The International Tax Law Concept of Dividend

Second Edition

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Series on International Taxation

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Wolters Kluwer

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Published by:
Kluwer Law International B.V.
PO Box 316
2400 AH Alphen aan den Rijn
The Netherlands
Website: www.wolterskluwerlr.com

Sold and distributed in North, Central and South America by:
Wolters Kluwer Legal & Regulatory U.S.
7201 McKinney Circle
Frederick, MD 21704
United States of America
Email: customer.service@wolterskluwer.com

Sold and distributed in all other countries by:
Quadrant
Rockwood House
Haywards Heath
West Sussex
RH16 3DH
United Kingdom
Email: international-customerservice@wolterskluwer.com

Printed on acid-free paper.

ISBN 978-90-411-8394-1

e-Book: ISBN 978-90-411-8395-8
web-PDF: ISBN 978-90-411-8396-5

Printed in the United Kingdom.

Preface

My doctoral thesis *The Dividend Concept in International Tax Law – Dividend Payments Between Corporate Entities* was published by Kluwer in 1999. In 2000, the book was awarded the International Fiscal Association Mitchell B. Carrol Price. Almost a decade later, the publisher contacted me with an interesting proposal. Kluwer wanted to publish an updated edition of my doctoral thesis, which they considered to have become a classic. My first reaction to the publisher's idea was somewhat suspicious because I had never heard about a second edition of a doctoral thesis. After some consultation with Kluwer, I however agreed to publish a second book on the international tax law concept of dividend with Kluwer. In order to make a clear difference between the original doctoral thesis and the new book on the dividend concept, I decided, however, not to publish the new book as a second revised edition of the original, but as a separate work with a slightly different title and somewhat different scope.

The first edition of this second book, *The International Tax Law Concept of Dividend,* was published in 2010. Since then the developments in international tax law have been rapid. The Organisation for Economic Co-operation and Development (OECD) and the European Union (EU) initiatives against base erosion and profit shifting (BEPS) have had and will have a huge impact on the tax treatment of different cross-border arrangements.

This second revised edition of *The International Tax Law Concept of Dividend* follows the structure and rough outline of the original doctoral thesis. The country specific parts of the book, however, have been replaced with more general parts providing examples of the different domestic law approaches. The core of this book is in the EU Parent-Subsidiary Directive concept of profit distribution and in the model tax convention concept of dividend. This second edition includes the impact of the BEPS project on the covered issues. The relevance of the EU Anti-tax Avoidance Directive and the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit shifting are taken into account. Also relevant new case law and new literature have been considered in this second edition.

Marjaana Helminen
Helsinki, December 2016

List of Abbreviations

AB	*Aktiebolag* (limited company, Sweden)
ABL	*Aktiebolagslag* (Act on Limited Companies, Sweden)
AG	*Aktiengesellschaft* (public limited company, Germany)
AktG	*Aktiengesetz* (Act on Public Limited Companies, Germany)
AO	*Abgabenordnung* (Fiscal Code, Germany)
Anti-Tax Avoidance Directive	Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.
AStG	*Aussensteuergesetz, Gesetz über die Besteuerung bei Auslandsbeziehungen* (International Tax Act, Germany)
AvrL	*Lag om avräkning av utländsk skatt* (Act on Foreign Tax Credit, Sweden)
BEPS	OECD/G20 Base erosion and profit shifting project
BFH	*Bundesfinanzhof* (Federal Fiscal Court, Germany)
BGB	*Bürgerliches Gesetzbuch* (Civil Code, Germany)
BMF	*Bundesministerium der Finanzen* (The Ministry of Finance, Germany)
BStBl	*Bundessteuerblatt* (Official Tax Gazette – laws, cases, etc., Germany)
CFC	Controlled foreign corporation
EC	European Community
EC Treaty	The Treaty establishing the European Community (the name of the treaty was changed to The Treaty on the Functioning of the European Union by the Treaty of Lisbon, which was signed on 13.12.2007 and which entered into force on 1.12.2009)

EEA	European Economic Area
EFL	*Lag om ekonomiska föreningar* (Act on Economic Associations, Sweden)
EFTA	European Free Trade Association
EStG	*Einkommensteuergesetz* (Income Tax Act, Germany)
EU	European Union
EU Court	The Court of Justice of the European Union
EVL	*Laki elinkeinotulon verottamisesta* (Business Income Tax Act, Finland)
GmbH	*Gesellschaft mit beschränkter Haftung* (Limited liability company, Germany)
GmbHG	*Gesetz betreffende die Gesellschaften mit beschränkter Haftung* (Act on Limited Liability Companies, Germany)
HBL	*Lagen om handelsbolaglag och enkla bolag* (Act on Partnerships, Sweden)
HE	*Hallituksen esitys* (Government Bill, Finland)
HGB	*Handelsgesetzbuch* (Commercial Code, Germany)
IBFD	International Bureau of Fiscal Documentation
IFA	International Fiscal Association
Interest-Royalty Directive	Council Directive 2003/49/EC of 3 June 2003 on a Common System of Taxation Applicable to Interest and Royalty Payments Made between Associated Companies of Different Member States.
IRC	Internal Revenue Code (the US)
IRS	Internal Revenue Service (the US)
KapErhStG	*Gesetz über steuerliche Massnahmen bei Erhöhung des Nennkapitals aus Gesellschaftsmitteln und bei Überlassung von eigen Aktien an Arbeitnehmer, Kapitalerhöhungsteuergesetz* (Act on Tax Measures in Connection with Increases in Nominal Capital out of Company Funds and with Distribution of Stock to Employees, Germany)
KG	*Kommanditgesellschaft* (limited partnership, Germany)
KGaA	*Kommanditgesellschaft auf Aktien* (partnership limited by shares, Germany)
KHO	*Korkein hallinto-oikeus* (Supreme Administrative Court of Finland)
KL	*Kommunalskattelagen* (Municipal Tax Act, Sweden)
KM	*Komitean mietintö* (committee report, Finland)

KStG	*Körperschaftsteuergesetz* (Corporate Income Tax Act, Germany)
KStR	*Körperschaftsteuer-Richtlinie* (Corporate Income Tax Guidelines, Germany)
KupL	*Kupongskattelag* (Withholding Tax Act, Sweden)
KVL	*Keskusverolautakunta* (Central Tax Board, Finland)
LähdeveroL	*Laki rajoitetusti verovelvollisen tulon ja varallisuuden verottamisesta* (Act on Taxation of Income and Wealth of a Person With Limited Tax Liability, Finland)
MenetelmäL	*Laki kansainvälisen kaksinkertaisen verotuksen poistamisesta* (Act on Elimination of International Double Taxation, Finland)
NSFS	*Nordiska skattevetenskapliga forskningsrådet skriftserie* (Series of publications of the Nordic Tax Scientific Research Board)
OECD	Organisation for Economic Co-operation and Development
OECD Model	Model Tax Convention on Income and Capital of the Organisation for Economic Co-operation and Development (15.7.2014)
OHG	*Offene Handelsgesellschaft* (partnership with unlimited liability, Germany)
OSK	*osuuskunta* (Cooperative Society, Finland)
Oy	*osakeyhtiö* (Limited Company, Finland)
OYL	*osakeyhtiölaki* (Companies Act, Finland)
P-S Directive	Council Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (30 November 2011)
RSV	*Riksskatteverkets rapport* (Report of the State's Tax Office, Sweden)
RFH	*Reichsfinanzhof* (Supreme Finance Court, Germany)
RÅ	*Regeringsrättens Årsbok* (Decision of the Supreme Administrative Court, Sweden)
SIL	*Lagen om statlig inkomstskatt* (National Income Tax Act, Sweden)
SijoitusrahastoL	*Sijoitusrahastolaki* (Act on Investment Funds, Finland)
SOU	*Statens offentliga utredningar* (State's public account, Sweden)

TEU	The Treaty on European Union (TEU is used in this book to refer to the Treaty on European Union in the form as amended by the Treaty of Lisbon of 13.12.2007, which entered into force on 1.12.2009)
TFEU	The Treaty on the Functioning of the European Union (i.e., the EC Treaty as amended and renamed by the Treaty of Lisbon, which was signed on 13.12.2007 and which entered into force on 1.12.2009)
TVL	*Tuloverolaki* (Income Tax Act, Finland)
UN Model	United Nations Model Double Taxation Convention between Developed and Developing Countries (2011)
US Model	US Model Income Tax Convention (17.2.2016)
VaVM	*Valtiovarainvaliokunnan mietintö* (Report of the Finance Committee of the Parliament, Finland)
VerL	*Verotuslaki* (On 18.12.1995 repealed Taxing Act, Finland)
VeroH	*Verohallitus* (The National Board of Taxes, Finland)
VKL	*Velkakirjalaki* (The Promissory Notes Act, Finland)
VM	*Valtiovarainministeriön työryhmämuistio* (working group report of the Ministry of Finance, also Ministry of Finance in general, Finland)
VML	*Laki verotusmenettelystä* (Taxing Act, Finland)
VVL	*Varallisuusverolaki* (Wealth Tax Act, Finland)
VäliyhteisöL	*Laki ulkomaisten väliyhteisöjen osakkaiden verotuksesta* (Act on Taxation of Shareholders of Foreign Controlled Corporations, Finland)
YHL	*Laki yhtiöveron hyvityksestä* (Act on Imputation Credit, Finland)

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CHAPTER 1
Introduction

§1.01 SUBJECT

Classification of corporate distributions is a major problem facing tax authorities and tax practitioners. Internationally, capital moves at a breakneck speed and the value of cross-border inter-corporate investments and finance has grown rapidly. The instruments used for finance and investment both in national and in international relations have become numerous and complex. There are many forms in which profits of a corporate entity resident in one state may be distributed to a corporate entity resident in another state. The fact that these different forms may be taxed very differently produces substantial tax planning opportunities for multinational enterprises. Due to the increasing amount and complexity of the possible inter-corporate cross-border transactions, it has become more and more difficult to keep abreast of them and to give them a name in order for the proper tax assessments to be made.

'Dividend' in its economic sense is the return on an equity investment in a corporate entity. Dividend distribution is a transaction in which corporate profits are distributed to the owners of the corporate entity without the corporate entity's expectation of receiving anything in return. As a result, the assets of the corporate entity decrease and the assets of the owners increase. A dividend distribution based upon the decision of the owners at a formally recognized meeting is the basic form of such a transaction. It is, however, only one of the forms in which corporate profits may legally be distributed to the owners of a corporate entity without any equivalent value or benefit in exchange or in which an investor may enjoy a return on an equity investment.

The question is to what extent do these other transactions, where corporate profits are transferred to the owners of the corporate entity, constitute a dividend and to what extent do they constitute some other type of income for tax purposes. From an economic perspective, it seems natural to tax all forms of return on equity investments in the same way. From a company law perspective, however, a distinction between the different possible forms may be made. It may be difficult to distinguish between a remuneration that actually constitutes a return on equity capital, and a payment from a corporate entity to its owners, that constitutes another form of a remuneration or repayment of capital.

The solutions to the classification problems are not necessarily the same for different states. The tax treatment of the different forms in which an owner may benefit from corporate profits is often different, not only in one state, but particularly in the cross-border situations where two different states are involved. The tax laws of two states may define the concept of 'dividend' differently. Therefore, in cross-border situations, classification conflicts may and do emerge. Certain transactions may be regarded as constituting a dividend in the view of the tax authorities of one state but not in the view of the tax authorities of another state. Such inconsistent classification may lead to either international double taxation or non-taxation. Therefore, it is important to draw the line between a dividend and other transactions similar in nature to a dividend, especially in cross-border situations.

This study covers different types of inter-corporate cross-border arrangements where an investor may receive a 'dividend equivalent return' directly from a corporate entity or indirectly through a third party. The issues covered will include:

- the extent to which these constitute a dividend for the purposes of the different legal systems of international tax law;
- the extent to which inconsistent income classification with respect to the covered arrangements lead or may lead to conflicts that further lead or may lead to international double taxation or non-taxation; and finally;
- whether and by what means such conflicts are or may be resolved in practice.

§1.02 SPECIFIC PURPOSE AND SCOPE OF THE STUDY

In order for proper tax assessment to be carried out, four basic determinations must be made:

(1) Who is the right tax subject?
(2) What is the tax object?
(3) What is the tax rate to be applied in connection with the tax subject and tax object?
(4) What is the amount of the tax when the tax rate is applied to the tax object?[1]

In cross-border situations, this enquiry also includes determining which state or states have taxing rights with respect to a specific tax subject and tax object, and to what extent. In cross-border interactions, the answers to these questions depend upon the different legal systems of international tax law, that is, the domestic tax law of each

1. *See* for these steps, for example, Tikka (1972), 30–46.

state concerned, upon any applicable tax treaty, and, with respect to the Member States of the European Union (EU), upon EU tax law.

In this study, the focus is on determining the tax object. The purpose is to determine under what conditions different cross-border arrangements produce income that is or that may be taxed as a dividend and thereby to clarify and define the concept of 'dividend' in international tax law.[2] The tax law term 'dividend' is defined with respect to different possible arrangements between parties resident in two different states. For the purposes of this study, it is irrelevant who the right tax subject is for a dividend, and what the actual tax burden is on the dividend.

In general, a dividend means a profit distribution from a corporate entity to its owners by virtue of the owner's status as such. Dividend distribution is a transaction by which the assets of the distributing corporate entity decrease and the assets of the receiving owner increase. Dividend distribution is a transfer of an economic benefit from a corporate entity to its owner for no equivalent value or benefit in exchange or, in the case that there might be some return value or benefit, it does not fully correspond to the economic benefit received.[3] This general definition of 'dividend' may be broken down further.

In order to answer the question as to what items of income qualify as a dividend, a determination must be made as to what entities qualify as dividend-distributing entities under the different legal systems of international tax law. Not all transfers of benefits from a qualifying entity to another entity constitute a dividend; a certain relationship must exist between the parties and the benefit must be transferred because of this special relationship. In addition, the question of which part of the benefit transferred is to be taxed as dividend must be answered. Finally, in order to arrive at the actual taxing consequence, it must be determined who the right tax subject is with respect to the dividend received. All these determinations must be made both in the state where the distributing entity is a resident and in the state where the income recipient is a resident. The answers to these questions depend upon domestic tax law, upon any applicable tax treaties, and, with respect to EU Member States, upon EU tax law.

Identifying the dividend-distributing entity, the dividend-generating relationship and the amount of taxable dividend determines the international tax law concept of 'dividend'. These, then, are the relevant features of this study. The questions concerning the right taxpayer of the dividend received and the actual tax rate do not, strictly speaking, determine the concept of 'dividend', but rather only give some indication of how a dividend is taxed and as whose income a dividend is recognized. These questions, therefore, are not covered by this study. The actual tax treatment of the

2. International tax law is a branch of tax law, traditionally considered to cover all tax provisions concerning situations involving the territory of more than one state. In other words, the term is used to refer to all tax provisions regulating the so-called cross-border situations. *See*, for example, Vogel et al. (1997), 10, Schaumburg (1998), 1–3, Helminen (2013), 29, Helminen (2016), 1, Helminen (2016a), Ch. 3 and Rohatgi (2005), 1. *See* for a discussion on the term from the time when the meaning was not yet quite clear in Bühler (1964), 3 and Knechtle (1979), 11–16.
3. *See* for these general characteristics of a dividend, for example, Sandström (1962), 3.