

Subject to tax condition in PSD and IRD

1st Nicolai Copernici Global Tax Talks: Withholding
Tax Challenges

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The views expressed during this presentation are those of the speaker and do not necessarily reflect the views of the organizations with which they are affiliated.



Background being ground for research on PSD and IRD subject to tax condition

- IRD and PSD provides for exemptions of dividend, interest and royalties within EU
- Both PSD and IRD contain a subject-to-tax condition.
- The subject to tax condition has been subject to CJEU judgments, which has led to interpretative doubts
- In Poland, the subject-to-tax condition has been for a while equated by the tax authorities and voivodship admonitive court in Lublin with the requirement of effective taxation of the dividend/interest recipient.
- In 2024, the Ministry of Finance issued two general interpretations, claiming that under PSD, subject-to-tax does not mean that a dividend needs to be effectively taxed to apply the dividend exemption. However, the Lublin Voivodship Administrative Court maintains a different view.
- A different approach was taken by Ministry of Finance in relation to interest. Even though local regulation wording is the same in both cases, the Ministry claims the application of the exemption from WHT is subject to the effective taxation of interest on side of recipient.



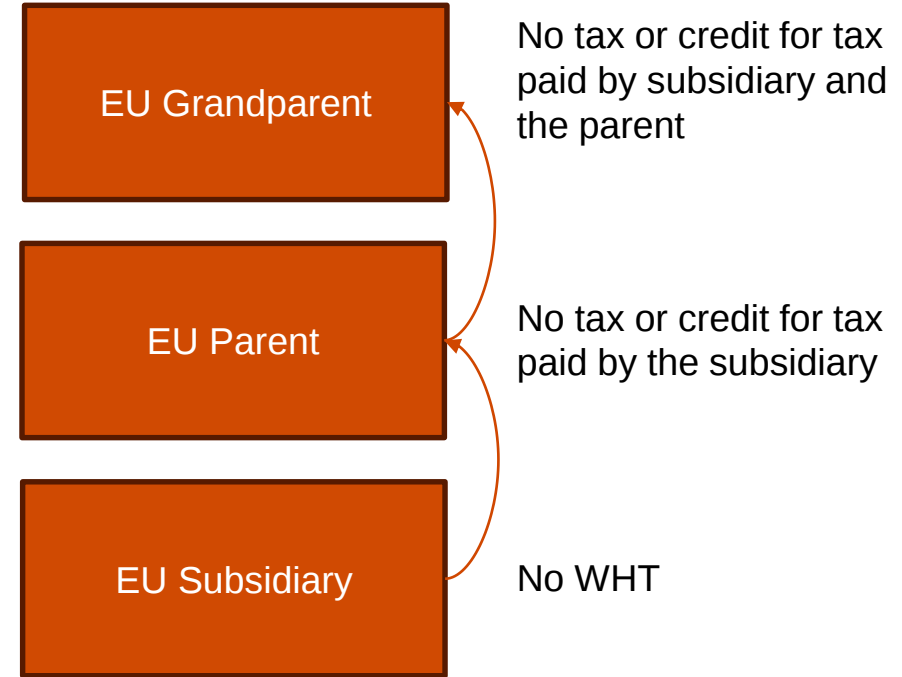
PSD Directive



> **The objective** of this Directive is to **exempt dividends and other profit distributions paid by subsidiary companies to their parent companies from withholding taxes and to eliminate double taxation of such income at the level of the parent company.**

> Profits which a subsidiary distributes to its parent company are to be exempt from withholding tax.

> Where a parent company by virtue of its association with its subsidiary receives distributed profits, the Member State of the parent company must either refrain from taxing such profits, or tax such profits while authorising the parent company to deduct from the amount of tax due that fraction of the corporation tax paid by the subsidiary which relates to those profits.



Directive applicability to „companies of Member State”



Article 2 of the
PSD directive

Article 2

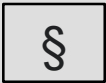
For the purposes of this Directive the following definitions shall apply:

(a) ‘**company of a Member State**’ means any company which:

(i) takes one of the forms listed in Annex I, Part A;

(ii) according to the tax laws of a Member State is considered to be resident in that Member State for tax purposes and, under the terms of a double taxation agreement concluded with a third State, is not considered to be resident for tax purposes outside the Union;

(iii) moreover, **is subject to one of the taxes** listed in Annex I, Part B, **without the possibility of an option or of being exempt, or to any other tax which may be substituted for any of those taxes**;



Article 3 of the
PSD directive

Article 3

1. For the purposes of applying this Directive:

(a) the status of parent company shall be attributed:

(i) at least to a **company of a Member State** which fulfils the conditions set out in Article 2 and has a minimum holding of 10 % in the capital of a **company of another Member State** fulfilling the same conditions;

(ii) under the same conditions, to a **company of a Member State** which has a minimum holding of 10 % in the capital of a **company of the same Member State**, held in whole or in part by a permanent establishment of the former company situated in another Member State;

CJEU ruling C-448/15 (Wereldhave)



- Dividend payments were made to Wereldhave International and Wereldhave, public limited companies under Netherlands law.
- These companies were fiscal investment institutions (FIIs).
- FIIs were taxable in the Netherlands.
- An FII may have been entitled to a zero rate of corporation tax, provided that it distributed all its profits to its shareholders.

CJEU reasoning:

- It must be pointed out in that regard that Article 2(c) of Directive 90/435 lays down a positive criterion for qualifying, that is to say, being subject to the tax in question, and a negative criterion, that is to say, not being exempt from that tax and not having the possibility of an option.
- The establishment of both those criteria, one positive, the other negative, leads to the **conclusion that the condition laid down in Article 2(c) of the directive does not merely require that a company should fall within the scope of the tax in question, but also seeks to exclude situations involving the possibility that, despite being subject to that tax, the company is not actually liable to pay that tax.**
- Although, formally, a company which is subject to tax at a zero rate, provided that all of its profits are paid to its shareholders, is not exempt from that tax, it is, in practical terms, in the same situation as the one which Article 2(c) of Directive 90/435 seeks to exclude, that is to say, a situation in which it is not liable to pay that tax.

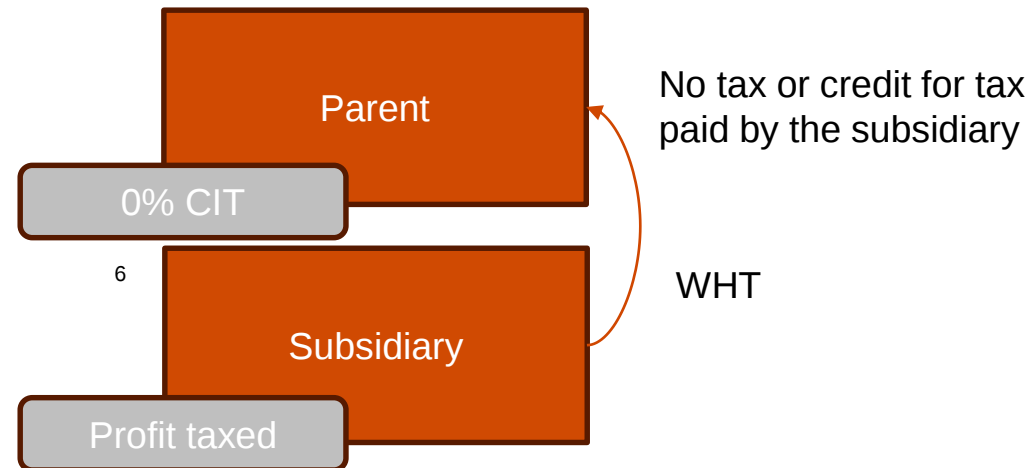
Subject to tax on side of a parent



- Where a parent company, like the FII at issue in the main proceedings, is entitled under the legislation of its Member State of establishment to a zero rate of taxation for all its profits, provided that all those profits are distributed to its shareholders, **the risk of double taxation on the part of that parent company of profits which were distributed to it by its subsidiary is ruled out.**

(CJEU ruling C-448/15 Wereldhave)

Example 1: 0% CIT and



Is PSD aimed at eliminating of:

(1) double taxation of subsidiary profit,

(2) double taxation of profit distribution (dividend transfer within EU)?



Answer lies in Article 4 and 5 of PSD

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Motives of the directive

The objective of this Directive is to exempt dividends and other profit distributions paid by subsidiary companies to their parent companies from withholding taxes and to eliminate double taxation of such income at the level of the parent company.

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Article 4 of the PSD directive

Article 4

1. Where a parent company or its permanent establishment, by virtue of the association of the parent company with its subsidiary, receives distributed profits, the Member State of the parent company and the Member State of its permanent establishment shall, except when the subsidiary is liquidated, either:

(a) refrain from taxing such profits; or

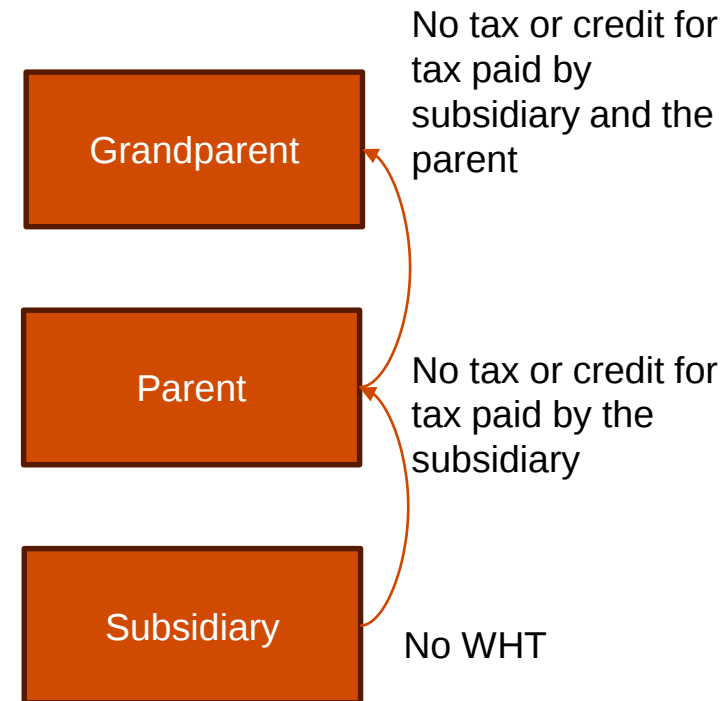
(b) tax such profits while authorising the parent company and the permanent establishment to deduct from the amount of tax due that fraction of the corporation tax related to those profits and paid **by the subsidiary** and any lower-tier subsidiary, subject to the condition that at each tier a company and its lower-tier subsidiary fall within the definitions laid down in Article 2 and meet the requirements provided for in Article 3, up to the limit of the amount of the corresponding tax due.

Article 5

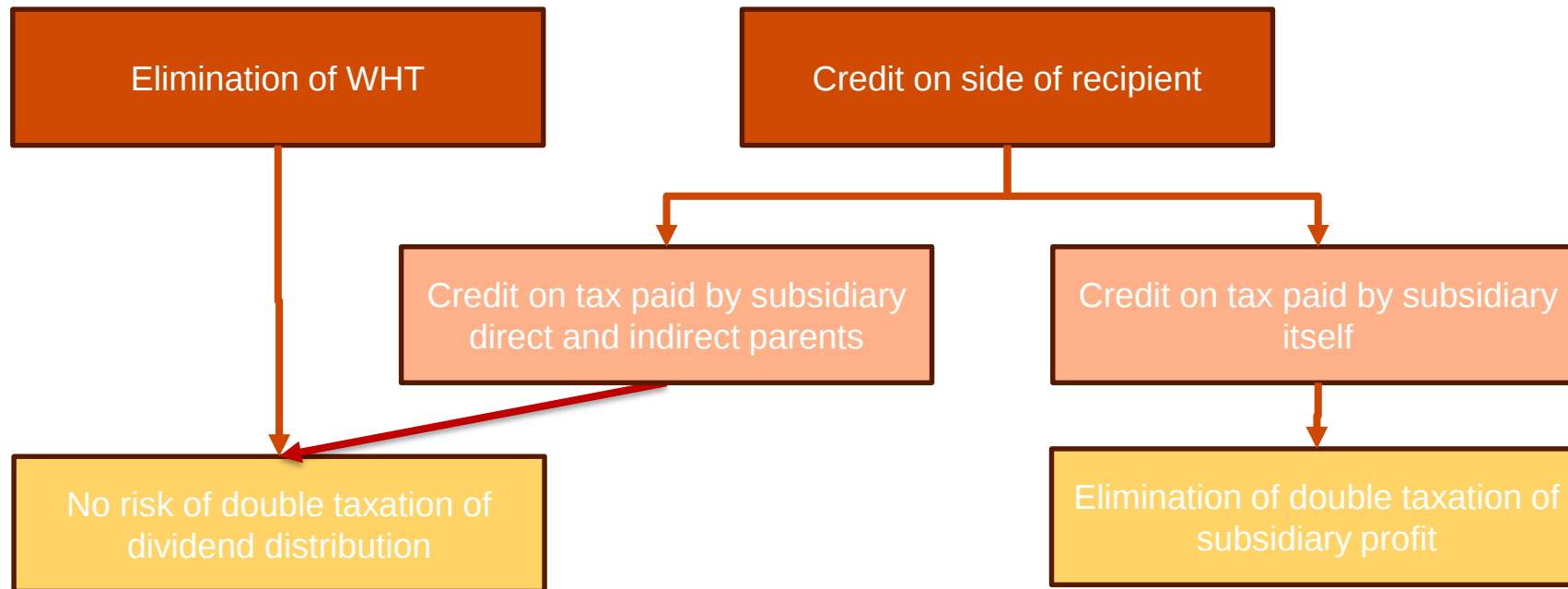
Profits which a subsidiary distributes to its parent company shall be exempt from withholding tax.

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Article 5 of the PSD directive



Dispute around aim of the directive



Directive is aimed at eliminating not only double taxation of profit distribution but double taxation of subsidiary profit as well.

Subject to tax on side of a parent

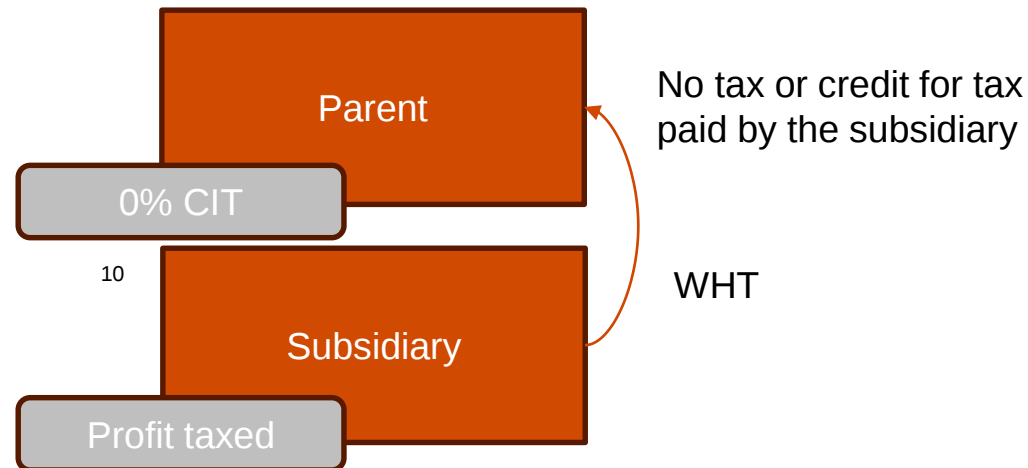


- Where a parent company, like the FII at issue in the main proceedings, is entitled under the legislation of its Member State of establishment to a zero rate of taxation for all its profits, provided that all those profits are distributed to its shareholders, **the risk of double taxation on the part of that parent company of profits which were distributed to it by its subsidiary is ruled out.**

(CJEU ruling C-448/15 Wereldhave)

That does not seem true!

Example 1: 0% CIT and



Profit is already taxed at level of subsidiary. Imposition on WHT means double taxation of the subsidiary profit.

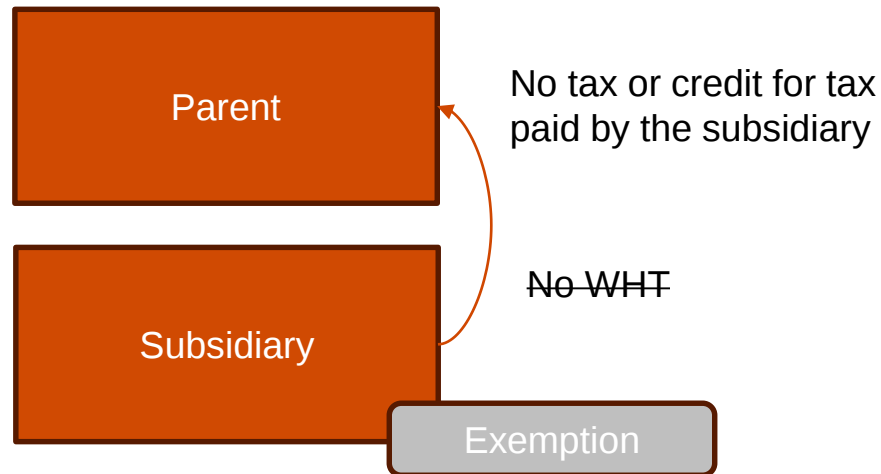
Subject to tax on side of a subsidiary



Article 2 of the
PSD directive
(fragment)

(iii) moreover, **is subject to one of the taxes** listed in Annex I, Part B, **without the possibility of an option or of being exempt, or to any other tax which may be substituted for any of those taxes;**

Example 1: Exemption in jurisdiction of the subsidiary



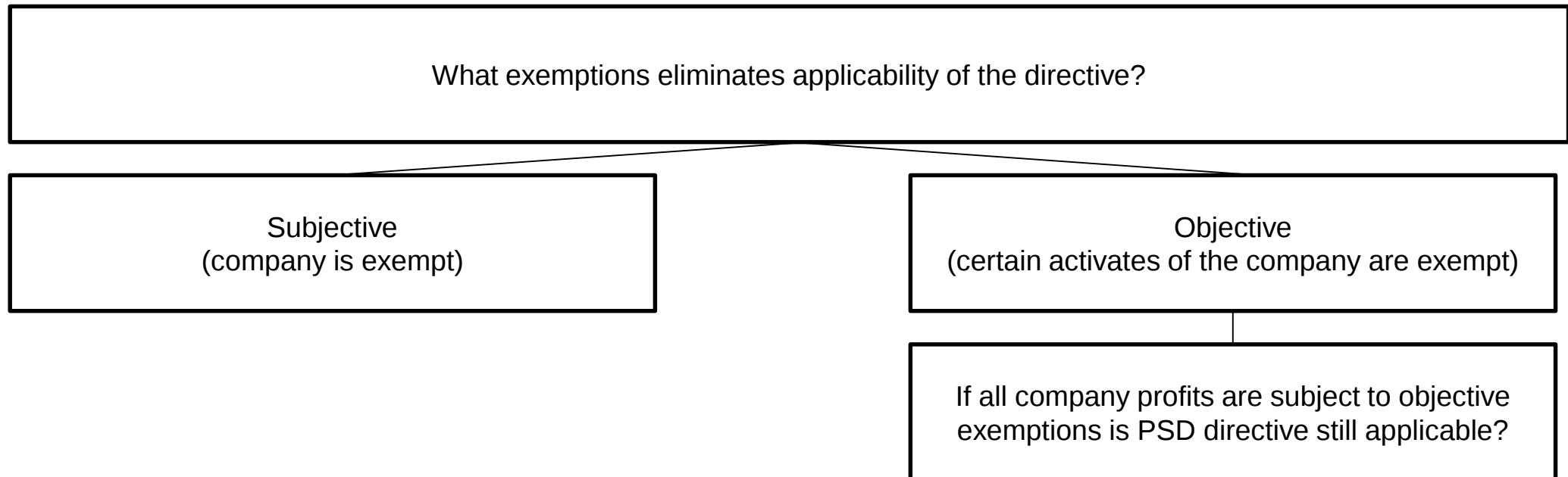
If no subject to tax condition applies to the subsidiary, it would eliminate the subsidiary's member state's right to impose WHT. (The parent company jurisdiction would still be able to tax the subsidiary's profits if it wishes)

What exemptions eliminate access to PSD?



CJEU Ruling

The establishment of both those criteria, one positive, the other negative, leads to the **conclusion that the condition laid down in Article 2(c) of the directive does not merely require that a company should fall within the scope of the tax in question, but also seeks to exclude situations involving the possibility that, despite being subject to that tax, the company is not actually liable to pay that tax.;**



What exemptions eliminate access to PSD?



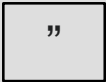
Article 2 of the
PSD directive

Article 2

(a) **'company of a Member State'** means any company which:

/.../

(iii) moreover, **is subject to one of the taxes** listed in Annex I, Part B, **without the possibility of an option or of being exempt, or to any other tax which may be substituted for any of those taxes;**



Doctrine

With regard to the dichotomy between subjective exemption versus objective exemption, it may be concluded that companies benefitting from subjective exemption schemes fall outside the scope of the Directive, while companies granted specific objective exemptions generally do not.

P. Arginelli, The Subject-to-Tax Requirement in the EU Parent-Subsidiary Directive (2011/96), „European Taxation“, August 2017, s. 339:

The provision does not exclude companies which are subject to tax but who may claim an exemption for certain items of income. For instance, a Netherlands company is subject to corporate tax, but may claim an exemption for dividends received from a foreign subsidiary. Even should the Netherlands company, acting as an (intermediate) holding company, receive no other income, and consequently effectively pay no corporate tax, the company would still, in principle, be subject to tax and, therefore, meet the requirement of Article 2(c)”

F.C. de Hosson, The parent-subsidiary directive, „Intertax“ 1990/18, s. 42

IRD subject to tax



Article 3 of the IRD directive

Article 3

(a) the term 'company of a Member State' **means any company:**

(i) taking one of the forms listed in the Annex hereto; and

(ii) which in accordance with the tax laws of a Member State is considered to be resident in that Member State and is not, within the meaning of a Double Taxation Convention on Income concluded with a third state, considered to be resident for tax purposes outside the Community; and

(iii) **which is subject to one of the following taxes without being exempt**, or to a tax which is identical or substantially similar and which is imposed after the date of entry into force of this Directive in addition to, or in place of, those existing taxes:



IRD motives

(3) It is necessary to ensure that interest and royalty payments are subject to tax once in a Member State.

(4) The abolition of taxation on interest and royalty payments in the Member State where they arise, whether collected by deduction at source or by assessment, is the most appropriate means of eliminating the aforementioned formalities and problems and of ensuring the equality of tax treatment as between national and cross-border transactions; it is particularly necessary to abolish such taxes in respect of such payments made between associated companies of different Member States as well as between permanent establishments of such companies.

Subject to tax condition and Danish cases



CJEU
C-115/16,
C-118/16,
C-119/16 and
C-299/16

150 As regards the third condition, it is not disputed that X SCA, SICAR is subject to impôt sur les revenus des collectivités (corporate income tax) in Luxembourg, which is one of the taxes listed in Article 3(a)(iii) of Directive 2003/49.

151 However, **should it have to be found that, as SKAT contends in the main proceedings in Case C-118/16, the interest received by X SCA, SICAR is in fact exempt in that respect from corporate income tax in Luxembourg, it would then have to be stated that that company does not satisfy the third condition referred to in paragraph 147 above and that it cannot therefore be regarded as being a ‘company of a Member State’ within the meaning of Directive 2003/49.** It is, however, for the referring court alone to make, if appropriate, the necessary checks in that regard.

152 That interpretation of the scope of the third condition referred to in paragraph 147 above is supported, first, by Article 1(5)(b) of Directive 2003/49, from which it is apparent **that a permanent establishment** can be regarded as being the beneficial owner of interest, within the meaning of the directive, only ‘if the interest ... payments [which it **receives**] **represent income in respect of which that permanent establishment is subject in the Member State in which it is situated to one of the taxes mentioned in Article 3(a)(iii) ...**’, and second, by **the objective of Directive 2003/49**, which, as has been recalled, in essence, in paragraph 85 above, **is to ensure that such interest payments are subject to tax once in a single Member State.**

CJEU seems to claim that effective taxation of interest on recipient site is needed for IRD applicability.

Legislation history of IRD

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Article 7 of the
proposal of IRD

Article 7

1. In addition to the situations covered by Article 6, Member **States shall be authorised** not to apply the provisions of Article 1 to any payments of interest or royalties made to an associated company of another Member State or to a permanent establishment situated in another Member State of an associated company of a Member State which, in respect of that income and by virtue of a provision made for its benefit or for the benefit of certain companies or permanent establishments or certain activities:

(a) is subject to the tax mentioned in Article 3(1)(a)(iii) **at a rate which is lower than the rate of tax which would otherwise normally be applicable to such income received by companies** of, or permanent establishments situated in, that other State; or

(b) **benefits from a reduction in the tax base which would not otherwise normally be available to companies** of, or permanent establishments situated in, that other State.

2. If the circumstances referred to in either of points (a) or (b) of paragraph 1 apply only to a part of the interest or royalties referred to in paragraph 1, Member States shall be authorised not to apply the provisions of this Directive to that part of the interest or royalties.

Proposal for a Council Directive on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States

COM/98/0067 final – CNS 98/0087 */. Official Journal C 123, 22/04/1998 P. 0009.

Legislation history of IRD

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Statements to the
protocol

„The Council and the Commission agree that the benefits of the Interest and Royalty Directive should not accrue to companies that are exempt from tax on income covered by that Directive. The Council invites the Commission to propose any necessary amendments to this Directive in due time”

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Directive
proposal
2003/0331/CN
S

“1. Interest or royalty payments arising in a Member State shall be exempt from any taxes imposed on those payments in that State, whether by deduction at source or by assessment, provided that the beneficial owner of the interest or royalties is a company of another Member State or a permanent establishment situated in another Member State of a company of a Member State and is **effectively subject to tax on the interest or royalty payments in that other Member State.**

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Directive
proposal
2011/0314/CN
S

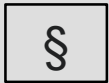
1. Interest or royalty payments arising in a Member State shall be exempt from any taxes imposed on those payments in that Member State, whether by deduction at source or by assessment, provided that the beneficial owner of the interest or royalties is a company of another Member State or a permanent establishment situated in another Member State of a company of a Member State and **is effectively subject to tax on the income deriving from those payments in that other Member State**

Motives of the directive



AG Kokott
opinion C-
118/16

The wording of Article 3(a)(iii) in conjunction with the annex makes it clear that a société en commandite par actions (S.C.A.) falls within the scope of Directive 2003/49. In addition, it should be noted that **none of the provisions in Directive 2003/49 stipulates that an actual taxation of the beneficial owner (here the Luxembourg companies) in a certain amount is a requirement for the exemption. The Commission's attempts at making changes (36) by linking the tax exemption not only with a company's corporation tax liability but with an 'effective' taxation of the interest and royalty income have so far not been implemented.**



IRD Directive
Motives

(1) In a Single Market having the characteristics of a domestic market, **transactions between companies of different Member States should not be subject to less favourable tax conditions than those applicable to the same transactions carried out between companies of the same Member State.**

(3) It is necessary to ensure that interest and royalty payments are subject to **tax once in a Member State.**

(4) **The abolition of taxation on interest and royalty payments in the Member State where they arise, whether collected by deduction at source or by assessment, is the most appropriate means of eliminating the aforementioned formalities and problems and of ensuring the equality of tax treatment as between national and cross-border transactions;** it is particularly necessary to abolish such taxes in respect of such payments made between associated companies of different Member States as well as between permanent establishments of such companies.

Thank you!

