentence, the payment recipient is not considered as beneficial owner in case this entity/person is only an “agent, nominal shareholder or intermediary” – even in case this agent, nominal shareholder or intermediary has got the right receiving this income.

Regarding art. 103.3 NTC 2nd sentence, the question is how to verify an entity/person is not only an “agent, nominal shareholder or intermediary”.

Since for example for registration of Ukrainian entities currently the total chain of shareholding documents (incl. apostil or legalization of respective documents + translation) is already required for determining final shareholders, there is a likelihood, that tax inspections will require – in addition to certificate of residence - same chain of documents for determining beneficial ownership.

That this approach in most cases would be practically not possible or at least outstanding time consuming is obvious and is not in line with international practice.

2. Possible Solution

In order to provide a solution for avoiding this problem, hereinafter is outlined how beneficial ownership for taxation is regulated in Germany.

As mentioned before in the OECD Model Convention and in the Ukrainian-German DTA a beneficial owner is not defined – even in most of the German DTAs beneficial owner is not defined, except for 4 DTAs with Italy, Norway, Sweden and the USA.

- According DTA with Italy and Norway, the recipient of dividends, interest and royalties is the beneficial owner in case he has got the right to receive this income and respective income is to be assigned to the recipient as taxable income **according tax legislation of both contracting states.**
- According DTA with Sweden the resident of a contracting state is regarded as beneficial owner of dividends, interest and royalties in case this income is to be assigned to the recipient as taxable income **according tax legislation of the recipients state**.
- According DTA 1989 with the USA (though not so any more according the minutes to USA 1989/2006) in case a recipient of dividends, interest and royalties out of the first state is a resident of the other contracting state, this recipient is regarded as beneficial owner, in case this recipient is the person, to whom this income is to be assigned as taxable income **according tax legislation of the first state.**

As additional information it is of interest, that in comments to the OECD model convention is - due to a missing definition of beneficial ownership - outlined, that not the final shareholder should be regarded as beneficial owner, but the person (or legal entity) who (which) can decide on its own discretion how to proceed with respective income. Even a profit transfer obligation at the recipient is not a criteria for denying beneficial ownership of received income. The core criteria is, that the recipient has got the right to decide on its own discretion what to do with received payments. Since proving “the right to decide on its own discretion” is in practice not manageable, the focus on tax residency – as outlined in above mentioned DTAs - is a common practicable approach – though with this approach a legal way of tax avoidance which contradicts common understanding of beneficial ownership cannot be excluded.

3. Suggestions

Following the above outlined we would suggest to Change wording in art. 103 NTC as follows:

- Art. 103.3.: Delete 2nd sentence.
- Provision of a certificate of residence as outlined in art. 103.4 – 103.6 is following German practice sufficient for proving beneficial ownership for dividends and interest, whereas in Germany the tax payer has to submit an application in order a certain DTA to be applied. To this application a valid certificate of residence has to be attached.
- In case of royalties, a copy of a brands registration or any other document which proves grounds of royalties can be requested in addition.
- Respective agreements as ground of receiving income might have to contain the phrase: “Company X (recipient) verifies being the beneficial owner of payments (income) according to this agreement”. This required phrase might be considered as a rather formal approach and will hardly avoid any intentional tax evasion, but it might give notice to sense of responsibility of respective recipients.

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