

*Interaction of paragraphs 6 and 7 with the determination of “beneficial ownership”*

With respect to payments of income, profits or gain arising in a Contracting State and derived directly by a resident of the other Contracting State (and not through a fiscally transparent entity), the term “beneficial owner” is defined under the internal law of the country imposing tax (*i.e.*, the source State). Thus, if the payment arising in a Contracting State is derived by a resident of the other State who under the laws of the first-mentioned State is determined to be a nominee or agent acting on behalf of a person that is not a resident of that other State, the payment will not be entitled to the benefits of the Convention. However, payments arising in a Contracting State and derived by a nominee on behalf of a resident of that other State would be entitled to benefits. These limitations are confirmed by paragraph 12 of the Commentary to Article 10 of the OECD Model.

Special rules apply in the case of income, profits or gains derived through a fiscally transparent entity, as described in new paragraph 6 of Article IV. Residence State principles determine who derives the income, profits or gains, to assure that the income, profits or gains for which the source State grants benefits of the Convention will be taken into account for tax purposes by a resident of the residence State. Source country principles of beneficial ownership apply to determine whether the person who derives the income, profits or gains, or another resident of the other Contracting State, is the beneficial owner of the income, profits or gains. The source State may conclude that the person who derives the income, profits or gains in the residence State is a mere nominee, agent, conduit, etc., for a third country resident and deny benefits of the Convention. If the person who derives the income, profits or gains under paragraph 6 of Article IV would not be treated under the source State's principles for determining beneficial ownership as a nominee, agent, custodian, conduit, etc., that person will be treated as the beneficial owner of the income, profits or gains for purposes of the Convention.

Assume, for instance, that interest arising in the United States is paid to CanLP, an entity established in Canada which is treated as fiscally transparent for Canadian tax purposes but is treated as a company for U.S. tax purposes. CanCo, a company incorporated in Canada, is the sole interest holder in CanLP. Paragraph 6 of Article IV provides that CanCo derives the interest. However, if under the laws of the United States regarding payments to nominees, agents, custodians and conduits, CanCo is found to be a nominee, agent, custodian or conduit for a person who is not a resident of Canada, CanCo will not be considered the beneficial owner of the interest and will not be entitled to the benefits of Article XI with respect to such interest. The payment may be entitled to benefits, however, if CanCo is found to be a nominee, agent, custodian or conduit for a person who is a resident of Canada.

With respect to Canadian-source income, profit or gains, beneficial ownership is to be determined under Canadian law. For example, assume that LLC, an entity that is treated as fiscally transparent for U.S. tax purposes, but as a corporation for Canadian tax purposes, is owned by USCo, a U.S. resident company. LLC receives Canadian-source income. The question of the beneficial ownership of the income received by LLC is determined under Canadian law. If LLC is considered the beneficial owner of the income under Canadian law, paragraph 6 shall apply to extend benefits of the Convention to the income received by LLC to the extent that the

