

# Withholding Taxes in Secondary Law

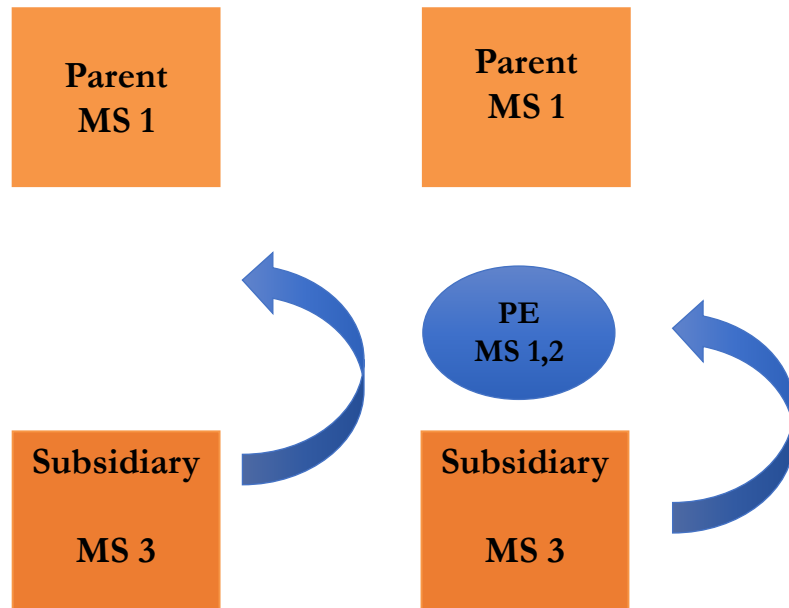
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# Withholding Taxes in General

- Collection mechanism of source state taxes on profit distributions, interest or royalty payments
  - If such payments are taxable...
- Withholding taxes under EU secondary law
  - Withholding taxes under the Parent/Subsidiary Directive
  - Withholding taxes under the Interest and Royalties Directive
  - Withholding taxes under the proposed FASTER Directive
- (Lack of) Withholding Taxes & Aggressive Tax Planning

# Withholding Taxes – Parent/Subsidiary Directive



- Parent company
  - Originally 25% capital ... now reduced to 10%
  - Options to use voting rights and require a holding period
- No withholding taxes
  - Original derogations for Germany, Greece and Portugal expired
  - Name immaterial ... 3 factor test
    - the chargeable event was payment of dividend
    - the taxable amount was the income from the shares
    - the taxable person was the holder of the shares
- Avoidance of double taxation
  - Exemption ... or tax with credit
  - From 2014 ... *'refrain from taxing such profits to the extent that such profits are not deductible by the subsidiary, and tax such profits to the extent that such profits are deductible by the subsidiary'*
- Anti-abuse/anti-avoidance provisions

## Withholding Taxes – Parent/Subsidiary Directive

- Case C-375/98 *Epson Europe BV*
  - Portugal allowed to impose 15% withholding tax. But it also imposed a 5% succession and donation tax (ISD) in respect of transfers, without consideration, of shares in companies. Tax levied, whenever profits were distributed, on the dividends paid by Portuguese companies.
  - Withholding tax in breach of Directive – name immaterial
- Case C-294/99 *Athinaiki Zythopii*
  - Under Greek law, when Greek subsidiary distributed profits to its parent, the subsidiary was required to include previously tax exempt income in its tax base for the purposes of assessing additional tax. If profits remained undistributed, then no additional tax assessed.
  - Withholding tax in breach of Directive – 3 factor test

## Withholding Taxes – Parent/Subsidiary Directive

- Case C-284/06 *Burda*
  - The distributable equity of German resident companies was divided into taxed and untaxed equity baskets. If a distribution was made out of the taxed basket, the corporation tax was reduced. If it was made out of the untaxed basket, it was increased to 30%.
  - Here, dividends paid by German company to Dutch parent were deemed (by tax authorities) to have been paid out of the untaxed equity basket and were subject to the tax uplift.
  - Tax uplift was not a withholding tax, because it was a tax burden on the subsidiary
    - Taxable person (German company) was not the holder of the shares (Dutch parent).

## Withholding Taxes – Parent/Subsidiary Directive

- Joined Cases C-338/08 & C-339/09 *Ferrero*
  - Tax on cross-border refund of adjustment surtax on dividends
  - Adjustment surtax was corrective mechanism intended to prevent a tax credit from being granted for tax that had not been paid.
    - The mechanism applied regardless of whether the parent company was resident in the same Member State or in another Member State.
  - Taxable person was not the shareholder but the company making the distribution
  - Not a withholding tax

# Withholding Taxes – Parent/Subsidiary Directive

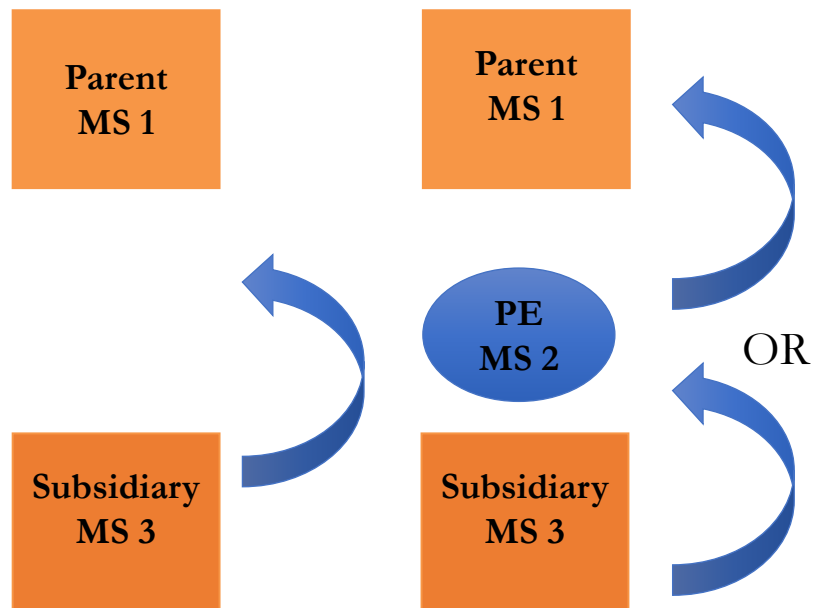
- Case C-68/15 *Belgian Fairness Tax*
  - Applying the 5.15% Belgian Fairness Tax, if a resident corporate taxpayer redistributed dividends (in a taxable period subsequent to the taxable period in which it received those dividends).
  - Breach of Directive because dividends received were, upon redistribution, included (once again) in the tax base.
- Case C-365/15 *AFEP*
  - French 3% contribution on redistribution of profits in breach of Directive
  - No distinction between a tax due by the parent company when it receives the distributed profits or when it subsequently redistributes those profits.

## Withholding Taxes – Parent/Subsidiary Directive

- Case C-310/09 *Ministre du Budget, des Comptes publics et de la Fonction publique v Accor SA*
  - A French parent entity receiving dividends from a resident subsidiary benefited from a tax credit equal to 50% of the distributed dividend, provided that the dividends were redistributed via a chain of companies. When distributed profits were derived from profits that had not been taxed or had been taxed only partially at the level of the distributing company, as a corrective mechanism, an advance payment of tax equal to the tax credit was payable upon redistribution.
  - For domestic dividends, the tax credit attached to the distribution was offset against the advance tax payment due on the redistribution of such dividends
  - No tax credit for dividends received from EU subsidiaries
  - Breach of P/S Directive



# Withholding Taxes – Interest and Royalties Directive



- 25% direct minimum holding
- No withholding tax if beneficial owner is
  - a company of another MS which receives payment for its own benefit and not as an intermediary ... such as an agent, trustee or authorised signatory
  - a PE of a MS company situated in another MS
    - if the debt-claim, right or use of information in respect of which payments arise *is effectively connected* with that PE and
    - Income *is subject to tax in the MS*
  - When a PE is a payer or beneficial owner of interest and royalties, *no other* part of the company shall be treated as payer or beneficial owner
- Source state need not exempt payments
  - Treated as a distribution of profits
  - From debt-claims carrying a right to participate in profits
  - From debt-claims entitling creditor to exchange right to interest with profit participation
  - From debt-claims with no provision for repayment or where repayment due in 50+ years after issue date.
- Holding period option
- Anti-abuse/anti-avoidance provisions

# Withholding Taxes – Interest and Royalties Directive

- Case C-397/09 *Scheuten Solar Technology*
  - Under German law, loan interest paid by company of one MS to associated company of another MS was added to the basis of assessment to trade tax for the first company.
  - Art 1(1) only relevant to the tax position of the interest creditor. The method of calculating the basis of assessment of the interest payer and the elements to be taken into account for that purpose (e.g. the taking of certain expenditure into consideration when performing that calculation) *were* not the subject of Art 1(1).
  - The Directive does not oppose the interest deduction limitation at the level of the payer company.

## Withholding Taxes – Interest and Royalties Directive

- Case C-257/20 *Viva Telecom Bulgaria*
  - Withholding tax on fictitious interest (deemed interest) assessed on interest-free loans between related parties was not covered by the Interest and Royalties Directive.
  - When notional interest was set on an interest-free loan, the lender received no interest and could not be regarded as an actual beneficial owner. As such:
    - The notional interest could not be regarded as interest payment for the purposes of the Directive.
    - The interest could not be regarded as a ‘distribution of profits’ within the meaning of the Parent-Subsidiary Directive.

## **Draft FASTER Directive**

- Streamlining withholding tax procedures in the EU
- Common EU digital tax residence certificate issued by investor's state
- Choice between 'relief at source' system and a 'quick refund' system – or combination of two
- Common reporting obligations on all financial intermediaries in the chain through the establishment of a national register of certified financial intermediaries.

# **(Lack of) Withholding Taxes & Aggressive Tax Planning**

- An ATP indicator?
- Commission's 2016 Study on Structures of Aggressive Tax Planning and Indicators
  - Lack of withholding taxes considered a passive indicator: it did not by itself promote or prompt any aggressive tax planning structure but was needed in order not to hinder or block such structure.
  - Lack of beneficial ownership tests for reduced withholding taxes considered a lack of anti-abuse ATP indicator (?): it represented the lack of rules aimed at counteracting the avoidance of tax.

# (Lack of) Withholding Taxes & Aggressive Tax Planning

- EU's list of non-cooperative jurisdictions
  - Recommended that Member States should impose withholding taxes on outbound payments to non-cooperative jurisdictions, as a defensive legislative measure.
  - See Guidance on defensive measures in the tax area towards non-cooperative jurisdictions, dated 25 November 2019. Doc 14114/19, available at: <https://data.consilium.europa.eu/doc/document/ST-14114-2019-INIT/en/pdf>
- Country Specific Recommendations to some Member States (e.g. Cyprus) to introduce withholding taxes for payments to low tax jurisdictions (i.e. not just listed jurisdictions).

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