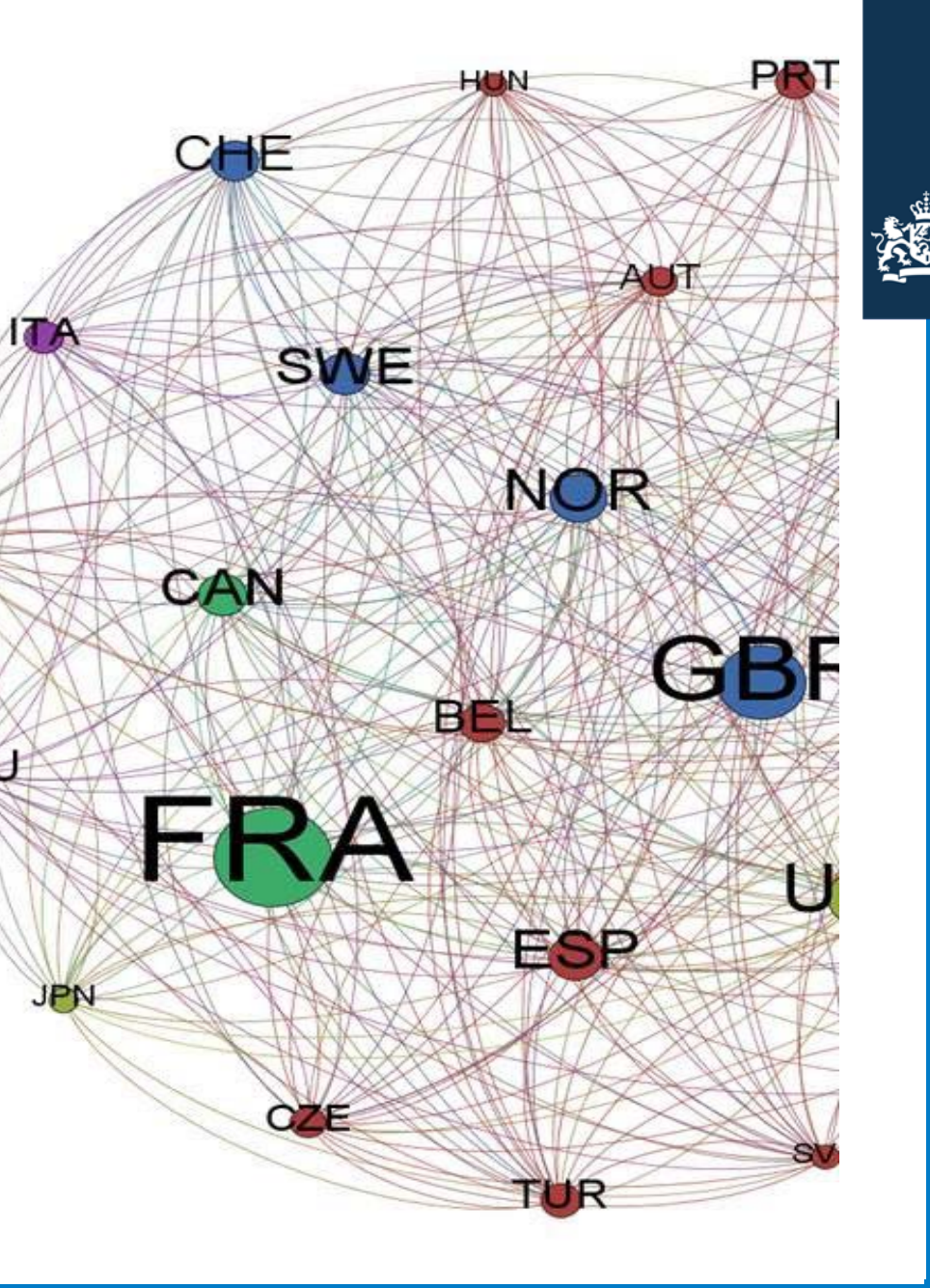


CPB Netherlands Bureau for Economic Policy Analysis

The Danish Beneficial Ownership (BO) cases

Legal perspective

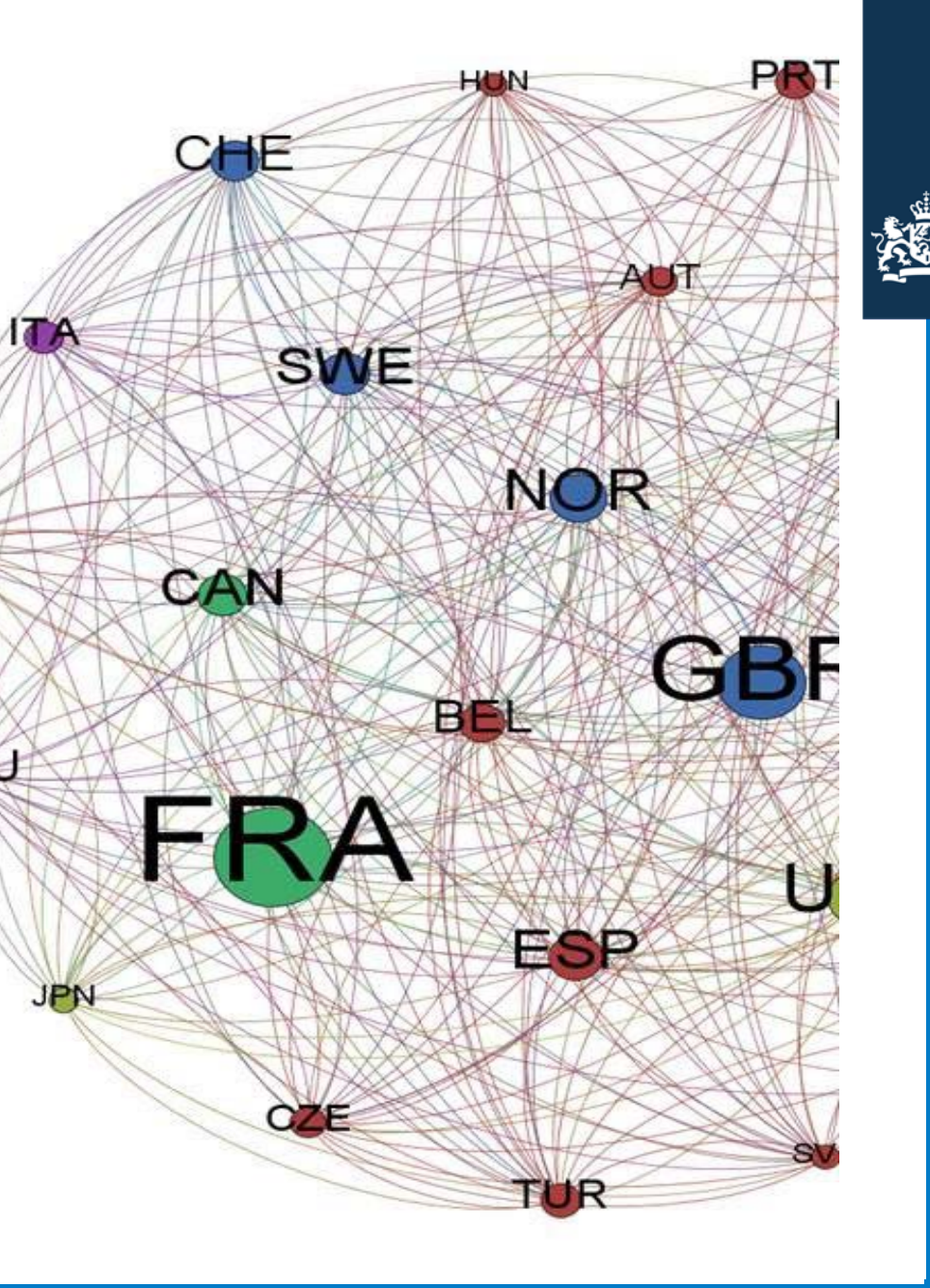
Susi Hjorth Bærentzen (IBFD)

'Economic' perspective

Maarten van 't Riet (CPB)

NTRC, Reykjavik

5 May 2022



CPB Netherlands Bureau for Economic Policy Analysis

The Danish Beneficial Ownership (BO) cases

'Economic' / quantitative perspective

I : a tax tool

Network analysis of dividend repatriation

II : an application

Impact analysis of 'the Danish BO cases'

Optimal Tax Routing:
network analysis of tax treaty shopping & FDI diversion

Basic idea: **a navigation tool**

for international tax 'routes'
- in particular for firms

Van 't Riet & Lejour (ITAX, 2018)

- Inspiration? **Barrios et al. (JPubEc, 2012)**
- Table with bilateral Effective Tax Rates (ETRs) :
- home taxation matters as well for bilateral investment

Definitions of treaty shopping

- **van Weeghel (1998)**:'connotes a situation in which a person who is not entitled to the benefits of a tax treaty makes use – in the widest meaning of the word – of an individual or legal person in order to obtain those treaty benefits that are not available directly'.
- **Davies (2004)**: 'investment through a third country to take advantage of treaty provisions not found between the host and residence countries directly'
- **OECD (2015)**: Treaty shopping may involve treaty abuse and be illegal, the granting of (tax) treaty benefits in inappropriate circumstances.

- *We use 'treaty shopping' as diversion of investment flows,*
  and hence the re-routing of the flows of distributed dividend
  <u>assuming</u> that the treaty benefits along the way are available

- Treaty shopping was neglected in the empirical literature ….. except for **Weyzig (ITAX, 2013)** and **Weichenrieder and Mintz (2010)**

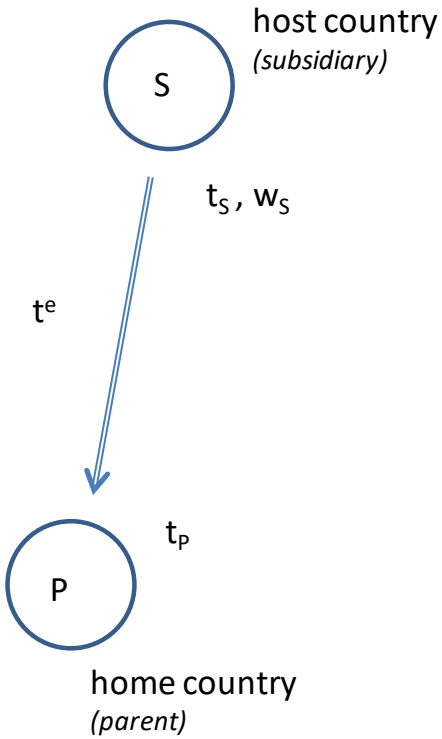
International corporate taxation: double ? triple ?

Double taxation: both in host and home

1 - corporate income taxation (CIT) host
2 - non-resident withholding tax on dividends
3 - CIT of the home (parent) country

Combined effective taxation:

t_{sp}^{e} : compounded tax rate



International corporate taxation: double, but ...

- double tax relief of the home country:
  - deduction, credit or exemption
- bilateral tax treaties
  - reduced withholding taxes (instead of the standard rate)
  - more lenient double tax relief for treaty partner

matrix structure: t_{SP}^{e} : bilateral specific compounded tax rates

Tax distance matrices for dividend repatriation

Approach:

1. **create a matrix of bilateral tax 'distances'**
2. compute (weighted) country and world averages
   - using cell, column and row averages
3. generate matrix of 'shortest distances'
4. compute (weighted) country and world averages
   - using cell, column and row averages
5. find the countries ('nodes') most used as intermediate station
6. econometrics on bilateral FDI

Disclaimer:

- our tax distances concern repatriation of dividends
  - royalty and interest payments are not considered (later we did)

Data: tax parameters of 108 jurisdictions

- tax parameters of 2013 [later 2018], public sources, IBFD, EY …
- 108 countries, including tax havens
  - corporate income tax (CIT) rate
  - double tax relief method
  - general rate of non-resident withholding tax on dividends
  - bilateral withholding tax rates from the treaties
    - *only for dividends*
  - EU's Parent - Subsidiary directive : 0% and exemption
  - CFC rules
- matrix of bilateral (compounded) double tax rates
  - without CIT of host country

Selected tax parameters for (2013) [later 2018]

Country	CIT	DTRM	THR	CFC	WHT-div	no. trts	tax haven
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Bermuda	0.0	xmp		0	0	0	1
Brazil	34.0	crd		1	15	35	0
Canada	26.3	crd	xmp	0	25	75	0
China	25.0	crd		1	10	64	0
France	34.3	ded	crd	1	30	80	0
Germany	30.2	crd	xmp	1	25	71	0
Hong Kong	16.5	xmp		0	0	14	1
Japan	37.0	xmp		0	20	48	0
Luxembourg	29.2	xmp		0	15	56	0
Malta	35.0	xmp		0	0	40	1
Netherlands	25.0	xmp		0	15	72	0
Switzerland	21.1	xmp		0	35	70	0
Utd Arab Em.	0.0	xmp		0	0	23	0
UK	23.0	xmp		1	0	55	0
US	39.1	crd		1	30	54	0

Dividend withholding tax matrix 2013 (selection)

From \ To	Bermuda	China	Germany	Malta	NLD	Nigeria	USA	*Standard*
Bermuda	-	0	0	0	0	0	0	*0*
China	10	-	10	5	10	7.5	10	*10*
Germany	25	10	-	0	0	25	5	*25*
Malta	0	0	0	-	0	0	0	*0*
Netherlands	15	10	0	0	-	12.5	0	*15*
Nigeria	10	7.5	10	10	7.5	-	10	*10*
United States	30	10	0	5	0	30	-	*30*

Dividend withholding tax matrix 2013 (selection)

From \ To	Bermuda	China	Germany	Malta	NLD	Nigeria	USA	*Standard*
Bermuda	-	0	0	0	0	0	0	*0*
China	10	-	10	5	10	7.5	10	*10*
Germany	25	10	-	0	0	25	5	*25*
Malta	0	0	0	-	0	0	0	*0*
Netherlands	15	10	0	0	-	12.5	0	*15*
Nigeria	10	7.5	10	10	7.5	-	10	*10*
United States	30	10	0	5	0	30	-	*30*

Compute bilateral dividend repatriation tax rates

- Use the bilateral withholding tax rates and other tax parameters

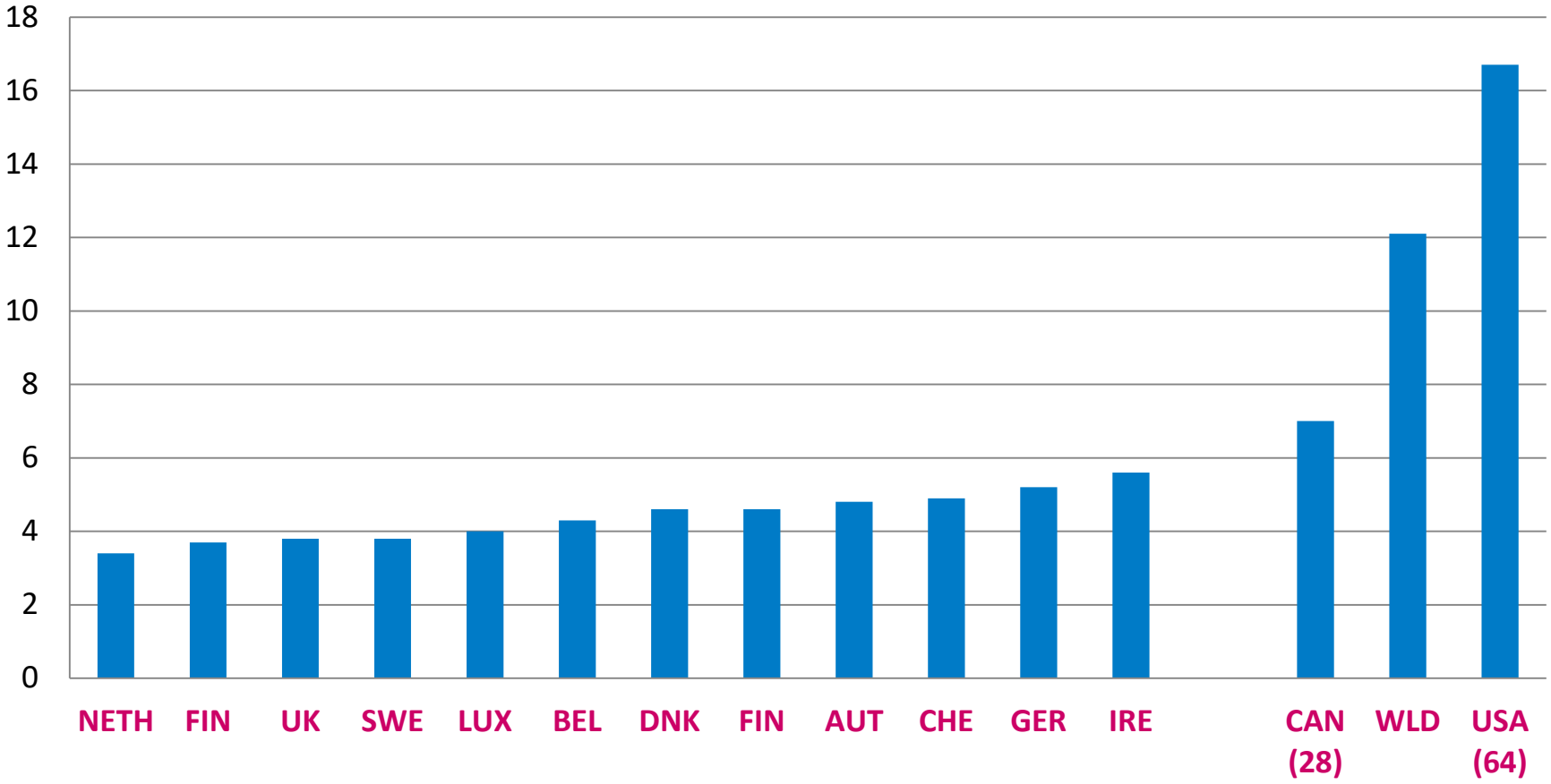
The combined effective tax rates $t^e_{SP}(rm_{SP})$ for the multinational can be determined depending on the relief method;
all are fully in line with Barrios et al. (2012)

$$t^e_{SP}(deduction) = \quad 1-(1-t_S)(1-w_{SP})(1-t_P)$$
$$t^e_{SP}(credit) = \quad \max\{1-(1-t_S)(1-w_{SP}), t_P\}$$
$$t^e_{SP}(exemption) = \quad 1-(1-t_S)(1-w_{SP})$$

- The dividend repatriation tax rates are the tax 'distances', without the CIT in the source jurisdiction

- Then compute (weighted) country averages … !!

Average tax rates for inbound dividends (ranked)



Why?

Tax Inversion!

- Mylan N.V. registered in Neth. operational headquarters in US
- deal Mylan Inc. and Abott Labs completed Feb 2015

- Pfizer? In 2014 bid on AstraZeneca (UK): 118 bln USD
- Pfizer – Allergan (IRE), 2015: 160 bln USD!

- tax inversion:

  Burger King buys Tim Hortons (Can), 11.4 bln USD and moves ***legal residence*** to Canada

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   - *using cell, column and row averages*

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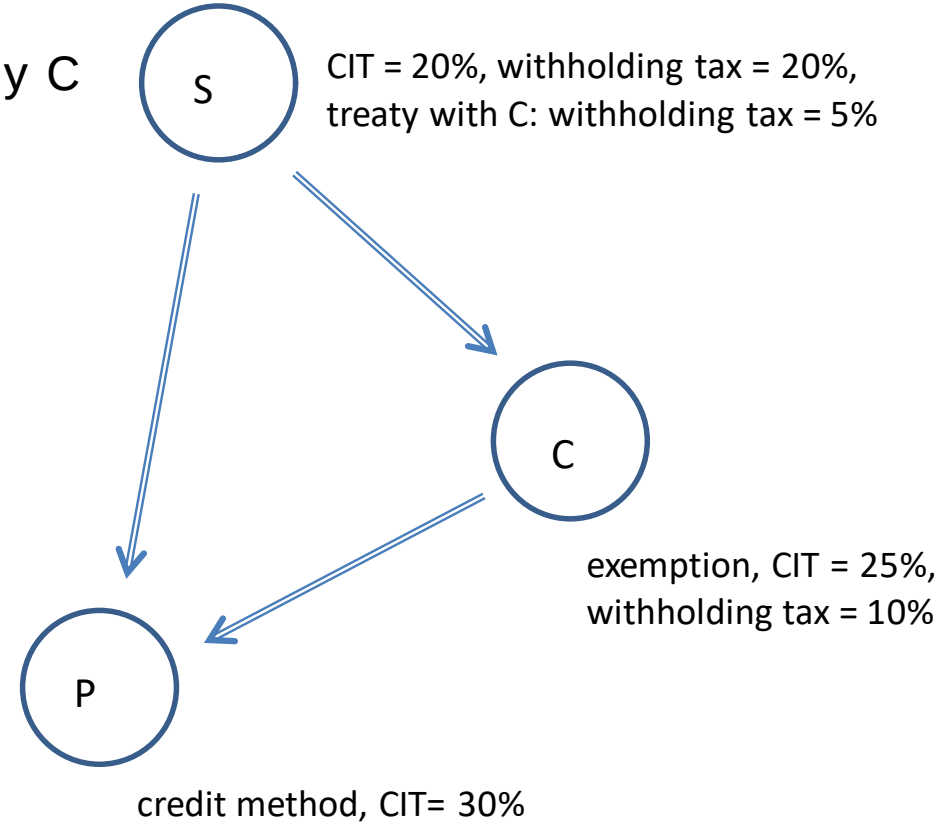
6. econometrics on bilateral FDI

International tax system as a transport network

- indirect route over conduit country C
- economic definition TS
- route over one **or more** conduits rational when it leads to tax reduction
- determine cheapest tax route : algorithms of
  Dijkstra / Floyd-Warshall



our contribution: adaptations to fit the tax world

Treaty shopping reduces double tax rates

- World average double tax rate is reduced with 6 % points, i.e.

  treaty shopping gain = 6% points

- Potential reduction: for all pairs optimal tax route is used

- For 67% of all pairs the optimal route is indirect

%	Direct	Optimal
WHT	**7.7**	**2.1**
CIT home	**4.4**	**3.7**
Double tax	**11.8**	**5.8**
Source	*7.7*	*2.1*
Conduit		*0.3*
Residence	*4.1*	*3.3*

- Withholding taxes most avoided
- Conduit taxation is, of course, minimal: 0.3% of worldwide dividend flows

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5. **find the countries ('nodes') most used as intermediate station**

6. econometrics on bilateral FDI

Network centrality identifies conduit countries !!

- Computing (all) optimal = cheapest tax routes

- Betweenness centrality :

  percentage of all country pairs for which a given country is an intermediate station on a cheapest tax route

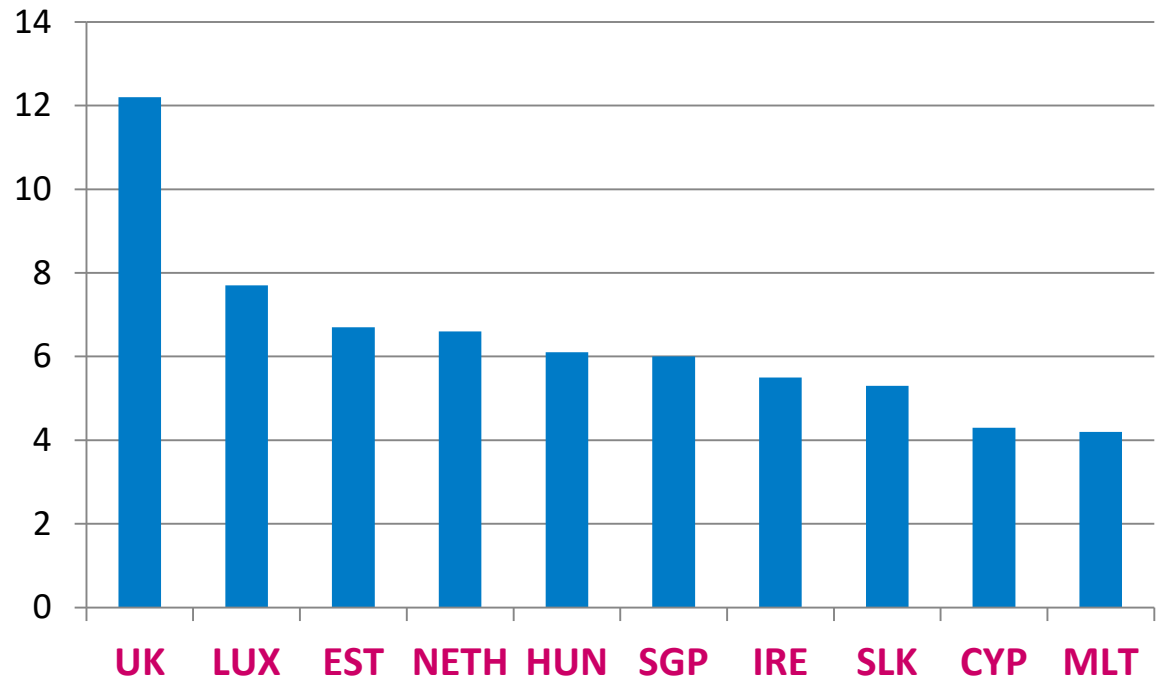
  (taking into account multiplicity of cheapest tax routes)

- Centrality measure(s) reflect necessary condition for conduit function

- Multiplicity of cheapest tax routes due to zero's and identical tax rates and not strictly cheapest route for non-tax reasons (+0.5%)

- Double GDP - weighting of the country pairs
  - as alternative weights based on bilateral dividends and FDI stocks

Centrality ranking (most used conduits)



- Contributing to a high rank are: -EU membership, - general rate of 0% for withholding tax, - exemption, - high number of treaties
- LUX first with non-zero general dividend rate, NETH second, IRE third

Tax distance matrices for dividend repatriation

Approach:

1. *create a matrix of bilateral tax 'distances'*
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5. *find the countries ('nodes') most used as intermediate station*

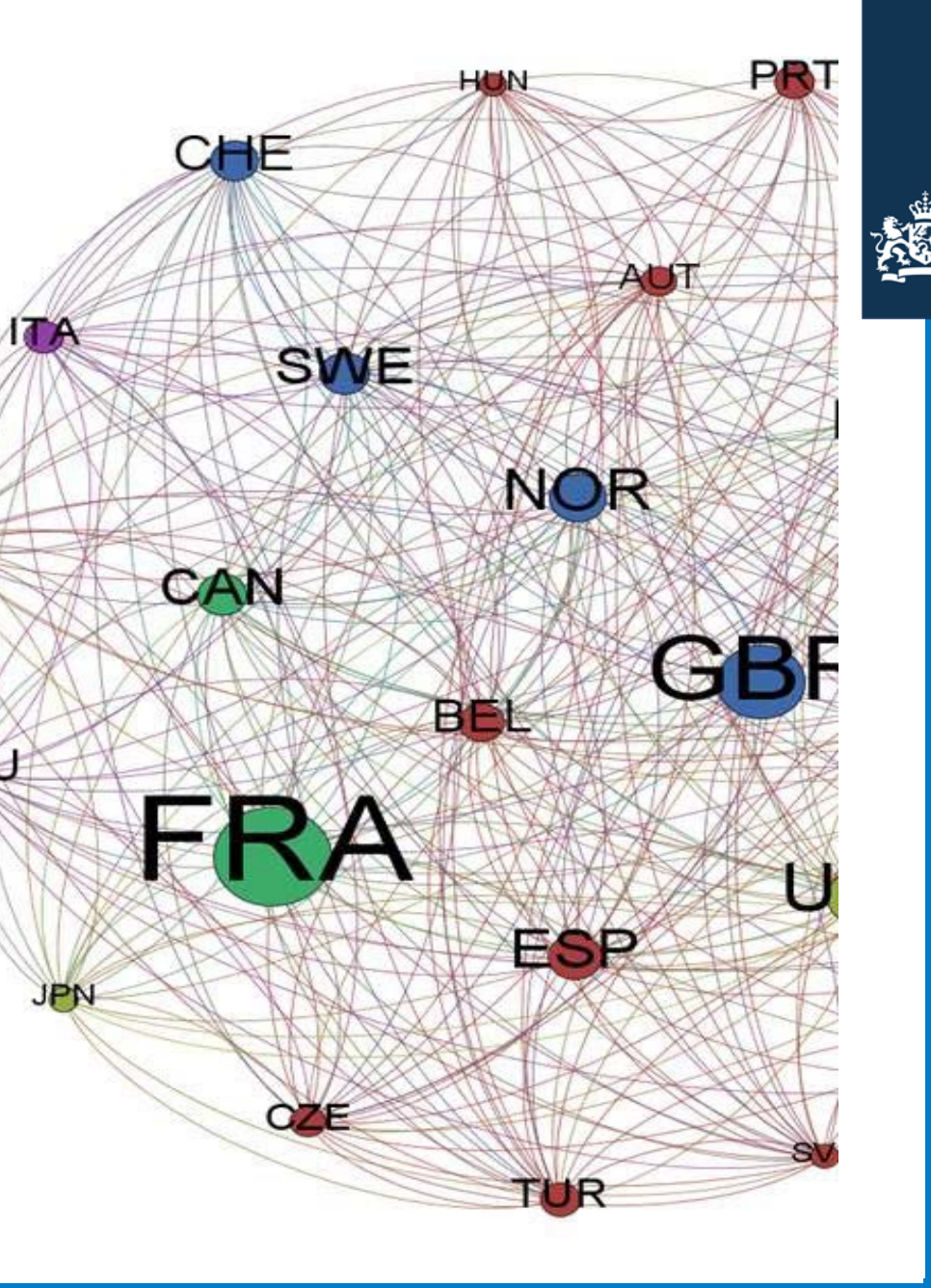
6. **econometrics on bilateral FDI**

Bringing the centrality results to the data …

- Can network centrality explain FDI stocks? econometrics!
- Tax data only for 1 year, causality problem?
  - no, not for centrality

- Regressions on bilateral FDI data (IMF, incl. SPE's):
  - economically, statistically significant results , and robust !!

- The regression results are an empirical validation our network approach **Van 't Riet & Lejour (ITAX, 2018)**



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Application of the network tool: OECD work

- Work done early 2019 for OECD

- Impact of Analysis of
  - BEPS Action 6 Minimum Standard
    - A : express statement …
    - B : Principal Purpose Test (PPT) / LOB rule …

  - Action 15 : Multilateral Instrument
    - Primary way that jurisdictions implement Action 6 Min. Standard
    - Implementation is flexible and dependent on bilateral agreement

So, the MLI is basically … bi-lateral !!

It impacts on the links in the network

Implementation of policy scenarios : links

- MLI is bi-lateral, with compliant bilateral tax agreements (TA)

- So, for the bilateral links in the network
  - indicated to have a compliant TA , we perform a treatment

- One treatment is: **a prohibitive (tax) penalty**
  - when the link is used on an *indirect* repatriation route
    [which blocks its use on a treaty shopping route]
  - but it remains open for *direct* repatriation
    [with the usual reduced bilateral withholding tax rate]

- Set of indicated links, and a given treament : a policy scenario

Rulings of the European Court of Juctice (CJEU)

Our dual presentation both quantitative and legal:

1) OECD: pre-ambule, ppt, LOB rule …

2) Also rulings of the European Court of Juctice (CJEU)
   concerning Limitation of holding structures for intra-EU dividends

   i.e. concerning withholding taxation of multinational corporations

Why important?
EU directives, OECD agreements and bilateral tax treaties
contain anti-abuse clauses, meaning anti-avoidance clauses

but the CJEU rulings seem to give them teeth!

Impact analysis: Baseline 2018 (incl. US tax reform)

- Network approach generates *treaty shopping potential*

  which is the difference between the worldwide average dividend repatriation tax rate (double GDP weighted)

  i) for the direct routes and

  ii) for the optimal routes (which may involve treaty shopping)

- Baseline *potential treaty shopping gain* is 5.6%-point [9.4% - 3.8%]

- Moreover, it is determined which countries are used most on optimal routes, this gives a ranking of conduit countries

- Top-3 conduits: 1 GBR , 2 NLD and 3 SWE
- EU countries ranked high: PSD !

Impact analysis: implementation

- 108 x 107 links: direct route between two countries, in one direction

- covered link: link subjected to treatment of the scenario,
  i.e. a tax penalty ***when used on an <u>indirect</u> route***

  makes it costly to use the link on detours,
  less likely to be on an optimal, *treaty shopping*, route

  when used as a direct route – no penalty!

- tax penalty: "deny treaty benefits"
  = <u>standard rate</u> instead of reduced rate
  or a <u>prohibitive penalty</u> ; blocks use on indirect routes

Impact analysis: country coverage by scenario

1. Denmark unilateral: all 107 outbound links from DNK

2. EU – wide: EU(27) + CHE, ICE, NOR ; 30 x 107 = 3210 links

3. IF = OECD Inclusive Framework on BEPS
   Action 6 Minimum Standard : Principal Purpose Test
   Multi Lateral Instrument
   Compliant Tax Agreements

4. EU – wide (prohib. penalty) : as 2.

5. “Strong” as 3. + all OECD countries on all outbound links

Impact analysis: 5 policy scenarios

	Policy scenario	Implementing countries	Covered links, no.	Tax rate on covered links
1.	Denmark unilateral	Denmark	107	Standard rate
2.	EU wide	EU and EFTA	3210	Standard rate
3.	Inclusive Framework	BEPS IF	3492	Standard rate
4.	EU wide (p.p.)	EU and EFTA	3210	Prohibitive penalty
5.	OECD-IF (Strong)	BEPS IF & all OECD	6888	Prohibitive penalty

Scenario results: 1, 2 & 3

	Baseline	Scenario 1	Scenario 2	Scenario 3
		DNK-uni	EU-wide	IF
Instrument		Standard withholding tax rate		
Links covered (number)	0	107	3210	3492
Treaty Shopping Gain (%)	5.60	5.58	4.52	4.22
Reduction of TSG (%)		0.02	1.08	1.38
% pairs indirect route optimal	65.7	65.1	53.9	52.8
Top 3 conduit countries: 1	GBR	GBR	GBR	GBR
2	NLD	NLD	SGP	ECU
3	SWE	SWE	MYS	CUW

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DNK-uni: DNK from 7th to 89th position in conduit ranking

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EU-wide: EU countries affected, not GBR with standard WHT of 0%

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3	SWE	SWE	MYS	CUW

OECD IF: large economies included, but ‘escape routes’, USA – GBR not covered

Scenario results: 2, 4 & 5

	Baseline	Scenario 2	Scenario 4	Scenario 5
		EU-wide	EU wide (p.p.)	IF (Strong)
Instrument		Standard	Prohibitive penalty	
Links covered (number)	0	3210	3210	6854
Treaty Shopping Gain (%)	5.60	4.52	4.09	0.34
Reduction of TSG (%)		1.08	1.51	5.26
% pairs indirect route optimal	65.7	53.9	45.6	20.1
Top 3 conduit countries: 1	GBR	GBR	MYS	ECU
2	NLD	SGP	AUS	CUW
3	SWE	MYS	SGP	ARE

Scenario results: 2, 4 & 5

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EU wide (p.p): with prohibitive penalty also GBR affected

Scenario results: 2, 4 & 5

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IF Strong: *treaty shopping* almost dissappears

Summary of results

- CJEU rulings in the Danish BO cases imply an economic abuse test:
  - do the tax benefits outweigh the other business reasons?
    - tax authorities must deny the tax benefits from the PSD

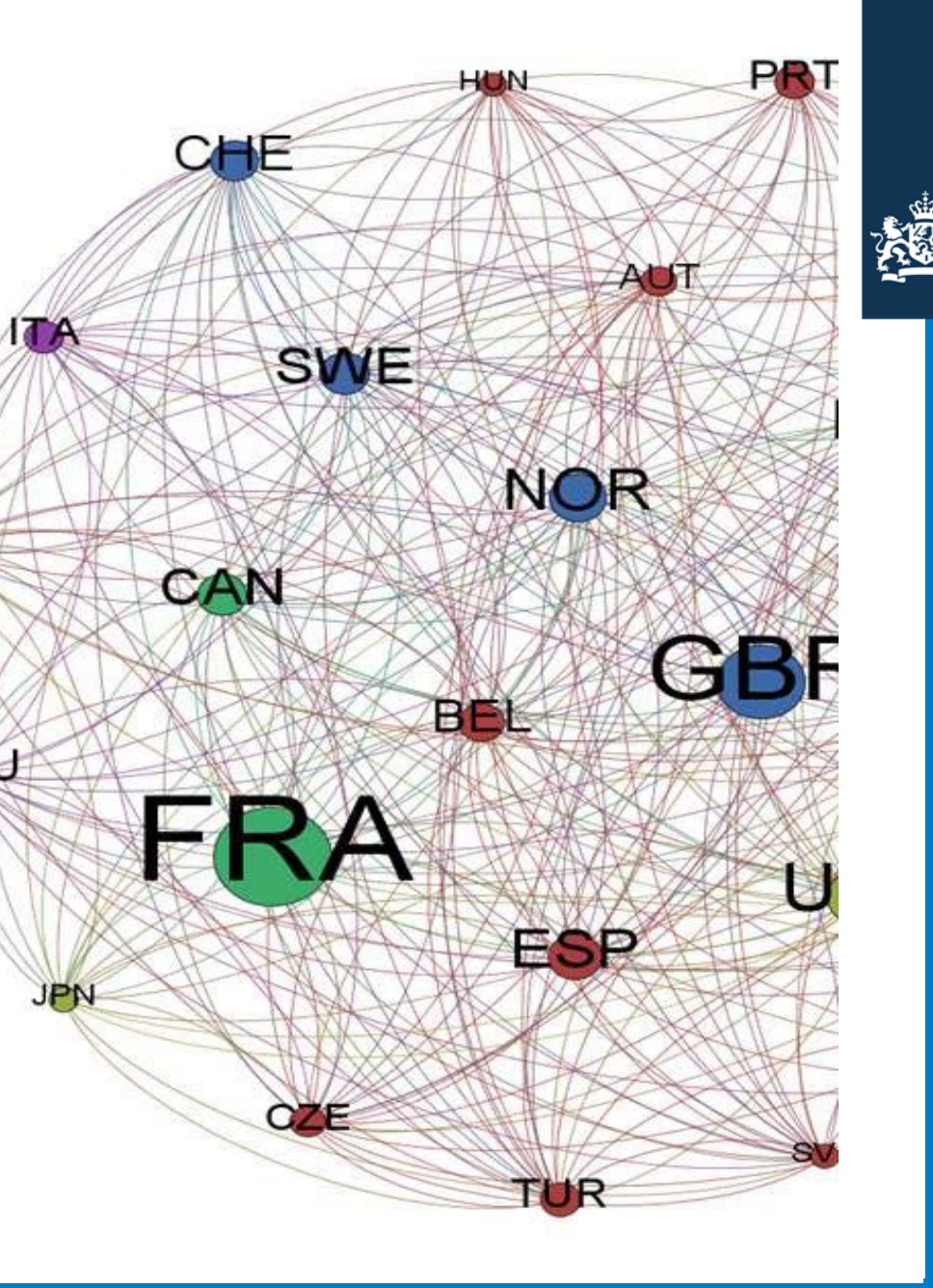
- CJEU rulings imply an alignment between EU and OECD

- Impact on *potential treaty shopping* is 1.1%-point (worldwide average) when EU countries cannot be used on indirect routes

- Combat against tax avoidance is more effective
  - with more countries involved
  - when countries cover all their treaties (no 'escape routes')
  - when countries with a standard rate of zero apply a tax penalty

Reference

- Bærentzen, Susi H., Arjan Lejour and Maarten van ‘t Riet, 2020, Limitation of Holding Structures for Intra-EU Dividends: An End to Tax Avoidance?, World Tax Journal, Volume 12, No. 2.



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Thank you