Throughout the European Union, national income tax systems support charitable activities by way of preferential treatment. However, a number of Member States operate relief regimes which appear to trigger the question of compatibility with Union law with respect to the fundamental freedoms. In this first study to examine charity and donor taxation regimes across a wide range of Member States, the author focuses on compatibility with EU non-discrimination law. She examines twenty national regimes, both comparatively and from the perspective of overarching EU law.

The countries covered are Austria, Belgium, Bulgaria, Cyprus, Estonia, Finland, Germany, Hungary, Ireland, Italy, Latvia, Lithuania, Malta, The Netherlands, Poland, Portugal, Slovakia, Spain, Sweden, and the United Kingdom. Even in a fully harmonized scheme of charity and donor taxation, the Member States must observe primary Union law and grant non-discriminatory treatment where a fact pattern falls within the ambit of the fundamental freedoms. In the course of defining this framework, the study addresses such issues as the following:

- types of relief schemes maintained for charities and donors;
- administrative requirements;
- international aspects (both inbound and outbound);
- privileged donations and capital gains treatment of in-kind donations;
- eligible donors;
- whether and to what extent charitable entities and donors can actually rely on the fundamental freedoms;
- specific applicability of each of the relevant fundamental freedoms;
- the issue of comparability;
- justifications for restrictive measures in Member State practice; and
- the issue of proportionality.

September 2011, 312 pp., hardbound
ISBN: 9789041138132
Price: EUR 130.00 / USD 176.00 / GBP 104.00
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Dividend Withholding Tax Planning Techniques: Part 1

Paulus Merks**

Although there is a confounding variety of cross border dividend withholding tax planning techniques available to the modern corporate taxpayer, this study has sought to identify, analyse and categorize these techniques in abstracto and, unless stated otherwise, without linking these techniques to particular countries. Part 1 of this two-part study identifies, analyses and categorizes the so-called formal dividend withholding tax planning techniques. Part 2 identifies, analyses and categorizes the so-called substantive dividend withholding tax planning techniques. In addition, part 2 provides a framework whereby the various dividend withholding tax planning techniques can be categorized in a consistent and universal manner.

Such framework may have more than a purely academic value. It may be of benefit for the corporate taxpayer and his advisors since the framework can make clear what sorts of dividend withholding tax planning techniques are worldwide available and what planning technique the respective taxpayer may suit best. In addition, the framework can also be of benefit to governments. It may prove a tool to categorize and administer what planning techniques are used by what sort of taxpayer and at what frequency. Moreover, the framework may perfectly show what dividend withholding tax loopholes in domestic legislation are still clear and present.

1. INTRODUCTION

The ongoing process of globalization not only results in a greater exchange of information, technology, and knowledge but also in a significant increase in tax planning, including planning with regard to the repatriation of cash. In this respect, international dividend withholding tax planning has been subject to a continuous improvement in recent years. The reason is twofold: the globalization drive led to an increased knowledge and understanding of the various tax systems in countries around the world and makes it easier for international operating companies to reduce dividend withholding tax by way of planning. Consequently, cases whereby cross-border dividend payments are subject to no taxation at all may become increasingly frequent. Although there is a confounding variety of cross-border dividend withholding tax planning techniques available to the modern taxpayer, in this two-part study, I try to identify, analyse, and categorize these various techniques in abstracto and, unless stated otherwise, without linking these techniques to particular countries. In Part 1, I will identify, analyse, and categorize the so-called formal dividend withholding tax planning techniques, whereas in Part 2, I will identify, analyse, and categorize substantive dividend withholding tax planning techniques. Also in Part 2, I will provide a framework, whereby the various dividend withholding tax planning techniques can be categorized in a consistent and universal manner. Before doing so, however, I will first outline the general starting points and the corporate cross-border dividend withholding tax planning ‘base case’.

2. DIVIDEND WITHHOLDING TAX PLANNING STARTING POINTS

The base case is simple. A parent company, resident of Country X, is liable to dividend withholding tax on dividend payments received from the dividend payor, resident of Country X. Before articles have been accepted for publication in Intertax’ peer-reviewed section, they have been subject to double-blind peer review; that is, two academic reviewers who shall remain anonymous to the author and to each other and neither of whom are from the same country as the author have evaluated the article’s academic merit. Only articles confirmed by the reviewers to show the highest standards of scholarship are accepted for publication in this section.

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1 The term ‘tax planning’ as used in this article includes both acceptable (or harmless) and unacceptable (or harmful) tax planning; the latter is also known as ‘tax avoidance’.


4 See, for instance, the ‘International Tax Expert Online’, which is advertised as ‘a full-feature tool that simulates the most tax-efficient route to structure a cross-border transaction in just a few clicks’ for EUR 1,810/USD 2,510 (VAT excluded) at <www.ibfd.com>, 2011.


6 See, for example, Rainer Zentke, ‘International Tax Planning with Comtax’, Intertax 37, (March 2009).
Country Z.\textsuperscript{6,7} Apparently, there is no tax treaty or European Directive applicable that de facto eliminates the withholding tax due in the base case at hand. There may be all sorts of reasons for this. For instance, if there is a tax treaty applicable between Country X and Country Z, that is identical to the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention 2010, dividends paid by the company in Country Z may not only be taxed in Country X, they may also be taxed against 5% or 15% in Country Z.\textsuperscript{8}

Consequently, under all tax treaties that have a dividend article that is identical to the OECD Model Tax Convention (2010) in this respect, there may at least be 5% withholding tax due on dividend payments. A minimum of 5% withholding tax that may effectively not be creditable against corporate income tax at the level of the parent company either because the underlying dividend income is tax exempt in the state of residence (e.g., under a domestic participation exemption or because the state of residence has adopted a territorial system of taxation) or because the state of residence does not grant a foreign tax credit in the case at hand.\textsuperscript{9}

The objective of international corporate dividend withholding tax planning is to minimize the incidence of dividend withholding tax without creating additional tax in order to maximize total net profits.\textsuperscript{10} The main reason is that it is the after-tax profit that determines the earnings per share ratio and therefore the shareholder value of the underlying corporation. Or, in other words, it is the after-tax profit that typically drives the stock price. Therefore, to be fully competitive in the international market, a company engaging in cross-border business has to obtain information on the tax treatment of its proposed cash repatriation both in the source and the residence jurisdiction and then to seek favourable planning taking into account the associated risks and opportunities. In this respect, dividend withholding tax can be a serious burden for the shareholders of the underlying corporation.\textsuperscript{11}

3. SUBSTANTIVE VERSUS FORMAL DIVIDEND WITHHOLDING TAX PLANNING

A first distinction that can be made in dividend withholding tax planning techniques is the distinction between substantive and formal tax planning.\textsuperscript{12} Substantive tax planning alters the pattern of economic activity. For example, if the dividend withholding tax rate is high in a certain jurisdiction, a company may either leave this jurisdiction, in response to the high tax rate, and move its operations to an effectively 0% dividend withholding tax jurisdiction (e.g., Cyprus, Ireland, Malta, the United Kingdom) or it may not start operations in the high dividend tax jurisdiction in the first place.

On the other hand, formal dividend withholding tax planning retains the substance of the activity however inserts steps or transactions for the purpose of reducing the amount of dividend withholding tax due. Formal dividend withholding tax planning typically includes nothing more than one or more paper transactions. For example, instead of distributing a dividend that may be liable to dividend withholding tax, a company may do a tax-free formal capital repayment for the sole purpose of lowering the dividend withholding tax on the intended cash repatriation.

4. FORMAL DIVIDEND WITHHOLDING TAX PLANNING

Formal dividend withholding tax planning comes in many forms and varieties. However, it can simply be divided in planning that does make use and in planning that does not make use of a holding company.\textsuperscript{13} The first mentioned group can be subdivided in two main forms of dividend withholding tax planning, both entailing the use of a
holding company: (A) the sale of the dividend payor to a holding company against a note payable\(^1\) and (B) the contribution of the dividend payor to a holding company against share capital. In this regard, for a jurisdiction to be considered as an attractive holding company location, four criteria must typically be met: (1) incoming dividends remitted by a subsidiary to the holding company must either be exempted from withholding tax or subject to a low withholding tax rate in the subsidiary’s jurisdiction pursuant to the bilateral tax treaty or the European Union (EU) Parent-Subsidiary Directive (hereinafter the ‘Directive’);\(^2\) (2) dividend income received by the holding company from the subsidiary must be exempt from tax or subject to a low effective tax rate in the holding company’s jurisdiction; (3) profits realized by the holding company on the sale of shares in the subsidiary must either be exempt from tax or subject to a low effective rate of capital gains tax in the holding company’s jurisdiction; and (4) outgoing dividends paid by the holding company to the ultimate parent corporation must either be exempt from or subject to low withholding tax rates in the holding company’s jurisdiction.\(^3\)

Additional tax criteria for an attractive holding company jurisdiction include the absence of tax on capital contributions, the deductibility of losses on participations, the deductibility of costs relating to participations, the ability to obtain in advance certainty from local tax authorities,\(^4\) the absence of withholding tax on interest paid by the holding company, the absence of withholding tax on royalties paid by the holding company, the absence of anti-abuse regulations including Controlled Foreign Corporation (CFC) provisions. Moreover, non-tax criteria for an attractive holding company jurisdiction include, but are not limited to, political and financial stability, a modern and efficient financial infrastructure, the possibility to distribute dividends during the financial year, and a business friendly government.\(^5\)

The second mentioned group whereby no special holding company is used can in its turn be subdivided in the following four subgroups: (C) the conversion of the dividend payment in a repayment of capital to the parent company, (D) the conversion of the dividend payment into a loan from the subsidiary (the creditor) to the parent company (the debtor), (E) the conversion of the dividend payment into a liquidation of the company that would otherwise pay out the dividend, and (F) the conversion of the dividend payment into an asset acquisition payment. All the aforementioned six forms are described in this paragraph.

### 4.1. Sale of Dividend Payor to a Holding Company against a Note Payable

In this dividend tax planning scenario, the parent company that in the basic setting would be liable to dividend withholding tax incorporates a holding company\(^6\) in a state where no withholding tax is actually levied (this may either be the same jurisdiction as where the (future) dividend payor is established or in a third jurisdiction). Subsequently, the parent company sells its shareholding in the dividend payor to the new holding company for a note.\(^7\)

Depending, inter alia, on the tax treatment of dividends and interest in the country where the recipient of the income is a resident, the differentiation between dividends and interest in the source state may form an incentive to change from equity financing to debt financing.\(^8\) In treaty scenarios, this may be the case in several source states, since under several tax treaties, the source state taxation of interest is more favourable than the source state taxation of dividends.\(^9\)

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**Notes**

\(^{14}\) The note may be for the full amount of the share price or, alternatively, part of the amount of the share price whereby the remaining part of the share price may be paid-in cash or in shares in the acquiring entity.


\(^{16}\) In this regard, typical holding company jurisdictions include, but are not limited to, Cyprus, Hong Kong, Luxembourg, Malta, the Netherlands, Singapore, Spain, Switzerland, and the United Kingdom.

\(^{17}\) Both by way of advance tax rulings (ATRs) and advance pricing agreements (APAs). For example, Willem Vermeend, Rick van der Ploeg & Jan Willem Timmer, ‘Taxes and the Economy: A Survey on the Impact of Taxes on Growth, Employment, Investment, Consumption and the Environment’ (Cheltenham, United Kingdom: Edward Elgar Publishing Limited, 2008), 276.


\(^{19}\) This can either be a newly incorporated holding company, an existing company within the group, or a shell company to be bought from a third party.

\(^{20}\) The remaining part of the dividend payor-shares, if any, may be contributed into the holding company, for example, by a share-for-share merger.


\(^{22}\) Assuming the debt is a short-term, regular debt obligation and assuming interest would be deductible at an arm’s length basis only, the interest payments could be insufficient to fully reduce the income of the subsidiary. Consequently, this income may still have to be distributed in the form of taxable dividend. In order to minimize the amount of withholding tax due the parent company and the subsidiary could increase the arm’s length interest on the debt instrument, for example, by making the debt
Under the OECD Model Convention 2010, the source state taxation of dividend is limited to 5% of the gross amount if the beneficial owner is a company (other than a partnership) that holds directly at least 25% of the capital of the company paying the dividends and limited to 15% of the gross amount if these conditions are not met. The taxation of interest may not exceed 10% of the gross amount thereof if the beneficial owner of the interest is a resident of the other contracting state. Under various tax treaties, only the country where the recipient of the interest is a resident may tax the interest.23 The important point here is that the withholding tax is generally lower on interest than on dividend payments.

Also in non-treaty scenarios, the differentiation between dividends and interest may form an incentive to change from equity financing to debt financing. This may, for instance, be the case in scenarios whereby the state of the holding company typically taxes outgoing dividends, whereas it does not typically tax outgoing interest payments (examples of such holding company states include Luxembourg, the Netherlands, and Switzerland).24

4.2. Contribution of Dividend Payor to a Holding Company against Share Capital

Instead of selling the shares in the dividend payor against a note, the parent company could also consider making use of a certain holding company whereby dividend withholding tax is circumvented because the country where the holding company is a resident does not levy dividend withholding tax or alternatively levies less withholding tax than the source state in the original scenario.25 In this respect, the parent company could transfer its shareholding in the dividend payor to the holding company as a capital contribution. Subsequently, the dividend payor may distribute dividends to the holding company. The holding company in its turn may use the funds received to pay dividends to the parent company. The following three types of holding companies can be distinguished in this respect:

1. holding company in the source state;
2. holding company in a third (treaty) jurisdiction; and
3. holding company that is resident of another European Member State.

4.2.1. Holding Company in the Source State

Possibilities for dividend withholding tax planning may be opened up by certain features of domestic tax laws. The dividend withholding tax planning at hand is based on three elements:

1. the possibility of using a domestic holding company in the source country (Country Z), whereby withholding tax on outbound dividends is wholly or partly eliminated (examples include a cooperative 'Coop' in the Netherlands26 and a so-called 80/20 company in the United States);27
2. dividend payments received by the domestic holding company should be exempt from tax, for example, under a participation exemption; and
3. dividend payments to the domestic holding company should not be liable to domestic dividend withholding tax, thus taxing the domestic dividend payments less cumbersome than dividend payments directly to a foreign parent company.

Notes

23 See, for example, the tax treaties as concluded by the United States with Denmark, Finland, France, Germany, Iceland, India, Luxembourg, the Netherlands, Sweden, Switzerland, Ukraine, and the United Kingdom.
24 An example of the herein mentioned planning technique can be found in the Swiss ‘V SA case’ VPB 65.86, Commission fédérale de recours en matière de contributions, <www.vpb.admin.ch/deutsch/doc/65/65.86.html> (in French, German and Italian), 28 Feb. 2001, whereby the aforementioned Commission surprisingly concluded that the terms ‘beneficiary’ and ‘beneficial owner’ had the same meaning. Even more surprisingly, the Commission searched for the ordinary meaning of the term ‘beneficiary’ using ‘Le Petit Larousse Illustre’, a non-legal French dictionary, famous for its beautiful pictures. For a both detailed and excellent analysis of the case, see Luc De Broe, ‘International Tax Planning and Prevention of Abuse’, IBFD Doctoral Series 14 (2008): 702.
25 See, for an example of this planning, the Canadian Prévost Car case (i.e., the first Canadian case to deal with the meaning of ‘beneficial owner’ in the context of a Canadian tax treaty) whereby the original dividend withholding tax percentages of 15% under the Canada-Sweden income tax treaty 1996 and 10% under the Canada-UK income tax treaty 1978 were mitigated to a percentage of 5% under the Canadian-Dutch treaty. Prévost Car Inc. v. The Queen, Canadian Revenue Agency v. Federal Court of Appeal, 26 Feb. 2009.
27 However, the US House passed legislation that would limit tax treaty benefits for multinational companies based in third-party countries by—among other plans—repealing the 80/20 rules for foreign company withholding. See HR 4849, 24 Mar. 2010.
Alternative dividend withholding tax planning using a holding company in the source state entails planning whereby the shareholders in the state of residence own a minority interest in a company resident in the state of source and interpose a holding company in the state of source in order to obtain treaty benefits that are not available had the shareholder owned the shares in the dividend paying entity directly.

In such scenario in a European context (i.e., whereby both Country X and Country Z, as depicted, are both European Member States), pursuant to Article 3 of the Directive, both Member States may deny Parent-Subsidiary Directive status to companies that are not affiliated by a qualifying shareholding for an uninterrupted period of at least two years. This is a specific anti-abuse provision, aimed at preventing the short-lived concentrations of non-qualifying participations in one hand, in order to pass the participation threshold temporarily, with a view to an expected profit distribution.

Special domestic holding company planning includes a permanent establishment in the source country whereby the shares in the original dividend distributor are allocated to this permanent establishment. In this dividend withholding tax planning scenario, a permanent establishment is created in a country that does typically exempt income as received and that does not levy withholding tax on an outbound profit repatriation by the permanent establishment to its head office. Legally speaking, this planning technique does not entail holding company planning in case there is in fact a permanent establishment in Country Z instead of a domestic holding company. For this reason, this planning technique does not fit easily under the title of this section 4.2 or subsection 4.2.1. However, since this planning technique is economically very similar to domestic holding company planning, it is for this reason that it was included in this paragraph.

Pursuant to this planning technique, dividend payments by the dividend payor to the permanent establishment (i.e., legally distributed by the dividend payor to the parent company) should preferably be free of dividend withholding tax at the level of the dividend payor and free of corporate income tax – for example, under a participation exemption – at the level of the permanent establishment. In addition, a profit repatriation by the permanent establishment to its head office should be typically free of (branch) withholding tax. This tax planning strategy has been explicitly recognized by the OECD in various versions of the Commentary to the OECD Model Tax Convention, although these versions make a general reservation for the effect of domestic anti-abuse rules. In this regard, the OECD Model Tax Convention stated in a 2003 addition to

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**Notes**


30 See, for example, the Dutch *Hoge Raad* 20 Dec. 2002, BNB 2003/246.

31 For example, Luxembourg, the Netherlands, and Spain.
the Commentary on Article 10 (under paragraph 4, number 32):

It has been suggested that the paragraph could give rise to abuses through the transfer of shares to permanent establishments set up solely for that purpose in countries that offer preferential treatment to dividend income. Apart from the fact that such abusive transactions might trigger the application of domestic anti-abuse rules, it must be recognised that a particular location can only constitute a permanent establishment if a business is carried on therein and, also, that the requirement that a shareholding be ‘effectively connected’ to such a location requires that the shareholding be genuinely connected to that business.32

The 2010 Commentary to the Model Tax Convention, approved by the OECD Council on 22 July 2010 (hereinafter ‘the 2010 Commentary’) replaces the latter sentence as follows:

Apart from the fact that such abusive transactions might trigger the application of domestic anti-abuse rules, it must be recognised that a particular location can only constitute a permanent establishment if a business is carried on therein and, as explained below, that the requirement that a shareholding be ‘effectively connected’ to such a location requires more than merely recording the shareholding in the books of the permanent establishment for accounting purposes.

Subsequently, the 2010 Commentary states in paragraph 32.1:

A holding in respect of which dividends are paid will be effectively connected with a permanent establishment, and will therefore form part of its business assets, if the ‘economic’ ownership of the holding is allocated to that permanent establishment under the principles developed in the Committee’s report entitled Attribution of Profits to Permanent Establishments . . . 33 In the context of this planning, the economic ownership of a holding means the equivalent of ownership for income tax purposes by a separate enterprise, with the attendant benefits and burdens (e.g., the right to the dividends attributable to the ownership of the holding and the potential exposure to gains or losses from the appreciation or depreciation of the holding).34, 35

The afore cited 2010 Commentary can be regarded as a significant improvement in the sense that it provides more detail than earlier commentaries on the allocation of a shareholding to a permanent establishment. In various jurisdictions, the allocation of a shareholding to a permanent establishment is cumbersome, and any guidance in this respect is useful. Probably the most helpful, for jurisdictions, tax authorities, and taxpayers, would be specific OECD guidelines on exactly what is required in order to allocate, or not allocate, a shareholding to a permanent establishment. Such OECD guidelines should aim to avoid different views by different OECD Member States on the allocation of the same shareholding. In the scenario whereby the OECD guidelines are also followed by countries in purely domestic scenarios, these guidelines may even eliminate the uncertainty in one Member State (typically between taxpayers and tax authorities)36 that is currently connected with the possible effect of domestic anti-avoidance rules.

4.2.2. Holding Company in a Third (Treaty) Jurisdiction

In this scenario, the holding company is resident of a jurisdiction (Country Y) that entered into a tax treaty between the jurisdiction of the dividend payor (Country Z) whereby the tax treaty (between Country Y and Country Z) de facto reduces the dividend withholding tax payable to a lower percentage than in the original, base case, scenario.37 Consequently, tax treaties may, as a side effect, increase these dividend withholding tax planning opportunities. As a result, the holding company situated in Country Y is acting as a conduit for channelling income economically accruing to the parent company in Country X who is thereby able to take advantage of the benefits

Notes

32 In this regard, in 2000, the following text in the Commentary—originating from 1977—was deleted: ‘The rules set out above also apply where the beneficiary of the dividends has in the other Contracting State for the purposes of performing any of the kinds of independent personal services mentioned in Article 14, a fixed base with which the holding in respect of the dividends are paid is effectively connected’.

33 In this regard, the 2010 Commentary refers in particular to paras 72–97 of Part I of the OECD, Report on the Attribution of Profits to Permanent Establishments (Paris: OECD, 2010) for the purposes of the application of para. 2 of Art. 7.

34 Similar wording has been added in the 2010 Commentary with respect to Art. 13. See the new 2010 Commentary paras 27.1 and 27.2 on Art. 13 in this regard.

35 In the case of the permanent establishment of an enterprise carrying on insurance activities, the 2010 Commentary states in para. 32.2: ‘the determination of whether a holding is effectively connected with the permanent establishment shall be made by giving due regard to the guidance set forth in Part IV of the Committee’s report with respect to whether the income on or gain from that holding is taken into account in determining the permanent establishment’s yield on the amount of investment assets attributed to it (see in particular paragraphs 165–170 of Part IV). That guidance being general in nature, tax authorities should consider applying a flexible and pragmatic approach which would take into account an enterprise’s reasonable and consistent application of that guidance for purposes of identifying the specific assets that are effectively connected with the permanent establishment’.


37 Typically 0% since various tax treaties do—under certain conditions—allocate the taxing right on dividends to the state of residence only. Examples include the tax treaties concluded between Sweden and Japan, Iceland and the Netherlands, and Mexico and Finland, to name just a few.
provided by the tax treaty between Country Y and Country Z.

This situation is often referred to as ‘treaty shopping’. Although a subject of intense international debate and a topic for study in itself, treaty shopping typically implies a premeditated effort to take advantage of the international tax treaty network and a careful selection of the most favourable tax treaty for the specific purpose. The holding company or ‘conduit company’ in Country Y, which is characteristic of this planning, is usually a corporation but may also be a partnership, a trust, or a similar entity.

Through the configuration described above, the conduit company takes advantage of the treaty provisions under its own name in the state of source; economically however, the benefit goes to the parent company not entitled to use that treaty. A net tax advantage results because little or no taxation occurs in the state of conduit (Country Y).

As a result of this dividend withholding tax planning, treaty benefits negotiated between two states are economically extended to persons resident in a third state in a way unintended by the contracting states; thus, the principle of reciprocity is breached and the balance of sacrifices incurred in tax treaties by the contracting parties is altered. Moreover, the state of residence of the parent company (Country X) has little incentive to enter into a treaty with the state of source (Country Z), because the residents of the state of residence can indirectly receive treaty benefits from the state of source without the need for the state of residency to provide reciprocal benefits.

A recent example of this planning can be found in a Danish case whereby a dividend was distributed to a Luxembourg holding company that was eventually owned by a consortium of private equity funds and other investors. In this case, the National Danish Tax Tribunal referred to the OECD Model Commentary 2003, in particular Article 10, paragraphs 12, 12.1, and 22. The Danish tribunal emphasized that a conduit company could only be disregarded as the beneficial owner of dividends if the company had very narrow powers to act regarding the disposition of the dividends. However, in itself, narrow powers to act were not sufficient for a holding company to be disregarded as a beneficial owner.

In this case, since the Luxembourg holding company had not redistributed the dividends received to its parent company, it could not be characterized as a conduit company regarding the dividends by the Danish court. Consequently, the Luxembourg holding company was held to be the beneficial owner of the dividends under the Denmark-Luxembourg tax treaty. Moreover, the tax authorities were not entitled to deny the taxpayer access to the Directive because the conditions for applying the Danish substance-over-form and the assignment of income doctrines were not met. The majority of the tribunal thus concluded that the taxpayer had not violated its Danish withholding tax obligation.

Under Article 50d (3) of the German Einkommensteuergesetz (EStG), Germany challenges this dividend withholding tax planning. The aim of the German anti-abuse provision is to prevent taxpayers who are not entitled to a withholding tax relief (exemption or refund) from obtaining one by means of a foreign company set up for this sole purpose. With this objective, the German anti-abuse provision refuses the tax relief if any of the following conditions are met:

Notes

39 See de Broe, 5, ibid.
40 Illustrative for the different views on treaty shopping are, for example, the Canadian case on presumed treaty shopping, MIL (Investments) SA v. Canada, Judgment date 18 Aug. 2006, 9 International Tax Law Reports, 25, and the diametrically opposed conclusion in the Swiss case 'A Holding ApS v. Federal Tax Administration'. In the latter case, the Swiss Federal Court held in a scenario whereby the shares in a Swiss company were owned by a Danish holding company that in its turn was owned by a Guernsey company: (1) the doctrine of abuse of rights applies to a tax treaty that contains a beneficial ownership limitation—even if it does not contain a specific anti-avoidance provision; (2) an abuse can be assumed if the interposed company does not carry a real economic activity or an active business activity and disproved if the company demonstrates that its main purpose is based on valid economic grounds and not aimed at the obtaining of the advantages of the applicable convention; and (3) since the Danish holding company in case has no offices or staff and pays the dividend received directly to its parent company, the Swiss court ruled that in those circumstances, the Tax Administration was entitled to assume an abuse of the tax treaty. Judgment date 28 Nov. 2005, 8 International Tax Law Reports, 536.
41 See the OECD, 1987a, ibid., 90.
43 See the OECD, 1987a, ibid., 90.
44 See Denmark's National Tax Tribunal, SKM2010.268.LSR, 16 Apr. 2010.
45 However, the minority of the tribunal concluded in favour of the tax authorities on the grounds that it was immaterial whether the dividends were channeled to the parent company. See also Jens Witterndorff, 'Danish Tax Tribunal Rules in Favor of Taxpayer in Beneficial Ownership Case', Worldwide Tax Daily (20 Apr. 2010).
(1) there is no economic or other relevant reason to establish the foreign company;

(2) the foreign company does not earn more than 10% of its gross income from its own economic activity; or

(3) the foreign company has no adequate business premises for its activities.46

On 18 March 2010, the European Commission has formally requested Germany to change this anti-abuse provision on withholding tax relief. German tax authorities refuse withholding tax relief for a foreign company owned by persons who would not be entitled to the relief if they received the income directly, and if the foreign company does not pursue genuine economic activities. It should be underlined that the Commission does not criticize the aim of the anti-abuse measure but solely the disproportionate requirements imposed on foreign companies in order to prove the existence of a 'genuine economic activity'.47

According to the Commission, the contested measure is disproportionate in particular as regards the second condition listed above, where the possibility to produce proof to the contrary does not exist. Therefore, according to the European Commission, the German measure goes beyond what is necessary to attain its objective of preventing tax avoidance.48 The request takes the form of a reasoned opinion (the second step of the infringement procedure provided for by Article 258 of the Treaty on the Functioning of the EU (TFEU)). If there is no satisfactory reaction to the reasoned opinion within two months, the Commission may decide to refer the matter to the European Court of Justice (ECJ).49

4.2.3. Holding Company that is Resident of another EU Member State

A company that is resident of a Member State of the EU must in principle refrain from levying dividend withholding tax on a dividend distribution to a foreign EU company, under the Directive,50 provided certain conditions are met. The gist of the Directive is that cross-border profit distributions paid out of after-tax profits by an EU subsidiary to its EU parent company, or to the branch of such company, must be free of dividend withholding tax in the Member State of source and free of double corporate taxation in the Member State of the parent company.51

As to the location of the EU holding company, a number of alternatives could be considered including but not limited to Belgium, Cyprus, Denmark, Gibraltar, Hungary, Ireland, Luxembourg, Malta, the Netherlands, Spain, Sweden, and the United Kingdom.

In this dividend withholding tax planning scenario, ECJ Case C-521/07 is relevant since it shows that dividend withholding tax may also be eliminated in the scenario whereby Member State Y is an European Economic Area (EEA) state.52 In this case, the ECJ states that a Member State fails to fulfil its obligations under Article 40 of the EEA Agreement where it does not exempt dividends paid by a resident company to a company established in an EEA state from dividend withholding tax under the same conditions as dividends paid to a resident company or, alternatively, to a company established in another Member State.

In a case, the requirement that, in order to benefit from the exemption, companies established in the EEA state in question should hold at least, respectively, 10% or 25% of the shares of the distributing resident company and companies having their seat in the Member State concerned or in another Member State should hold shares representing at least 5% of the paid-up nominal capital of the resident distributing company, was not in line with Article 40 of the EEA Agreement.53

Notes

46 The incriminated German provision is the second clause of Art. 50d (3) EStG. See IP/10/298, Brussels, 18 Mar. 2010.
48 The 18 Mar. 2010 Commission report abuses here the term ‘tax evasion’ instead of the proper term ‘tax avoidance’.
50 See n. 27.
53 In case, Iceland and Norway, see para. 9, C-521/07, which reads: ‘As regards companies established in Iceland or Norway, the Netherlands legislation contains no specific provision taking account of the fact that they may rely on Article 40 of the EEA Agreement. It is on the basis of bilateral agreements for the avoidance of double taxation concluded with those States parties to the EEA Agreement that the tax on dividends is not levied in the case of a holding in a Netherlands company of at least 10% (Article
According to the ECJ, such a difference in treatment as regards the method of taxing dividends paid to beneficiary companies established in the EEA states in question, compared with those paid to beneficiary companies established in the Member States, is likely to deter companies established in the former two states from making investments in the Member State concerned. Moreover, according to the ECJ, it makes it more difficult for a resident company to raise capital from the two EEA states in question than from the Member State concerned or another Member State of the Community. It thus constitutes a restriction on the free movement of capital, which, is, in principle, prohibited by Article 40 of the EEA Agreement.54

In addition, according to the ECJ, the argument based on the different situations of, on the one hand, companies having their seat in Member States of the Community and, on the other hand, companies established in the two EEA states in question cannot justify the requirement that the latter companies hold a higher stake in the capital of the resident companies distributing the dividends in order for them to benefit, like the former companies, from exemption from the deduction of tax at source on the dividends that they receive from resident companies.

In that regard, according to the ECJ, although a difference in the system of legal obligations of the EEA states in question in the tax area, in comparison with those of the Member States of the Community, is capable of justifying a state in making the benefit of exemption from deduction at source of the tax on dividends subject, for companies established in the two EEA states in question, to prove that those companies do in fact fulfil the conditions laid down by its national legislation, it does not justify that legislation in making the benefit of that exemption subject to the holding of a higher stake in the capital of the distributing company.55 Such a requirement bears, according to the ECJ, no relation to the conditions otherwise required from all companies in order to be entitled to that exemption, namely that companies take a certain legal form that they be subject to tax on profits and that they be the final beneficiary of the dividends paid, those being conditions with which the national tax authorities must indeed be able to verify compliance.56

In addition to the EU holding company planning discussed in this paragraph, a holding company could also be located in a jurisdiction that both entered into a tax treaty between the jurisdiction of the dividend payor (Country Z) whereby the tax treaty (between Country X and Country Z) de facto reduces the dividend withholding tax payable to zero and whereby the Directive is applicable. For example, this so-called belt and suspenders planning is from a Dutch perspective possible under the treaties as concluded between the Netherlands and Denmark and between the Netherlands and Ireland.57 Not only is the dividend withholding tax on certain intra-group dividends under the Directive limited to zero, the same goes for certain dividends distributed under the abovementioned treaties. Consequently, in case tax authorities successfully challenge the taxpayer on this planning under the respective bilateral treaty, the taxpayer may still be able to rely on the Directive. Vice versa, in case tax authorities challenge the taxpayer successfully under the Directive, it may still be possible to rely on the 0% in the respective bilateral tax treaty.58

### 4.3. Conversion of a Dividend Payment into a Repayment of Capital

The planning whereby the intended dividend payment is converted in a repayment of capital may be feasible for taxpayers in jurisdictions that do not levy tax on the legal conversion of share premium into share capital. For example, this planning may work in the Netherlands since the legal conversion of share premium into bonus shares is tax free. A Dutch entity’s (BV) total paid-in capital may consist of the capital paid-up on the common shares and of share premium paid on these shares.59 In principle, in the Netherlands, a repayment of paid-in capital is considered a dividend if and to the extent the company has net profits. However, a repayment of BV’s paid-in capital would not be considered a dividend and therefore not subject to

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**Notes**

54 C-521/07, para. 39.
55 With regard to the EEA, the ECJ states: ‘One of the principal aims of the EEA Agreement is to provide for the fullest possible realisation of the free movement of goods, persons, services and capital within the whole European Economic Area, so that the internal market established within the European Union is extended to the EFTA States. From that angle, several provisions of the abovementioned Agreement are intended to ensure as uniform an interpretation as possible thereof throughout the EEA (see Opinion 1/92 [1992] ECR I-2821). It is for the Court, in that context, to ensure that the rules of the EEA Agreement which are identical in substance to those of the Treaty are interpreted uniformly within the Member States (Spelit on Schleids Wasseborg, paragraph 29).’
56 C-521/07, para. 48.
57 One could also imagine a combination of all three sorts of holding company planning, for example, whereby the new holding company is a dividend tax exempt Dutch Coop that in principle should qualify both under the EC Parent-Subsidiary Directive and under bilateral tax treaties.
58 In this regard, the EU Parent-Subsidiary Directive states in Art. 1, para. 2: ‘This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse’.
59 From a Dutch civil law perspective, the share premium is not part of the nominal share capital.
The conversion of a dividend payment into a loan is relatively simple to achieve and may result in the objective of a cash repatriation to the parent company without triggering dividend withholding tax. For this reason, instead of paying a dividend, the subsidiary grants a loan to the parent company. Consequently, the parent company is a debtor whereas the entity that used to be the dividend payer is currently a creditor. Typically, a loan to a parent company results in interest payments that may be deductible in the country of residence of the parent company and that may be taxable at the level of the subsidiary. Obviously, since the idea is to repatriate cash to the parent company, it is important to keep the interest percentage as low as possible. In addition a loan to a parent company may result in either withholding tax at the level of the parent company or alternatively taxable income in the country of residence of the parent company for the fair market value of the underlying loan. For example, in the United States, a US resident parent company may be required to include the loan receipts from a direct or indirect subsidiary as a constructive dividend under the US Subpart F rules.

4.5. Conversion of a Dividend Payment into a Liquidation of the Dividend Payor

The conversion of the dividend payment into a liquidation of the company that would otherwise pay out the dividend may only be fiscally advantageous in those countries where the wholly or partly liquidation of an entity does not result in dividend withholding tax being due. Luxembourg is an example of a country that does typically levy withholding tax on dividend distributions, whereas a liquidation of an entity is typically exempt from dividend withholding tax. Consequently, some Luxembourg corporate structures do have a chain of several Luxembourg entities owning the majority of the shares in another Luxembourg company (‘special purpose vehicle’) for the purpose of dividend withholding tax planning only. Instead of a dividend distribution each time the Luxembourg parent company that is on top of the Luxembourg chain is liquidated. Since dividend distributions from one Luxembourg entity to another Luxembourg entity are typically free from Luxembourg dividend withholding tax, Luxembourg dividend withholding tax can be avoided as long as there are Luxembourg parent companies left within the corporate chain that can be liquidated. The majority of OECD member countries, however, tax liquidating distributions similar to dividend distributions.

4.6. Conversion of a Dividend Payment into an Asset Acquisition Payment

In the scenario whereby the sale of an asset by a parent company does not result in capital gain taxation (e.g., because the gain is not deemed to be taxable income or the fair market value of the asset is lower than the underlying value of the asset), dividend withholding tax if (1) BV’s general meeting of shareholders were to decide in advance to reduce the par value of the BV shares, and (2) BV’s articles of association were to be amended accordingly. In order to benefit from this rule, BV’s untainted surplus premium should first be converted into common shares. Such a conversion should not trigger dividend withholding tax. Next, BV could repay (part of) this capital without dividend withholding tax becoming due, provided that the two formal requirements stated above have been met (lowering nominal value pursuant to a shareholders decision followed by an amendment of the articles of association). This tax planning technique may be possible in a few countries only since many jurisdictions do tax a repayment of capital with dividend withholding tax.

4.4. Conversion of a Dividend Payment into a Loan

The conversion of a dividend payment into a loan is relatively simple to achieve and may result in the objective of a cash repatriation to the parent company without triggering dividend withholding tax. For this reason, instead of paying a dividend, the subsidiary grants a loan to the parent company. Consequently, the parent company is a debtor whereas the entity that used to be the dividend payer is currently a creditor. Typically, a loan to a parent company results in interest payments that may be deductible in the country of residence of the parent company and that may be taxable at the level of the subsidiary. Obviously, since the idea is to repatriate cash to the parent company, it is important to keep the interest percentage as low as possible. In addition a loan to a parent company may result in either withholding tax at the level of the parent company or alternatively taxable income in the country of residence of the parent company for the fair market value of the underlying loan. For example, in the United States, a US resident parent company may be required to include the loan receipts from a direct or indirect subsidiary as a constructive dividend under the US Subpart F rules.
book value for tax purposes or the capital gain can be absorbed by net operating losses from the parent company), it may be beneficial to certain taxpayers, instead of receiving a relatively high taxed dividend from a subsidiary, to sell an asset for fair market value to a subsidiary against a payment of cash. The payment of an at-arm’s-length acquisition price is typically not regarded as a dividend payment nor as a hidden dividend and therefore, in case there is no taxable gain on the transaction, typically not liable to tax at the level of the parent company nor at the level of the source state. Assets that can be transferred this way may include shares in the parent company (e.g., treasury stock), machinery, vessels, aircrafts, subsidiaries, or branches owned directly by the parent company. In this regard, the taxation of capital gains varies considerably from country to country. In some countries, capital gains are not deemed to be taxable income. In other countries, capital gains are taxed as ordinary income and therefore added to the income from other sources. In a number of OECD member countries, however, capital gains are subject to special taxes, such as taxes on profits of the alienation of immovable property, or general capital gains, or taxes on capital appreciation (increment taxes). Such taxes are levied on each capital gain or on the sum of the capital gains accrued during a year, mostly at special rates, which do not take into account the other income or losses of the taxpayer.

Capital gains realized on shares by companies in various jurisdictions (including Belgium, Cyprus, Denmark, Hungary, Ireland, Luxemburg, the Netherlands, and Sweden) may be fully exempt from corporate income tax under a participation exemption, provided certain requirements are met. Typically as a counterpart to the exemption of realized capital gains, capital losses on shares, both realized and unrealized, may not be tax deductible.

Notes

66 See the 2010 Model Tax Convention Commentary on Art. 13 concerning the taxation of capital gains.

67 See the 2010 Model Tax Convention Commentary on Art. 13, ibid. See also Stefano Simontacchi, ‘Taxation of Capital Gains under the OECD Model Convention: With Special Regard to Immovable Property’ (2007), 121 et seq.


69 However, losses incurred in connection with the liquidation of a subsidiary company may in some countries (e.g., Belgium, the Netherlands) still be deductible up to the amount of the paid-up share capital.