BENEFICIAL OWNERSHIP AND THE PRIMACY OF SUBSTANCE OVER FORM

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ABSTRACT

Beneficial ownership is a fundamental concept in international taxation, particularly in determining eligibility for tax treaty benefits and addressing arrangements involving treaty abuse and tax avoidance. Despite its significance, the term is not expressly defined under the Income Tax Act, 1961 or most tax treaties, resulting in its interpretation largely through judicial precedents, OECD guidance, and anti-abuse provisions. This article examines the evolution and practical application of beneficial ownership through the doctrine of substance over form, distinguishing economic ownership from mere legal title. It analyses the key parameters relevant to determining beneficial ownership, including control and enjoyment of income, commercial substance, economic risk, independent decision-making, and the existence of genuine commercial rationale. The article further examines the interaction of beneficial ownership with the Principal Purpose Test (PPT), General Anti-Avoidance Rule (GAAR), and Limitation of Benefits (LOB) provisions. Through judicial precedents and practical illustrations, it highlights how tax authorities and courts assess whether an entity is the true beneficial owner or merely a conduit for income. The article concludes by emphasizing the importance of genuine commercial substance and robust documentation in substantiating beneficial ownership and accessing treaty benefits, reinforcing that economic reality, rather than legal form alone, remains central to its determination.

Introduction

The concept of beneficial ownership occupies a pivotal place in international taxation, particularly in the interpretation and application of tax treaties or Double Taxation Avoidance Agreements and anti-abuse provisions such as General Anti-Avoidance Rule ('GAAR') and Limitation of Benefits ('LOB').

The expression appears deceptively simple, yet its application is anything but straightforward. In practice, it gives rise to several fundamental questions:

- who, in substance, is the beneficial owner of income?
- how is beneficial ownership determined?
- what parameters do tax authorities and courts rely upon to identify a beneficial owner?

This article explores the concept of beneficial ownership from its theoretical origins to its practical application under tax treaties.

1. Key Terms to Understand

The term 'beneficial ownership' is not defined under either the Income Tax Act, 1961 or tax treaties. Accordingly, to understand the concept, it is useful to first examine the ordinary meaning of its constituent terms. As defined by the Oxford English Dictionary:

The term **'beneficial'** denotes something that is helpful, useful, or advantageous.

'Beneficiary' refers to a person who derives an advantage or benefit from something.

'Ownership' signifies the fact or state of owning property or rights.

When these terms are read together, 'beneficial ownership' focuses on the person who ultimately enjoys the economic benefits associated with ownership, irrespective of whether such person is reflected as the legal owner in documentation.

Rationale Behind Introduction of Beneficial Ownership

The concept of beneficial ownership was introduced in international tax treaties to serve two closely connected objectives: grant of treaty benefits to genuine taxpayers and prevention of abuse of tax treaties.

1.1 Grant of Tax Treaty Benefits

Tax treaties provide reduced withholding tax rates or exemptions in respect of passive income such as dividends, interest, royalties, fee for technical/ included services subject to the condition that the recipient is the beneficial owner of such income.

This requirement ensures that treaty benefits are:

- Restricted to genuine residents of the contracting state; and
- Granted only where the recipient substantively owns and controls the income, rather than merely receiving it in a legal capacity.

1.2 Anti-Abuse and Anti-Avoidance Objectives

Beneficial ownership serves as a key anti-abuse mechanism by enabling tax authorities to look beyond formal legal structures and examine the economic substance of transactions and arrangements. In particular, the concept helps to:

- **Counter treaty shopping** by ensuring that treaty benefits are accessed only by entities with genuine substance, rather than intermediaries that merely route income to residents of non-treaty jurisdictions or jurisdictions with less favorable treaty provisions.
- **Facilitate the application of GAAR**, which empowers tax authorities to examine arrangements that lack commercial substance and are undertaken primarily to obtain tax benefits. Such arrangements may fall within the scope of GAAR based on their overall substance and purpose.

2. Beneficial Ownership vs Legal Ownership: A clear distinction

Legal ownership denotes the holding of legal title to an asset and is evidenced by formal documentation or registration and is recognized by law as the owner of the property

Conversely, beneficial ownership exists where a person, irrespective of holding legal title, possesses the substantive rights associated with ownership. These rights include:

- the right to enjoy the economic benefits arising from the underlying asset; and
- the ability to exercise control over the use, management, and disposal of the asset.

Accordingly, beneficial ownership focuses on economic reality rather than legal form. It follows a substance over form approach. A person may qualify as the beneficial owner even in the absence of legal ownership, provided such person effectively enjoys the benefits of, and exercises control over, the underlying asset[1].

Thus, beneficial ownership requires a deeper inquiry into who, in substance, enjoys and controls the income, an inquiry that is guided by specific parameters and tests, which are discussed in the next section.

3. Parameters for Determining Beneficial Ownership

The Tax Residency Certificate (TRC) issued by the country of residence constitutes sufficient evidence of tax residence and beneficial ownership for treaty purposes, thereby creating a strong presumption in favor of the taxpayer[2].

However, it may be refuted if the revenue furnishes cogent evidence establishing that the recipient lacks beneficial ownership[3]. Moreover, the Supreme Court in *Tiger Global International Holdings* has emphatically reaffirmed that the determination of beneficial ownership must be guided by the doctrine of substance over form. This doctrine requires tax authorities and courts to assess the real nature of an arrangement by examining its economic and commercial substance, rather than being confined to its legal form and TRC.

Subsequently, the scope of applicability of GAAR has been notified to provide that income arising from transfer of investments made prior to April 1, 2017 shall not be subjected to

[1] Organisation for Economic Co-operation and Development (OECD), Building Effective Beneficial Ownership Frameworks
Authority for Advance Rulings (Income-tax) v. Tiger Global International II Holdings, 182 TAXMANN.COM 375 (S.C. 2026)
[2] Union of India v. Azadi Bachao Andolan, (2003) 263 I.T.R. 706 (S.C. 2003)
[3] Lowy P.I. (Lux) S.A.R.L. v. Assistant Commissioner of Income Tax (International Taxation), 170 TAXMANN.COM 475 (Delhi Trib. 2025)

GAAR, notwithstanding that such tax benefits may arise thereafter[4].

Judicial precedents, OECD commentaries, and administrative guidance demonstrate that beneficial ownership is best assessed through a series of fact-specific questions, rather than a rigid formula.

Question 1: Does the recipient entity have the unrestricted right to use and enjoy the income received?

Answer: The recipient qualifies as the beneficial owner where it has the independent right to retain, deploy, or reinvest the income for its own commercial purposes. Control over, and the unrestricted ability to use or dispose of, the assets and income is a core attribute of beneficial ownership; where the taxpayer exercises such control independently, it cannot be denied the beneficial owner status[3].

Further, the assumption of economic risk in relation to such income serves as an important reinforcing factor. An entity that bears the risks associated with the income is more likely to be regarded as the beneficial owner. Conversely, where the entity is shielded from such risks, it may indicate the absence of true ownership.

Question 2: Does the entity have commercial substance?[5]

Answer: Beneficial ownership vests in the person/ entity that exercises effective decision-making authority, including decisions relating to investment strategy, timing of exit, and distribution of returns. The Court clarified that the presence of upstream investors or fund participants does not, by itself, negate beneficial ownership, so long as the recipient exercises commercial discretion.

Further, the Delhi High Court in *Principal Commissioner of Income-tax, Central-1 vs. Pradeep Wig [2026] 185 taxmann.com 1002 (Delhi)[24-04-2026]* held that Indian resident shareholders of a British Virgin Islands company could not be treated as the beneficial owners of the company's underlying assets merely because they exercised effective control over the

[4] Notification No. 54/2026, Central Board of Direct Taxes (2026) (India)
[5] Sanofi Pasteur Holding SA v. Department of Revenue, Ministry of Finance, 30 TAXMANN.COM 222 (A.P. 2013)

company.

The Court noted that the company had been validly incorporated, acquired properties in the United Kingdom through funds remitted under the Liberalized Remittance Scheme and bank borrowings, and had paid applicable taxes in the United Kingdom. In view of these facts, the Court held that the company possessed independent legal and commercial substance, and its rental income and capital gains could not be taxed in the hands of the shareholders.

Question 3: Is the arrangement primarily tax-driven? ***(Principal Purpose Test('PPT'))***[6]

Answer: It provides that tax treaty benefits shall be denied where it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining such benefit was one of the principal purposes of any arrangement or transaction that directly or indirectly resulted in that benefit.

PPT thus operates as a substance-based anti-abuse rule, ensuring that treaty relief is available only to arrangements reflecting genuine commercial rationale rather than predominantly tax-driven structures.

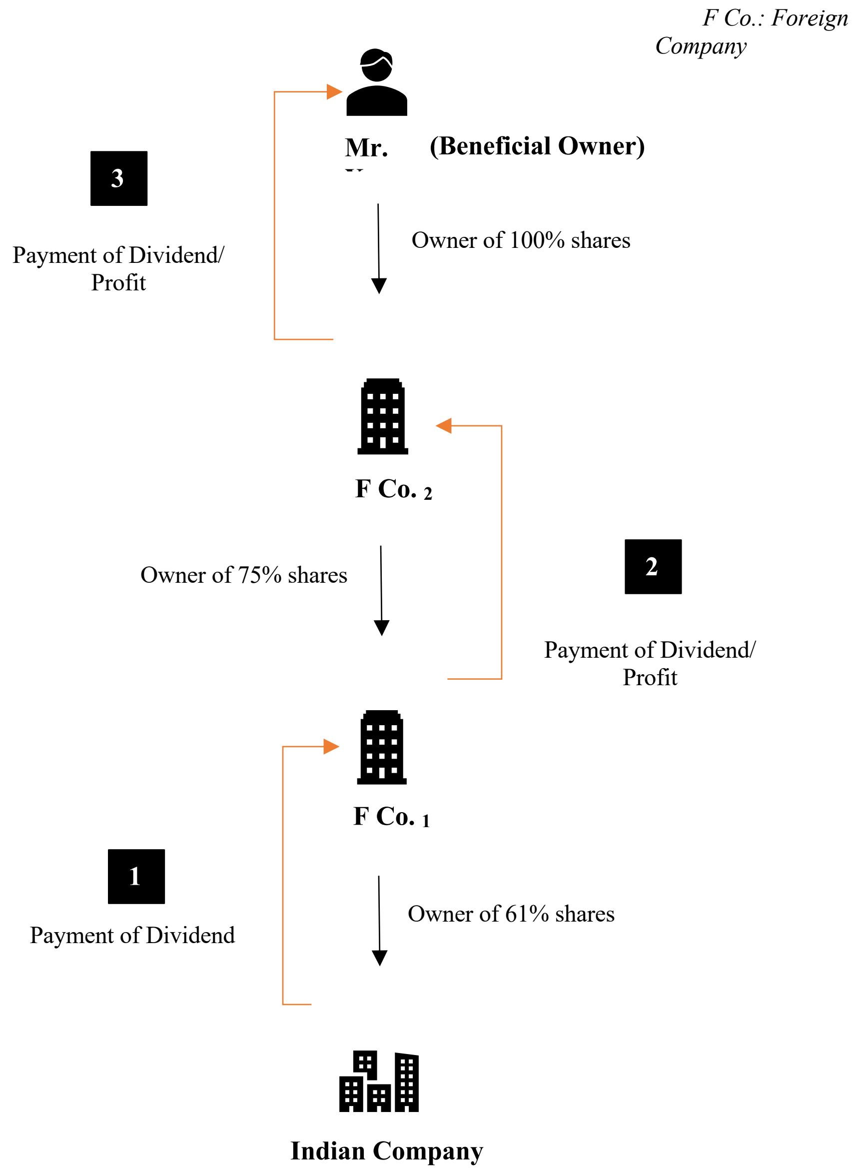
Question 4: When would provisions of GAAR be applicable?

Answer: The provisions of GAAR shall not be invoked in cases where income accrues or arises to, accrues to, or is deemed to accrue or arise to, or is received or deemed to be received by a person from transfer of such investments which were made prior to April 1, 2017.

[6] Circular No. 1/2025, Central Board of Direct Taxes (2025) (India)

4. Understanding Beneficial Ownership in Practice

Illustration 1- Transaction Flow depicting Beneficial Owner



- **Flow of income:** The illustration shows dividends moving upward from the Indian Company to F $Co._1$ (as the immediate shareholder), then to F $Co._2$, and finally to Mr. X. At each stage, the intermediary entity is the legal recipient of the dividend.

- **Control and enjoyment:** However, since Mr. X ultimately owns 100% of F $Co._2$, which in turn holds 75% of F $Co._1$, he exercises effective control over the structure and ultimately enjoys the economic benefit of the dividend income, making him the true beneficial owner.

For treaty benefits to apply, tax authorities will examine whether F $Co._1$ and F $Co._2$ are the beneficial owners of the dividend i.e., whether it has the independent right to use and enjoy the income or whether it merely acts as an intermediary for Mr. X, in which case tax treaty benefits may be denied.

To substantiate claims of beneficial ownership and eligibility for treaty benefits, taxpayers should maintain robust documentation, as discussed in the following section.

5. Suggested Documentation

- **Valid TRC:** Availability of a valid TRC issued by the tax authorities of the country of residence for the relevant period.

- **Evidence of Commercial Substance:** Evidence of genuine commercial activities, operational expenditure, and independent decision-making. The entity should not function merely as an intermediary.

- **Control over Income and Assets:** Documentation demonstrating the entity's unrestricted right to use, enjoy, and dispose of the income or assets, without any obligation to pass them on.

- **Economic Rationale:** Clear commercial or economic justification for the existence of the entity and the transaction, independent of tax considerations or confirmation that the arrangement is not structured solely to avoid taxes.

- **Compliance with LOB and GAAR Provisions:** Where applicable, evidence of satisfaction of LOB clauses under the relevant tax treaty and assessment of exposure under GAAR.

In summary, taxpayers must ensure that their structures reflect genuine commercial substance and that the entity claiming tax treaty benefits is the true beneficial owner of the income.

Conclusion

Beneficial ownership is a substance-driven concept that goes beyond mere legal title and focuses on identifying the true economic owner of income for tax treaty purposes. The absence of its definition under Indian tax law or tax treaties has led to its evolution through judicial precedents, OECD commentaries, and anti-avoidance frameworks.

Courts and tax authorities consistently rely on parameters such as control over income, commercial substance, economic rationale, and the absence of conduit arrangements to distinguish genuine beneficial owners from intermediaries. While a valid TRC creates a strong presumption in favor of the taxpayer, such presumption can be contradicted where evidence indicates lack of substance or treaty abuse.

However, the notified scope of GAAR ensures that income arising from transfer of investments which were made prior to April 1, 2017 remains outside its ambit, taxpayers seeking tax treaty benefits must ensure that their structures reflect real commercial substance and are supported by robust documentation, as beneficial ownership will be tested on economic reality rather than legal form alone.