

Withholding Taxation...

of Fictitious, Deemed or Constructive Payments

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- Fictitious, Deemed and Constructive payments
 - Possible antonyms: ‘real income’, ‘actual payment’, ‘wealth increases’
 - No clear dividing line in academic literature
 - Discussion whether possible and or necessary to distinguish (e.g. Wattel/Marres, Lang)
- Income for tax purposes = as defined in law
- Income from economic perspective = All increases in wealth and consumption (over a defined period of time) (*Schanz-Haig-Simons*: $\text{Income} = \text{Consumption} + \text{Saving}$)
- Proposed categorisation:
 - “**Fictitious**” here refers to instances in which tax laws stipulate income that does not correspond to an economic benefit under SHS
 - “**Deemed**” here refers to items of income corresponding to increases in wealth that are recognised without any transfer of wealth from a civil law point of view
 - “**Constructive**” here refers to items of income that are “recharacterised” for tax purposes relative to its civil law form

- Does a tax treaty apply to fictitious / deemed income?
 - (Ir)relevance of the terms “paid to”, “received by” and “derived from”
 - Scope of a tax treaty – “taxes on income”
- Which treaty article (if any) applies?
 - Articles 6-20
 - Article 21
- Limited case law

■ *Fictitious dividend*

■ Example

- Law stipulates ‘withholding tax’ on fixed percentage of share value held by foreign owners

■ Does the tax treaty apply?

- Article 2: There shall be regarded as taxes on income and on capital all ***taxes imposed on total income, on total capital, or on elements of income or of capital***, including taxes on gains from the alienation of movable or immovable property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.
- The Convention shall apply also to ***any identical or substantially similar taxes*** ...

■ Can Article 10 apply?

- Article 10(3): The term “dividends” as used in this Article means ***income from shares***, “jouissance” shares or “jouissance” rights, mining shares, founders’ shares or other rights, not being debt-claims, participating in profits, as well as ***income from other corporate rights*** which is subjected to the same taxation treatment as income from shares by the laws of the State of which the ***company making the distribution*** is a resident.
- Article 21: Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Convention shall be taxable only in that State.
- Article 22: All other elements of capital of a resident of a Contracting State shall be taxable only in that State.

- ***Deemed dividend***

- Examples

- CFC income attribution by way of constructive dividend
 - Deemed 'dividend' from PE to head office (branch remittance tax) or company shareholders (second level withholding tax)

- Can Article 10 apply?

- Article 10(3): The term “dividends” as used in this Article means ***income from shares***, “jouissance” shares or “jouissance” rights, mining shares, founders’ shares or other rights, not being debt-claims, participating in profits, as well as ***income from other corporate rights*** which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.
 - Article 7 / 21

- ***Constructive dividend***

- Examples

- Excessive interest paid by subsidiary to parent company
 - Secondary adjustment made following arm's-length based primary adjustment

- Can Article 10 apply?

- OECD Commentary para. 28: includes 'disguised distributions of profits'
 - Article 11(6): Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt-claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

- Sense and sensibility of imposing a “withholding tax” where no payment occurs
 - Indistinguishable from shifting tax burden to resident (presumptive “payer”)
 - Serious risk for relief mechanism to fail
- CJEU: lack of payment means that restriction on withholding taxation cannot apply (C-257/20, Viva Telecom)

Room for Debate

