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COMMON CONSOLIDATED CORPORATE TAX BASE WORKING GROUP (CCCTB WG)

Dividends

Meeting to be held on 12 September 2006

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WORKING DOCUMENT

I Introduction and purpose of the paper

1. On various occasions the discussions in the CCCTB WG and the subgroups (mainly SG1 and SG3) have touched upon the treatment of dividends and profit distributions, although the issue has not been treated in a systematic manner. For this reason the Commission Services committed itself to table a document on dividends in which dividends are analysed in a comprehensive way.
2. Two levels of taxation will be analyzed in this document: the taxation of the company that pays the dividends and the taxation of the shareholder that receives the dividends.
3. For the purposes of this document dividends should be understood as those distributions of taxed profit made by a company to its shareholders. Other types of payments of dividends to shareholders, such as return of capital are not covered. The document does not cover dividends received from non EU companies.

II Taxation of dividends

4. The taxation of dividends has therefore to be analysed in two sides: the payer (the company paying the dividends) and the recipient (the shareholder receiving the dividends). The CCCTB will have to determine the rules applicable in both sides.
5. In the national tax systems it is generally accepted that payments of dividends should not be deductible for the payer as they do not constitute an expense but a distribution of profit. This issue was already discussed in SG3 and experts agreed that also under CCCTB dividends paid should not be deductible.
6. On the other hand dividends received by the shareholder are usually subject to tax although they can be exempted to avoid double taxation. The CCCTB will have to deal with those cases where the shareholder receiving the dividends is a corporation or a permanent establishment and choose one of the different techniques currently applied.
7. The dividends received by the shareholder can be taxed in different ways; basically two approaches can be used: either the dividends received by the shareholder are integrated in the taxable base with the rest of the sources of income or they can receive a special treatment. This would usually be a withholding tax withheld by the payer of the dividend or they can constitute a separate tax base in the hands of the recipient.
8. Probably the preferable option under the CCCTB will be to integrate dividends received in the taxable base and tax them together with the rest of the income obtained by the company. This system is simpler and neutral as it does not discriminate between the different sources of income. This will imply no withholding taxes imposed by Member States on dividends. In any cases where dividends are subject to withholding taxes the same difficulties arise as those

being discussed in SG4 in relation to foreign income. Additionally, in the discussions carried on in the main group and in the subgroups experts are not usually in favour of distinguishing between different sources of income but prefer to integrate all income received in the base and give equal treatment to it.

III. Double taxation

9. The CCCTB will have to provide rules for those cases when double taxation occurs. Double taxation can be economic, when the same income is taxed twice in different companies or juridical, when the same taxpayer is taxed twice on the same income but by different tax administrations. This document will deal with economic double taxation as the juridical double taxation is currently being analysed by SG4.
10. Economic double taxation occurs because a company is taxed in its profits and latter these profits are either distributed to the shareholders or retained in the company as reserves. The shareholder can be taxed when receiving the dividends or when selling the shares whose value has increased due to the retained profits. Double taxation can therefore occur when the shareholder receives the dividends or when he sells the shares and there is a capital gain originating from the (taxed) reserves. Some preliminary discussion on this has been held on SG1. The technique to provide and the requirements to qualify for double taxation relief should be symmetric for dividends and capital gains.
11. When providing for double taxation relief it is therefore necessary to make sure that the dividends (or the capital gains) were effectively taxed: that the profit distributed has been included in the tax base or that the capital gain is effectively derived from taxed profits retained in the company as reserves, i.e. the profit or gains being distributed have actually been included in the tax base. Any distribution to shareholders that has not been included in the tax base should not be exempted.
12. Double taxation relief could also be provided for example in those cases when a company is liquidated, when a shareholder leaves a company or when a company purchases its own shares from a shareholder. In all these cases only that part of the income obtained by the shareholder that has been subject to tax needs relief from double taxation.
13. Various situations can be examined: (i) Distribution of profits within a CCCTB group; (ii) Distribution of profits between two companies that apply CCCTB rules belonging to different groups; (iii) Inbound dividends: distribution of profits from a company that does not apply CCCTB rules to a company that applies CCCTB rules; (iv) Outbound dividends: distribution of profits from a company that applies CCCTB rules to a company that does not apply CCCTB rules.
14. (i) Within a CCCTB group intra-group payments of dividends must be eliminated through the consolidation process. The dividends received by the holding are

- taxed profits of the subsidiary usually from previous years and will therefore not form part of the consolidated tax base. If the method chosen to consolidate under the CCCTB is full consolidation (as the majority of experts in SG5 seem to agree) all intra-group payments of dividends will be completely eliminated. Intra-group dividends are therefore a non-issue as they would disappear with the consolidation.
15. (ii) When the distributions of profits are between two companies that apply CCCTB rules but that belong to different groups double taxation relief should be provided by the CCCTB rules. (iii) Double taxation relief should also be granted in those cases when the company that receives the dividends is a company that applies CCCTB rules even when the dividends are paid by a company that does not apply CCCTB rules but national rules. In situation (iii) double taxation relief should equally be provided by CCCTB rules and probably according to the same rules as in situation (ii) otherwise non-discrimination issues could arise.
 16. Double taxation relief can be basically granted through exemption or credit. The Parent Subsidiary Directive (90/435/ECC, of 23 July 1990) allows these two methods as it obliges the state of the parent company either to refrain from taxing the distributed profits (exemption) or tax such profits while authorising to deduct from the amount of tax due that fraction of the corporation tax related to those profits (credit).
 17. Under the CCCTB common rules are needed and double taxation relief has to be provided by one of the two methods foreseen in the Directive and at least in those cases when the Parent Subsidiary Directive provides for it. In CCCTB the exemption method is probably preferable as it is easier to apply, guarantees the complete elimination of the double taxation and as the distribution is always inside the EU the companies have been effectively taxed.
 18. The Parent Subsidiary Directive establishes certain conditions that must be fulfilled in order to qualify for double taxation relief, providing a common starting point for the CCCTB (basically a threshold of 10% from 1 January 2009; although a minimum holding period of two years can be imposed by Member States by way of derogation).
 19. (iv) When one company taxed according to national rules receives dividends from a CCCTB company the double taxation should be eliminated by the national rules applicable to the company receiving the dividends. Under the CCCTB rules the only aspect that could be decided is if the company can apply a withholding tax when paying the dividends. In this respect it could be logical not to apply a withholding tax to the payments of dividends within the EU.

IV. Treatment of losses and expenses

20. The shareholder when selling the shares in the subsidiary may also have a capital loss. In principle the treatment should be symmetrical to the treatment of capital

gains and when the requirements to qualify for the double taxation relief are fulfilled, the capital losses should not be deductible. In parallel, in those cases, the provisions for unrealized capital losses should not be deductible.

21. It can be considered that expenses related to non taxable income are non deductible. A rule can be introduced in this direction as a pro-rata rule to determine the part of the expenses deemed to be connected to exempted income. However, this situation is not specific to the dividends/capital gains but applies to all exempted income.
22. The Parent Subsidiary Directive allows the non deductibility of charges relating to the holding or losses resulting from the distribution of profits with certain limits. Again the CCCTB can follow these rules or provide for a more favorable regime.

V. Anti-avoidance

23. Several situations where anti-avoidance rules could be needed to counter tax planning can be envisaged; some are briefly discussed here.
24. As already mentioned, double taxation relief should not be provided in those cases when the dividends or capital gains have not been effectively taxed in the subsidiary. For instance when a company decreases the share-capital and distributes it to the shareholders or in those cases when it has previously decreased share-capital to constitute reserves or compensate losses.
25. During the discussions of the fourth meeting of SG1 some experts mentioned those cases when certain assets are sold in the form of shares to benefit from the exemption. However, it can be argued that probably no anti-avoidance rule is needed here. This situation, for example, will usually imply one company selling a line or branch of activity where the assets are allocated (for this purpose the company has to be first split in two parts):
 - (i) The buyer will own shares rather than assets, so will not be able to depreciate them.
 - (ii) The new company that has been split and bought will retain the pre-existing values of the assets (if according to the rules designed for business reorganisations neutrality principle is applied), in consequence the company will be able to depreciate only the amounts that were being depreciated before (i.e. there is no step up).
 - (iii) The taxation is therefore postponed until the moment when the assets are sold; the treatment will therefore be the same as for any other reorganisation.
26. If the assets are 'sold' via a merger of a line or a branch of activity where the assets are allocated with the buyer company, the same neutrality principle should be applied and the pre-existing values will be maintained.

27. Thin capitalisation rules are probably needed for payments of interest between related companies outside the EU, this issue could be analysed in detail in SG4 or when dealing with any general anti-avoidance rules.
28. It may be necessary at least to foresee the possibility that non-arm's length transactions between a company and its shareholders be treated as regular dividends unless the taxpayer shows the contrary. This issue will be dealt with in more detail when analysing the issue of related or connected companies when they are not part of the CCCTB group.
- I. Do members of the group agree that dividends received should be included in the taxable base in the same way as any other income?*
- II. Do members of the group agree that double taxation relief must be provided in all the cases mentioned in the document?*
- III. Do members of the group agree that double taxation relief should be provided in a symmetric way for dividends and capital gains?*
- IV. Do members of the group consider that the requirements to qualify for double taxation relief should be the same or more favourable than those provided by the Parent Subsidiary Directive given the nature of CCCTB?*
- V. Do members of the group agree that double taxation in payments of dividends within a CCCTB group is a non-issue?*
- VI. Do members of the group agree that a withholding tax must not be applied to the payments of dividends within the EU?*
- VII. Do members of the group agree that the treatment of capital losses should be symmetrical?*
- VIII. Do members of the group agree that charges and losses related with non taxable income should not be taxable?*
- IX. What anti-avoidance rules do member states consider necessary?*