

## Literature Review and Evolution of Beneficial Owner Concept. Views from the Accountancy Profession

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The purpose of this paper is to analyze and determine the meanings of the concept “Beneficial Owner”. We identified two approaches of the concept in the academic literature. One approach is related to corporate governance of complex ownership structures and the other approach is related to taxation. Professional accountants usually interrelate with beneficial ownership information as part of their activities. This makes the legal framework around beneficial ownership information of direct relevance to the accountancy profession.

### Introduction

The way companies are owned and controlled is a central topic of discussion for researchers and business people. Most studies in the academic literature analyze the ownership structure of companies as isolated structures (Wolfenzon, 1999). In the business environment, individuals, families or coalitions of families own and run several companies. Thus, the ownership structure of companies can vary from the simplest to the most complex. From a theoretical point of view, however, two basic models can be distinguished: the horizontal structure and the pyramidal structure. In the case of horizontal structures, there are no financial links between companies owned by the same person, family or coalition (figure no. 1).

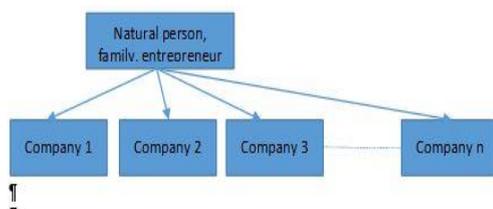


Figure 1 – horizontal structure of companies

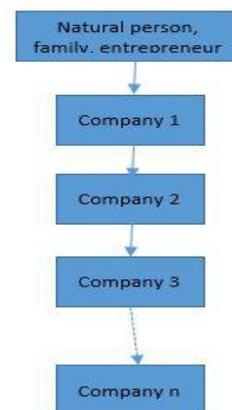


Figure 2 – vertical / pyramidal structure

In the case of pyramidal structures (figure 2) the natural person or the family obtains control over several companies through financial links of a hierarchical nature. In the real world of business, however, the ownership structures of companies have become so complex



and opaque that real or ultimate owner can be hardly identified. On the other hand, opaque corporate structures can serve as a means of financing economic crime, corruption, conflicts of interest and the activities of third countries subject to EU sanctions through public funds. The concept of "beneficial owner" has its origins in the United Kingdom, with the development of the law of trust, when a distinction was made between "legal owner" and "beneficiary". The legal ownership of the fiduciary property is with the fiduciary, but he owns it not for his own benefit, but for that of the beneficiaries. The trustee has the fiduciary obligation to manage the assets and revenues that are the object of the trust for the benefit of all beneficiaries. Although the term "beneficial owner" is currently applied in a wide variety of non-trust situations, the essence of the concept as referring to the person who ultimately controls an asset and can benefit from it remains the same. So the term has its origins in tax law but in civil law, although the first official use was in double taxation conventions, almost 50 years ago. Despite its seniority, the concept of the real beneficiary is still a hot topic of debate both in academia and in professional organizations. Meanwhile, the term has evolved from a legal concept difficult to understand for the general public to a generally recognized concept, used more and more often and taken over in the legislation of many states. Currently, we find the concept in the tax legislation of many states, in regulations aimed at preventing money laundering and terrorist financing, in treaties and studies developed by international organizations. In the literature, we have identified two approaches to the term real / final beneficiary, an approach in the context of company governance and an approach in the fiscal context. Therefore, we find the concept of real beneficiary in studies and works related to corporate governance of companies, but mostly the concept of real beneficiary is found in studies and research of a fiscal nature.

## 2. The corporate governance and beneficial owner

In the context of corporate governance, La Porta (La Porta, Rafael; Lopez-de-Silanes, Florencio; Shleifer, Andrei, 1999) identified two basic models of companies ownership: public interest companies and a companies that have a ultimate beneficial owner. Furthermore, La Porta classified the ultimate beneficial owners of companies into five categories: family or individual, state, financial institution, corporation and others (La Porta, Rafael; Lopez-de-Silanes, Florencio; Shleifer, Andrei, 1999).

In the business environment we find two basic categories of companies: those with dispersed ownership and those controlled by families or individuals. Public interest companies with dispersed ownership are more significant among large financial firms, while non-financial and small companies are controlled by families or individuals. On the other hand, in some continental European countries, the state controls a significant number of large firms (Faccio & Lang, 2002). From the point of view of the corporate governance, the presence of an ultimate beneficial owner deteriorates the corporate governance system, while dispersed ownership seems to strengthen it (Crisóstomo & de Freitas Brandão, 2018). Studies on corporate governance in Europe have shown that the ultimate beneficial owner on the top of pyramidal structures play a key role in the company's decision-making process (Becht (1999), Becht and RNoell (1999), Bianco and Casavola (1999), Faccio et al. (2001), Renneboog (2000), Barca and Becht (2001), Franks and Mayer (2001), Gugler (2001) and Franks et al. (2002).) Studies confirm the exacerbation of the problems of agency theory in conditions of low corporate transparency, associated with complex financial.

Paligorova and Xu (2012) found that complex pyramidal structures are affected by the risk of expropriation. The ultimate beneficial owners of pyramidal structures can increase the



debts of the affiliates and then direct the resources to the top of the pyramid for their benefit. Pyramidal structures are more disposed to such "debt tunneling activities", as ultimate beneficial owners are less exposed to the risk of bankruptcy due to their limited liability in affiliates. In addition, the reputation of the ultimate beneficial owners is less likely to be harmed, as it is difficult to establish their responsibility in the complex and opaque control network of the pyramid. (Paligorova & Xu, 2012).

Two conflicting views have emerged in the academic literature on the influence of ultimate beneficial owner on the cost of the agency, namely, one opinion that suggest a positive impact of ultimate beneficial owners and one opinion that suggest a negative influence of ultimate beneficial owners. Controlling owners appear to act as monitors of management which increase the value of the company to all stakeholders (Wiwattanakantang, 2001). In the same time, a negative effect may occur. Many studies highlight the negative impact on financial performance of owner's involvement in the company management.. When investors' rights are poorly protected, expropriation is feasible on a large scale, control gains enormous value because it gives to the ultimate controlling owner the opportunity to expropriate minorities. Thus a higher control is associated with a higher tendency of expropriation, the exclusive control cancels the positive incentive effect, thus resulting in a negative relationship between the owner or final beneficiary and the value of the company. Things get complicated when the state is the ultimate beneficial owner (Claessens & Fan, 2002)

### 3. Fiscal approach of beneficial owner

The concept of ultimate beneficial owner, later became a generally accepted tax concept transposed into a number of double taxation treaties. Internationally, the term was first introduced by the OECD in the Model Convention in 1977. Usually the double taxation treaties mention the notion of real beneficiary or beneficial owner, in connection with dividends, interest and royalties, income which normally has a preferential tax treatment for persons who obtain such income from another country (either a reduction in the tax base or a tax exemption). Such benefits shall be valid only if the recipient of dividends, interest or royalties is a resident of the other Contracting State. Therefore, the concept of the ultimate owner becomes particularly important for the eligibility of the person and for the allocation of income taxation rights between states. Despite the importance of the beneficial owner concept, there is still much controversy. Both the OECD and the UN have developed a series of brochures that address the concept of the real beneficiary or beneficial owner. The controversies concern: The role and place of the real beneficiary in the efforts to combat abuses regarding the tax treaties; the economic or legal meaning of the concept of beneficial owner and income allocation rules and relevant legislation (if any) to interpret terms such as source and country of residence.

The main problem is in fact the lack of an officially fixed definition of the term beneficial owner in international legal documents. The Financial Action Task Force (FATF) Standards, which set out global anti-money laundering and terrorist financing standards defined the concept as follows *“Beneficial owner refers to 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.”*

So we see that the key element of all definitions of beneficial owners is control. The control can be realized either directly or indirectly, via intermediaries, nominees, or through other contractual agreements. Control can be exercised in a variety of ways: for example by



holding – directly or indirectly – a controlling legal ownership interest or a significant percentage of voting rights; by having the ability to name or remove the members of an entity’s board of directors; or by holding negotiable shares or convertible stock.

Another important element in the definition is that a beneficial owner is a natural person. That means that a legal person cannot be a beneficial owner. The essence of beneficial owner is not ownership in the ordinary sense of the word, but control. Control and legal title often will lie in the same hands, but in some situations is not the case. It is important, therefore, not to confuse beneficial ownership with legal ownership. The concept of control is a difficult one, given the diverse ways in which it can be exercised. Who ultimately controls a corporate vehicle? The answers to this question depends on form of corporate vehicle. We have three main forms of corporate vehicle: companies, trusts and foundations.

As we already mentioned, the concept of beneficial ownership occurs in many tax treaties related to threshold on withholding tax. One important aspect for the source state to take into consideration, when assessing whether the tax limits need to be applied on its domestic rates, is if the one receiving the payment is the beneficial owner.

#### **4. The concept of beneficial ownership has a role in an EU law context and in the OECD Model treaty**

The concept of Beneficial Ownership first appeared in the OECD model convention in the 1977. It was an initiative of UK in order to clarify that the tax exemption should not be available in cases where residents could direct the income towards nominees or conduits in treaty states. This was the intended meaning of the articles on dividends, interest and royalties. While this intention could be satisfied with a subject to tax clause, meaning that the transfer would only be relived if it was taxed in the other state that does not seem to have been the preferred test. Even though the doctrine is not explained as an anti-abuse provision, it seems to be indicated that the absence of such a clarification or interpretation of the articles would allow abusive practices (Vann, 2013). Vann argues that many countries saw the insertion as a clarification. Whether that was a needed clarification or a product of compromise is not entirely clear, although Vann seems to lean towards the latter. That could explain the uncertainty shrouding the concept and its application. Some members might have seen the addition as something more than a pure clarification or maybe it has just been a convenient way of tackling tax avoidance and evasion since the concept is an international accepted one, although without a properly defined and uniform meaning. The concept can then become a way to circumvent strict legality requirements, by referring to a concept that ought to be clear but in reality, is not.

No distinction between beneficial owner on one side and the formal or legal owner, direct recipient, on the other side is required when it comes to assessing whether an owner should have the right to take tax advantage provided in the European laws. The constitutional rights emanating from the European laws form fundamental rights to uphold the single market. The fact that the beneficial owner is resident in a state, which would not allow to him to benefit from the fundamental freedoms, does not make the direct recipient, resident in the EU lose his right to rely on the same freedoms. There is no such assessment and even if the freedoms do not extend to persons resident in third states, there seems to be no room for



denial based on the beneficial ownership doctrine. In the absence of a definition in the double taxation treaty and in the domestic laws, the EU countries may refer to the definition of „beneficial owner” provided for in the EU law as the latter is a part of the legal system of the EU Member States. The concept of „beneficial owner” was implemented into Interest and Royalties Directive.

*The aim of the Interest and Royalties Directive is to ensure that interest or royalty payments are released from any taxes imposed in the source State, if the beneficial owner of these payments is an associated company or a permanent establishment of another Member State. The Directive specifies that a company shall be treated as the beneficial owner of interest or royalties only if it receives those payments for its own benefit and not as an intermediary, such as an agent, trustee or authorized signatory, for some other person.*

The directive exclude from the „beneficial owner”s” heading the agents collecting income in the name and for the account of another person and intermediaries collecting the income in their own name but for the benefit of another person. This approach is consistent with the meaning given in the OECD Commentaries with the exception that the latter is arguably wider than a mere exclusion of agents, nominees, trustees and fiduciary owners and could include conduit and holding companies receiving income in their own name and for their own account.

## 5. Concluding remarks

Ultimate beneficial owners can be dominant enough to control the corporate governance system to favor their own interests. The general idea that transpose from academic literature is that the absence of an ultimate beneficial owner has a positive effect on corporate governance, whereas the presence of ultimate beneficial owner has a negative effect. The outcomes are in line with the expropriation effect given that weaker corporate governance system facilitates ultimate beneficial owner ability to extract private benefits of control. On the other hand, beneficial owner is one of the most important concepts used in tax treaties, which has been adopted in most bilateral treaties, but was not defined in any. Its meaning is thus left to be interpreted under OECD rules.

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