Haven Indicator 18: Dividend withholding tax

What is measured?

This indicator measures the extent to which a jurisdiction levies withholding taxes on outbound dividends. As such, it assesses the lowest available unilateral withholding tax rate (WTR) on outbound dividend payments.

The lowest unilateral withholding tax rate on dividends is then assessed against 35% in line with haven indicator 1 on the lowest available corporate income tax rate ("spillover risk reference rate"). The highest available unilateral rate on dividend withholding tax in a democracy[1] amounts to 35% in Chile[2], followed by 33.3% in Jamaica[3]. We assume that any lower withholding rate creates risks for tax avoidance and spillovers by enticing the shifting of profits into lower taxed jurisdictions and for jurisdictions to lower their dividend withholding rates in response.

A zero withholding tax rate or an absence of withholding taxes on outbound dividends results in a haven score of 100. If the lowest available unilateral withholding rate on dividends is 35%, the haven score is zero. Any rate in between is linearly scaled against 35%. In cases where different tax rates apply, the haven score is calculated by the following steps: 1) determining the jurisdiction's lowest available withholding tax levied; 2) subtracting this tax from the spillover risk reference rate of 35%; 3) scaling this rate in proportion to a haven score between 0 and 100.

The scoring matrix is shown in Table 18.1, and full details of the assessment logic are given in Table 18.3 below.

Table 18.1: Scoring Matrix Haven Indicator 18

Regulation	Haven Score Assessment [Haven Score: 100 points = maximum risk; 0 points = minimum risk]
Dividend Withholding Taxes (WTR)	
<u>The unilateral withholding tax rate on outbound dividend payments imposed by the jurisdiction is scaled between zero and 35%</u> Jurisdictions with zero dividend WTR have a haven score of 100 while a 35% withholding tax rate is equal to a haven score of zero. The jurisdiction's WTR is subtracted from the rate of 35% and the haven score is then calculated by placing it on a scale of 0-100.	0-100

All underlying data can be accessed freely in the Corporate Tax Haven Indicator database[4]. To see the sources we are using for particular jurisdictions please consult the assessment logic in Table 18.3 and search for the corresponding info ID (ID 508) in the database report of the respective jurisdiction.

The data for this indicator was collected primarily from the IBFD-database (country analyses and country surveys)[5]. In some instances, we have also consulted additional websites and reports of accountancy firms and other local websites.

To assess the lowest dividend withholding taxes available in the jurisdiction, we consider the lowest rate available for any specific sector or type of company. For example, although Liberia levies a 15 per cent withholding tax on outbound dividends, a lower withholding tax rate (5 per cent) is implemented when the resident subsidiary is a mining, petroleum or renewable resource company. We thus consider 5 per cent as the rate for this indicator. We consider the rate is zero when there are exemptions for specific sectors or types of companies. The Seychelles, for example, levies a 15 per cent dividends withholding tax, but exempts dividend payments by resident exempt entities, i.e. international trusts, certain limited partnerships, international free-trade zone companies and foundations to non-resident companies.[6]

Countries from the European Union that exempt dividend payments to other EU Member States, under the conditions laid down in the Parent-Subsidiary Directive (2011/96/EU)[7], are also considered to have a zero withholding tax rate. Furthermore, treaties between the European Union and Iceland, Liechtenstein, Norway and Switzerland provide benefits similar to those in the EU-parent subsidiary directive, reducing withholding taxes to 0 per cent on cross border dividend payments between related companies.[8] In cases where these exemptions apply, we consider the lowest available rate as zero.

Why is this important?

The level of withholding taxes on dividends influence cross-border tax planning opportunities and play an important role in countering tax avoidance strategies especially of lower income countries.[9] The level of withholding taxes, along with the level of corporate income taxation and the double tax relief agreements are used as parameters by multinational corporations to determine which countries are used as investment platforms in repatriation strategies, acting as conduit countries.[10] The anti-avoidance role of withholding taxes has been recognised by the OECD already in 1998:

> As with the denial of deduction for certain payments, the imposition of withholding taxes at a substantial rate on certain payments to countries that engage in harmful tax competition, if associated with measures aimed at preventing the use of conduit arrangements, would

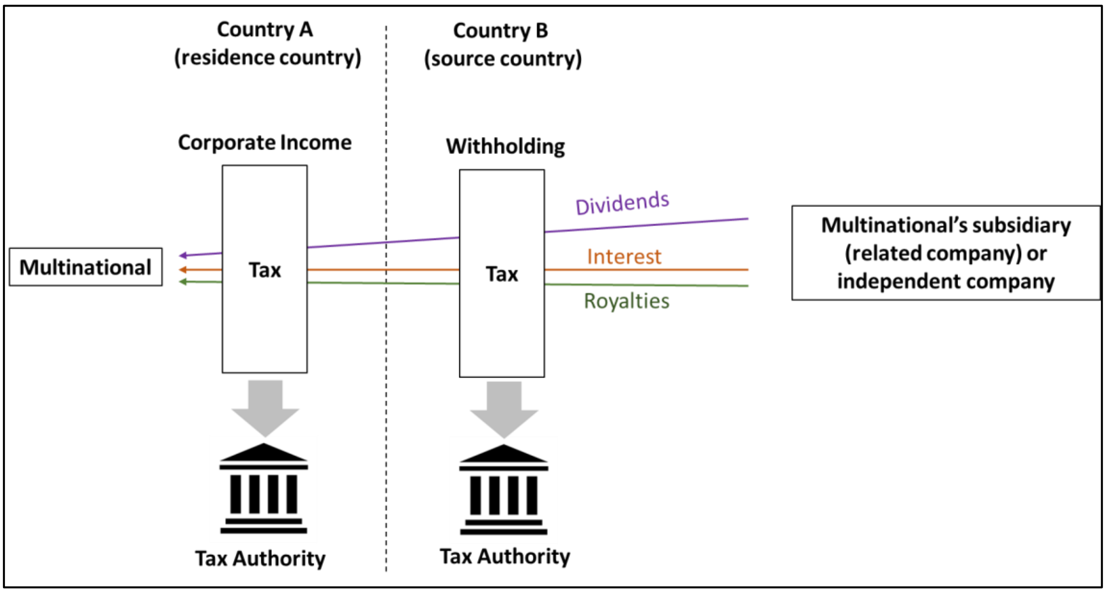
> act as a deterrent for countries to engage in harmful tax competition and for taxpayers to use entities located in these countries.[11]

Both the OECD[12] and the European Commission[13] include withholding taxes on dividends in their analysis of countries anti-avoidance rules or aggressive tax planning (ATP) opportunities. According to a study on structures of ATP produced by the European Commission in 2015, having withholding taxes in place may impede ATP:

> [...] under certain circumstance, the absence of such withholding taxes may allow for ATP in the sense that had a withholding tax existed, it could have impeded an ATP structure. ATP structures, particularly those that rely on tax-free repatriation of funds up to the ultimate parent company (i.e. the MNE [multinational enterprise] Group in the model ATP structures) rely on the absence of withholding taxes. The absence of withholding tax could enable unwanted tax practices, and hence constitutes a passive ATP indicator.[14]

Withholding tax on dividends contributes to protecting the tax bases particularly of capital-importing countries (e.g. countries hosting subsidiaries of multinational corporations). They can help to mitigate the unbalance in taxing rights between source countries (country B in the figure below) and residence countries (country A in Figure 18.1 below), in which headquarters of multinational companies are based.[15]

Figure 18.1: Application of withholding taxes for multinational companies



The use of multiple entities operating in different countries within a single group is a hallmark of globalisation and the modus operandi of any multinational corporate group. Source countries in which the subsidiaries of multinationals groups operate, often have their taxable income reduced by deduction of payments, such as interests, royalties and service fees, to other companies of the group, limiting corporate income tax revenues.[16] Such a reduction is especially of concern in lower income countries which are often more dependent on corporate income tax.

Deduction limitations or withholding taxes on royalties, interests, services and on dividends have the potential to compensate for these losses, protecting the taxing rights of the source countries.[17] [18]

However, in an attempt to attract investments, many jurisdictions reduce tax rates, create exemptions or even eliminate withholding taxes on outbound dividends. By lowering their tax rates, jurisdictions not only erode their own and other country's tax bases through base spillovers, but they also incite other countries to respond by further reducing their taxes[19] and engaging in a race to the bottom. According to the International Monetary Fund, average withholding tax rates on dividends, interests and royalties have declined in more than 30 per cent over the past decades as a result of these ruinous tax wars.[20] The race to the bottom in corporate taxes exacerbates income inequality between countries, since lower income countries are predominantly source countries.

One of the arguments for reducing or eliminating withholding taxes on dividends is the risk of double taxation in the source country and in the resident country. The Parent-Subsidiary Directive (2011/96/EU)[21] relies on this argument for exempting dividends and other profit distributions paid by subsidiary companies to their parent companies from withholding taxes.[22] However, the meaning of double taxation is an overlap between states' taxing claims which may result in a slightly higher effective tax rate rather than a rate twice as high, as the name misleadingly suggests. Furthermore, such cases of overlaps are rarely documented, while the more severe problem of double non-taxation is empirically observable.[23]

As a matter of fact, the Parent-Subsidiary Directive (2011/96/EU) in its current version has been viewed as almost encouraging the use of (aggressive) tax planning by European Union intermediate holding structures.[24] An ultimate parent entity resident in a member state might use an intermediate company resident in another member state for holding a subsidiary resident in a non-EU country imposing no or low tax. When the intermediate holding company is in a member state that holds a double taxation agreement with the non-EU country, the income may arrive at its final destination untaxed thanks to the participation exemption mechanism between two member states as a result of the Parent-Subsidiary Directive (2011/96/EU). To eliminate this risk, first the EU Code of Conduct Group (on business taxation) proposed a switch-over clause in 2010,[25] and then in 2011 the European Commission in a Council Directive proposed a Common Consolidated Corporate Tax Base (the draft CCCTB proposal)[26] and an Anti-Tax Avoidance (the ATAD proposal) in 2016, which included several different proposals alongside the switch-over clause.[27] The ATAD proposal explained the logic behind the switch-over clause as follows:

> Given the inherent difficulties in giving credit relief for taxes paid abroad, States tend to increasingly exempt foreign income from taxation. The unintended negative effect of this approach is that it may encourage untaxed or low-taxed income to enter the internal

> market and then, circulate – in many cases, untaxed – within the Union, making use of available instruments within the Union law.
>
> Switch-over clauses are commonly used against such practices. Namely, the taxpayer is subjected to taxation (instead of being exempt) and given a credit for tax paid abroad. In this way, companies are discouraged from shifting profits out of high-tax jurisdictions towards low-tax territories, unless there is sufficient business justification for these transfers.[28]

Even though the switch-over clause was not included in the final ATAD, the renewed proposal on C(C)CTB includes the switch-over clause in Article 53.[29] However, all these efforts to create a specific anti-avoidance rule indicate that the participation exemption for outgoing dividends income is problematic in itself. In fact, there is an example of changing policy direction in this regard; Kenya abolished the withholding exemption for dividends paid by special economic zone enterprises, developers or operators to non-residents and increased the withholding tax rate for dividends paid to non-residents from 10 to 15 per cent.[30]

The extensive net of bilateral income tax treaties, which typically eliminate or reduce withholding tax rates to lower levels than the ones prescribed in domestic law, may lead to a situation of double-non taxation where income is not taxed neither at residence or at the source country.[31] [32] These bilateral agreements create the possibility of diverting investment and dividend flows through a third country (conduit country) to take advantage of treaty provisions for reducing or eliminating tax payments, a practice known as treaty shopping[33]. The aggressiveness of the jurisdictions' bilateral treaties network is assessed in haven indicator 20.

Unilateral withholding taxes are an important tool for tackling inequality in taxing rights, assuring revenues for capital importing countries and limiting tax avoidance strategies.

Results Overview

Figure 18.2: Withholding Taxes on Dividends Overview

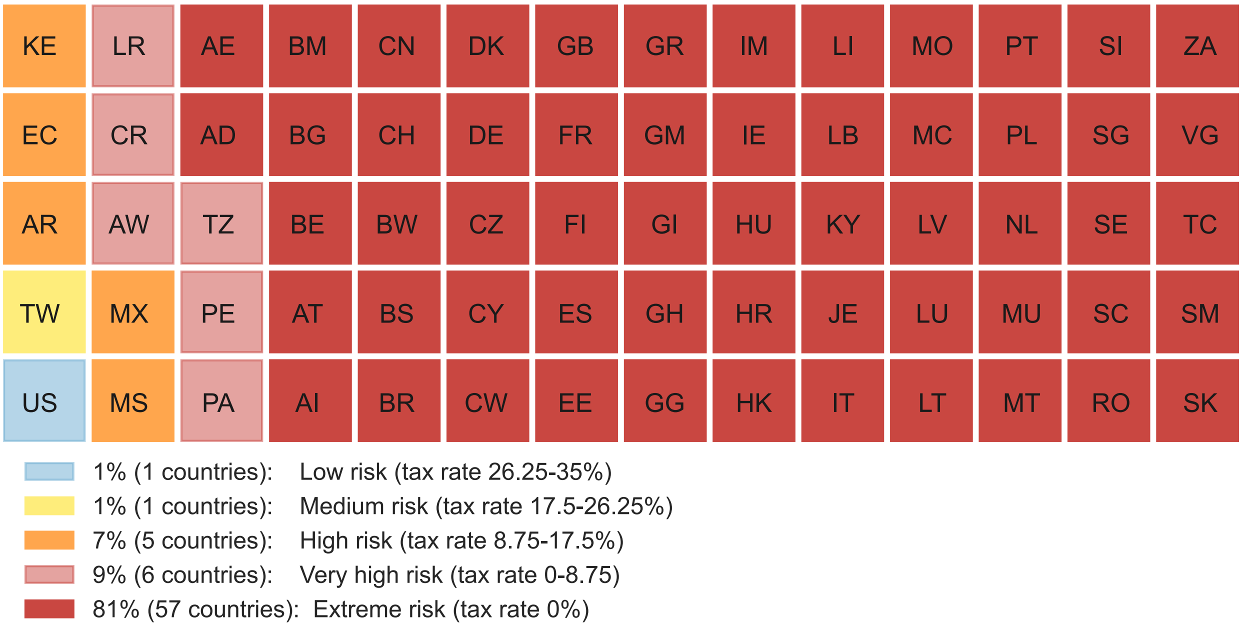


Table 18.2: Withholding Taxes on Dividends – Haven Indicator Scores

Haven Score	ISO2: Country Name	Haven Score	ISO2: Country Name
86	AW: Aruba	100	IM: Isle of Man
100	AI: Anguilla	100	IE: Ireland
100	AD: Andorra	100	IT: Italy
100	AE: United Arab Emirates	100	JE: Jersey
63	AR: Argentina	57	KE: Kenya
100	AT: Austria	100	LB: Lebanon
100	BE: Belgium	86	LR: Liberia
100	BG: Bulgaria	100	LI: Liechtenstein
100	BS: Bahamas	100	LT: Lithuania
100	BM: Bermuda	100	LU: Luxembourg
100	BR: Brazil	100	LV: Latvia
100	BW: Botswana	100	MO: Macao
100	CH: Switzerland	100	MC: Monaco
100	CN: China	71	MX: Mexico
86	CR: Costa Rica	100	MT: Malta
100	CW: Curaçao	57	MS: Montserrat
100	KY: Cayman Islands	100	MU: Mauritius
100	CY: Cyprus	100	NL: Netherlands
100	CZ: Czechia	86	PA: Panama
100	DE: Germany	86	PE: Peru
100	DK: Denmark	100	PL: Poland
71	EC: Ecuador	100	PT: Portugal
100	ES: Spain	100	RO: Romania
100	EE: Estonia	100	SG: Singapore
100	FI: Finland	100	SM: San Marino
100	FR: France	100	SK: Slovakia
100	GB: United Kingdom	100	SI: Slovenia
100	GG: Guernsey	100	SE: Sweden
100	GH: Ghana	100	SC: Seychelles
100	GI: Gibraltar	100	TC: Turks and Caicos Islands
100	GM: Gambia	40	TW: Taiwan
100	GR: Greece	86	TZ: Tanzania
100	HK: Hong Kong	14	US: United States
100	HR: Croatia	100	VG: British Virgin Islands
100	HU: Hungary	100	ZA: South Africa

Haven Score
Low Haven Score ← → High Haven Score
0 to <25 | 25 to <50 | 50 to <75 | 75 to 100

Table 18.3: Assessment Logic

Info_ID	Text_Info_ID	Answers (Codes applicable for all questions: -2: Unknown; -3: Not Applicable)	Valuation Haven Score
508	What is the (lowest) applicable unilateral cross-border withholding tax rate for outgoing dividend payments to a related party?	Withholding tax rate (between 0 and 35)	Haven score = ((35 – answer)/35)*100

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[1] Following the methodology used in haven indicator 1, we rely on the Polity Index (Polity2 measure of 2018) to identify democracies. Countries with a polity index of 7 or more are identified as democracies.

[2] 'Chile - Treaty Withholding Rates Table', *International Bureau of Fiscal Documentation - Tax Research Platform*, 2021 <https://research.ibfd.org/#/doc?url=/document/wht_cl> [accessed 5 March 2021].

[3] 'Jamaica - Treaty Withholding Rates Table', *International Bureau of Fiscal Documentation - Tax Research Platform*, 2020 <https://research.ibfd.org/#/doc?url=/document/wht_jm> [accessed 5 March 2021].

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[14] 'Study on Structures of Aggressive Tax Planning and Indicators', 58.

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[16] Michael Durst, *Taxing Multinational Business in Lower Income Countries: Economics, Politics and Social Responsibility*, 31–32.

[17] Michael Durst, *Taxing Multinational Business in Lower Income Countries: Economics, Politics and Social Responsibility*, 31–32.

[18] While this indicator focuses on withholding taxes on dividends, the potential of losses of revenues due to the deduction of expenses with interests, royalties and services are addressed by haven indicators 15, 16 and 17, respectively.

[19] This process of race to the bottom can also apply to corporate income tax rates, which are assessed in haven Indicator 1.

[20] International Monetary Fund (IMF), 'Spillovers in International Corporate Taxation', 2014, 68 <https://www.imf.org/external/np/pp/eng/2014/050914.pdf> [accessed 2 May 2019].

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[31] Sol Picciotto, *Unitary Taxation: Our Responses to the Critics*, 3.

[32] Michael Durst, *Taxing Multinational Business in Lower Income Countries: Economics, Politics and Social Responsibility*.

[33] For further details on the phenomenon of treaty shopping and the mechanism used to avoid taxation through conduit countries, see here: Michael Durst, *Taxing Multinational Business in Lower Income Countries: Economics, Politics and Social Responsibility* (2019) <https://opendocs.ids.ac.uk/opendocs/bitstream/handle/123456789/14336/Durst_Book_Final.pdf?sequence=1&isAllowed=y> [accessed 2 May 2019]. And: Maarten van 't Riet and Arjan Lejour, 'Ranking the Stars: Network Analysis of Bilateral Tax Treaties'.