Withholding Taxation in International and European Tax Law

Current Developments Regarding Passive Income

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General Aspects

The main issues in a box...

What is subject to WHT?
- Dividends
- Interest
- Royalties
- Technical Services*

*Not subject to the current analysis

Characteristics and functioning of Withholding Tax

- Levied by the source state
- Collected and retained by the payer of the income before remitting it to the source state
- Mostly levied on the gross amount of income; but taxation in the residence state regularly on a net basis (→ often leading to a credit surplus)
- Chronological priority due to being levied at the distribution of income
- Effective tool/tax collecting mechanism to secure a domestic tax base and combat profit shifting to low-tax jurisdictions

Relief from Withholding Taxation trough...

... Exemption of the payment at source
... Granting of a **tax credit** in the residence state
... Application for **refund** by the receiving party

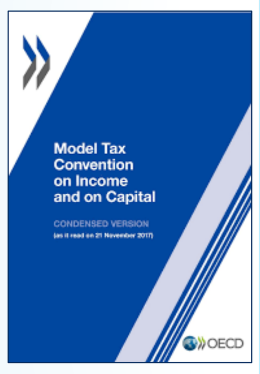
Issues

- **Neutralization of double taxation** not always granted through existing measures (e.g. due to unharmonized rules among different states and gross taxation)
- **Liquidity gap** for taxpayer even if refund is possible
- **Burdensome and time consuming withholding tax relief procedures** for cross-border investors in the securities market and smaller cross-border portfolio investors
- "Battle of neutralities"
- **Distortion of the capital market** and the single market (disadvantage of cross-border investments compared to domestic ones)
- **Legal uncertainty** resulting from different withholding tax regimes in different countries

International Tax Law

Legal bases and obstacles

OECD Model Tax Convention 2017



UN Model Double Taxation Convention 2021

Dividends Article 10 OECD MC

1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.
2. However, dividends paid by a company which is a resident of a Contracting State **may also be taxed in that State** according to the laws of that State, but if the **beneficial owner** of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:
a) 5 per cent of the gross amount of the dividends if the **beneficial owner is a company which holds directly at least 25 per cent of the capital of the company paying the dividends throughout a 365 day period** that includes the day of the payment of the dividend (...);
b) 15 per cent of the gross amount of the dividends in all other cases.
The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of these limitations. This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

Interest Article 11 OECD MC

1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.
2. However, interest arising in a Contracting State **may also be taxed in that State** according to the laws of that State, but if the **beneficial owner** of the interest is a resident of the other Contracting State, the tax so charged **shall not exceed 10 per cent of the gross amount of the interest**. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

Royalties Article 12 OECD MC

1. Royalties arising in a Contracting State and **beneficially owned by a resident of the other Contracting State shall be taxable only in that other State.**
2. (...)
3. The provisions of **paragraph 1 shall not apply if the beneficial owner of the royalties**, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise through a permanent establishment situated therein and the right or property in respect of which the royalties are paid is effectively connected with such permanent establishment. In such case the provisions of Article 7 shall apply.

Royalties Article 12 UN MC

1. Royalties arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.
2. However, royalties arising in a Contracting State **may also be taxed in that State** and according to the laws of that State, but if the **beneficial owner** of the royalties is a resident of the other Contracting State, the tax so charged **shall not exceed** ____ per cent *[the percentage is to be established through bilateral negotiations]* **of the gross amount of the royalties**. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

Article 29 – Principle Purpose Test

9. Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.

European Tax Law

Legal bases and current issues

Parent-Subsidiary Directive (2011/96):
Exemption of **dividend distributions** from Withholding Tax if...
(1) the parent company holds a shareholding of at least 10% in the subsidiary;
(2) both companies have a legal form as referred to in the annex to the Directive;
(3) both companies are established in a (different) Member State; and
(4) both companies are subject to a variant of a corporate income tax in a Member State

Interest & Royalties Directive (2003/49):
Exemption of **interest and royalty payments** from Withholding Tax if...
(1) the parent company holds a shareholding of at least 25% in the subsidiary;
(2) the interest or royalty payment arises in a Member State;
(3) both companies have a legal form as referred to in the annex to the Directive;
(4) both companies are established in a Member State;
(5) both companies are subject to a variant of a corporate income tax in a Member State; and
(6) The recipient of the payment is the beneficial owner thereof

New EU-initiative: The end of an everlasting story?

...Introduction of a common, standardised EU-wide system for withholding tax relief at source regarding interest and dividend payments coupled with a new exchange of information and cooperation mechanism between tax administrations, with the dual aims of both significantly lowering tax compliance costs for cross-border investors and also preventing tax evasion

The Roadmap:

- Inception Impact Assessment – 28 September 2021
- Feedback period – Until 26 October 2021
- Public Consultation – until 26 June 2022
- Feedback period
- Commission Adoption – expected in Q4 2022
- European Directive?