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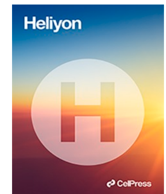

Optimized profit repatriation in multinational enterprises through cross-border change of legal form and international tax management

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A R T I C L E I N F O

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A B S T R A C T

This article shows for the first time that the cross-border change of legal form can be used for tax-optimized profit repatriation. By means of a cross-border change of legal form of the foreign EU corporation prior to distribution into another foreign EU corporation with subsequent dividend distribution after the cross-border change of legal form has taken place, the taxation of dividends with withholding tax can be avoided. This study develops and discusses this strategy for the first time and transfers it specifically to U.S. shareholders of European corporations. Moreover, this strategy is relevant in general for all shareholders of European corporations, irrespective of their residence, to get tax-optimized profit repatriation of dividends (retained earnings) and to avoid the problem of treaty shopping, which has been significantly strengthened by the introduction of the ATAD/BEPS principal purpose test (PPT) in all EU Member States. The study extends the state of knowledge in the area of international taxation, international mergers, finance and strategy.

1. Introduction: problem and research questions

Dividend distributions of a corporation to its shareholders may in principle be subject to taxation with withholding tax in the country of residence of the distributing corporation. Taxable person is the shareholder of the distributing corporation. If a double taxation agreement (DTA) exists, the withholding tax may be reduced to 15% of the gross amount [1] of the dividends [2]. In the case of a qualifying holding or if the requirements of the Parent-Subsidiary Directive are met, the withholding tax on dividends may be reduced to 0% [3]. However, the reduction of the withholding tax is subject to anti-avoidance provisions [4] and treaty shopping rules [5]. In this respect, the implementation of the Anti-Tax-Avoidance Directive [6] (ATAD) in the EU Member States has significantly tightened the situation (Art. 6 ATAD) [7]. With the implementation of this European secondary legislation in the respective domestic law, the Principal Purpose Test [8] (PPT) [9] has found its way into national regulations to combat treaty shopping [10]. Therefore, withholding tax on dividends can no longer be easily avoided through the interposition of a foreign holding company. For the shareholder of a foreign corporation, a withholding tax levied by the state of residence of the distributing company means an (additional) tax burden. This applies in particular if cross-border dividend payments are not taxed or are taxed at a favourable rate in the shareholder's country of residence (dividend participation exemption). Therefore, from the perspective of the shareholders of a foreign corporation, the question arises how withholding tax on dividend payments can be avoided in the foreign country of residence of the corporation. Classic and widely used strategies such as the aforementioned interposition of a foreign holding company, i.e.

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indirect participation in the distributing corporation via a foreign holding company, are largely ruled out by the introduction of the Principal Purpose Test in the EU Member States. Therefore, new and stable solutions are needed to optimise withholding tax on cross-border dividend payments.

This article is the first that develops the strategy of using a cross-border change of legal form within the EU/EEA as an option for tax-optimized profit repatriation of dividends. By means of a cross-border homogeneous [11] change of legal form [12] of the foreign EU corporation prior to distribution in an EU-foreign corporation of another EU Member State with later dividend distribution after the change of the legal form, taxation of dividends with withholding tax can be avoided. An EU Member State that does not unilaterally levy withholding tax on dividends (e.g. Liechtenstein, Hungary, Estonia, Malta, Cyprus) is chosen as the Member State of immigration for the cross-border change of legal form. This tax structuring option is universally applicable, regardless of whether the shareholders of the foreign EU corporation are third-country companies or shareholders resident in the EU/EEA. This tax strategy is particularly suitable for U.S. shareholders of European corporations in order to avoid the problem of treaty shopping, which has been significantly strengthened by the introduction of the principal purpose test (PPT) in all EU Member States. In principle, taxpayers are allowed to choose their circumstances and civil law arrangements in such a way to optimise their tax burden (settled case law) [13].

According to the *Polbud* [14] decision of the CJEU [15] (C-106/16) [16] and the EU Directive 2019/2121 [17] on cross-border conversions, the cross-border homogeneous change of legal form within EU corporations of different Member States is established as a form of conversion and legal certainty is given.

This article is structured as follows: The next sections discuss the research methodology and the cross-border change of legal form and its subtypes. Subsequently, the tax structuring idea and option of the cross-border change of legal form for the tax-optimal repatriation of dividends is developed and analyzed. Further sections examines the legal stability of the derived approach and the tax benefit is shown. Finally, the tax planning strategy is applied to U.S. shareholders of European corporations. In this regard, an illustrative legal case study is conducted. A brief summary concludes the article.

2. Methodology and literature review

This article uses theoretical, qualitative, and quantitative research methods to answer the relevant issues and questions. Thus, a mix of methods is applied. Within the framework of a theoretical and legal analysis, this article develops and discusses for the first time the cross-border change of legal form of corporations within the EU as a possible solution for the tax-optimized repatriation of dividends and retained earnings. Furthermore, the derived structuring option is analyzed and tested with regard to its legal stability and recognition. Methodologically, the research questions are also pursued with the legal-theoretical analysis, the analysis under EU law and the analysis of case law.

Since the relevant questions have not yet been examined in the literature, it is also necessary to transfer the existing case law (CJEU), to examine primary law and to derive corresponding legal conclusions. Importantly, the tax planning strategy gets transferred to U.S. shareholders of European corporations. For this purpose, an exemplary legal case study is conducted (see point 7). Since the questions to be investigated are legally based, the methodological approach and mix of methods used here is suitable and appropriate.

Burwitz (2006) examines the tax consequences of the migration of companies from a general view [18]. However, he does not deal with cross-border conversions and reorganizations in the light of tax optimization and tax planning. Devos et al. (2009) study how mergers create value [19]. They include taxation in general in their analysis, but do not address specific issues such as profit repatriation. Wang and Guo (2011) analyse the effect of dividend taxation on firms' dividend policies [20]. In their analysis, they do not address tax planning in connection with dividend repatriation, nor do they address cross-border conversions. Merks (2011) analyses cross-border dividend withholding tax planning techniques in general [21]. The cross-border change of legal form as a strategy for tax-optimized dividend repatriation is not discussed. Žárová et al. (2014) address tax aspects of mergers and cross-border mergers [22]. They do not deal with withholding taxes and tax optimization of dividend repatriation. Beer et al. (2018) investigate main channels of international tax planning [23]. They identify treaty shopping as a way to avoid withholding tax on dividends. However, they do not address cross-border conversions for withholding tax optimization and profit repatriation. Reddy (2015) survey the state of case study research in mergers and acquisitions literature [24]. He finds no literature on using cross-border conversions for tax-optimization. Johansson et al. (2016) state that withholding taxes on interest, dividends, and royalties can also influence tax planning incentives [25]. However, they do not analyse withholding tax planning in details. Ilaboya et al. (2016) provide literature review on tax planning and firm value [26]. In the existing literature, they do not find the use of cross-border reorganization as a possibility for withholding tax planning. Riedl (2018) gives a review of the academic literature on tax planning and addresses the possibilities [27]. Tax-optimization of dividend repatriation by using cross-border conversions is not included in the existing literature. Rammeloo (2018) only discusses the cross-border migration of companies within the EU territory from the background of general legal aspects [28]. However, he does not address tax issues or tax optimization. Gelder (2018) studies the expanding possibilities for cross-border conversions according to EU Law [29]. He does not take into account the tax structuring potential of cross-border reorganization. Benedetti et al. (2019) deal with the structural consequences of cross-border company seat transfers within the EU [14]. They do not address the issue of taxation and in particular tax optimization. Ohrn and Seegert (2019) study the impact of investor-level taxation on mergers and acquisitions [30]. They show that mergers are affected by taxation when capital gains are taxed at a lower rate than dividend payments. However, they do not address the tax optimization of dividend repatriation through cross-border conversions. Fillers (2020) analyses the cross-border change of legal form after the judgment of the CJEU in Polbud (C-106/16) [31]. Cooper et al. (2020) conduct a literature review regarding multinational enterprises and corporate tax planning [32]. They also derive suggestions for a future research agenda in that respect. However, they do not analyse cross-border withholding tax planning and the optimization of dividend repatriation. The study does not address tax aspects. Ftouhi et al. (2020) contribute with a review of the literature on

international tax planning techniques [33]. They do not find specific strategies for international withholding tax planning, especially not in connection with cross-border reorganization and conversion. Karjalainen et al. (2020) show that earnings management is driven by taxation [34]. They do not discuss cross-border reorganization as a possibility for optimising the tax burden on distributed profits. Panayi (2021) analyses cross-border conversions from the perspective of taxation [35]. She does not address the potential for tax optimization. Petkova (2021) studies withholding tax rates on dividends and the role of double tax treaties [36]. Her analysis does not deal with cross-border conversions to optimise withholding tax. Xiangxiang et al. (2022) investigate valuation methods in case of mergers and acquisitions [37]. They do not deal with the tax structuring potential of cross-border conversions. Prettl et al. (2022) analyse whether controlled foreign corporation (CFC) rules influence cross-border merger and acquisition activity [38]. They do not address withholding tax optimization. Beuselinck et al. (2022) examine the dynamics between local and international tax planning in multinational corporations [39]. They do not deal with cross-border reorganization as strategy for tax optimization. Kouroub et al. (2022) investigate tax planning from the background of theory and modelling [40]. They do not address dividend repatriation. Aggarwal and Garg (2022) analyses the impact of mergers and acquisitions on accounting-based performance of the acquiring firms [41]. However, they do not analyse taxation and tax optimization in the context of cross-border conversions.

The cross-border change of legal form as a strategy for tax-optimized profit repatriation of dividends has not been discussed in the literature so far. Therefore, this article extends the state of knowledge in the area of international taxation, international mergers, finance and strategy.

3. Cross-border change of legal form: legal basis

In its case law, the CJEU has developed and established the cross-border change of legal form between EU corporations [42]. According to the CJEU's *Polbud* decision, the cross-border change of legal form within the EU/EEA between corporations falls under the protection of the freedom of establishment (Articles 49, 54 TFEU), even if only an isolated transfer of the registered office to another EU Member State of immigration takes place in the context of the cross-border change of the legal form [43]. A transfer of business activities to the Member State of immigration is not required in the case of a cross-border change of legal form and may not be demanded [44]. Furthermore, the cross-border homogeneous change of legal form between corporations within the EU must be carried out in a way that preserves the identity of the corporation; dissolution and liquidation of the corporation changing its legal form across borders cannot be considered, similar to a domestic change of legal form [45]. This applies both to the Member State of departure and the Member State of immigration of a cross-border change of legal form and applies equally to the outward and inward change of legal form. According to the CJEU in *Polbud*, the cross-border transfer of the registered office for the purpose of executing the change of legal form must not lead to the liquidation of the company [46]. Thus, the cross-border change of legal form of corporations within the EU is established as a new option for conversion.

On the basis of secondary legislation, the cross-border change of legal form is supported by the EU Directive 2019/2121 [47] on cross-border transformations, which all EU Member States have to transpose into their respective national law by January 31, 2023. The Directive contains regulations on company law and register law [48]. Thus, this directive contains company law and register law provisions on the implementation of cross-border changes of legal form. Until the implementation of the EU Directive 2019/2121 into national law, Member States must treat the cross-border change of legal form of corporations within the EU like a domestic change of legal form in accordance with the principle of equivalence [49] and the freedom of establishment. This provides adequate legal certainty for the implementation of a cross-border change of legal form within the EU/EEA.

The cross-border change of legal form can be carried out in two different ways (subtypes). One possi-bility is that the EU corporation cumulatively transfers its registered office and its administrative headquarters (place of management) from one Member State to another Member State and assumes the legal form of a foreign EU corporation there [50]. Another possibility is that the EU corporation only transfers its registered office to another EU Member State and assumes the legal form of a foreign EU corporation there in compliance with the legal provisions of the EU Member State of immigration [51]. After the cross-border change of legal form, the EU corporation is subject to the laws of the Member State of immigration while legally retaining its identity.

4. Tax-optimized dividend repatriation through cross-border change of legal form

The EU corporation in question initially retains its profits. For the purpose of tax-optimized repatriation of dividends, the cross-border homogeneous change of legal form of the EU corporation into another EU corporation by cumulatively transferring the registered office and the administrative seat (place of management) to the Member State of immigration is an option. The Member State of immigration or the Member State of destination is a Member State which unilaterally does not levy withholding tax on dividends (e.g. Liechtenstein, Hungary, Estonia, Malta, Cyprus). The cross-border change of legal form itself is carried out in a way that preserves the company's legal identity, i.e. the corporation changing its legal form into another EU corporation without dissolution and liquidation. A deemed distribution of dividends or retained earnings is not associated with the cross-border change of legal form. Hence, the company changes its legal form within the corporations. According to the freedom of establishment (Art. 49 TFEU), there may also be no deemed distribution of dividends in the case of a cross-border homogeneous change of legal form between corporations, since in a pure domestic change of the legal form within corporations, there is also no deemed distribution of retained earnings given. Another question is whether a corporation changing its legal form across borders will be taxed on its income if it cumulatively moves its registered office and administrative headquarters (place of management) to another EU country. Such an exit tax does not occur if the assets of the corporation changing its legal form in the Member State of departure (continue to) be allocated to permanent establishments, so that the taxation right of the former State of residence of the corporation changing its legal form is not excluded or limited

after the departure [52]. In principle, this condition is fulfilled, so that the cross-border homogeneous change of legal form of corporations within the EU with a cumulative transfer of the registered office and administrative headquarters to the Member State of immigration is possible under civil law (legally preserving identity) and completely neutral under tax law [53,54].

After the cross-border change of legal form has been carried out, a foreign EU corporation exists (legal form) which has its registered office and place of management cumulatively in the foreign EU Member State of immigration. Dividend distributions of this corporation are no longer subject to taxation in the former Member State of departure, not even with withholding tax. According to national tax law the distributing company has neither its registered office nor its place of management there, i.e. the case of a distribution from a foreign corporation to a foreign shareholder exists. Consequently, no withholding tax can be levied under the national tax law of the Member State of departure. Also pursuant to treaty law (DTA), the Member State of departure or the former State of residence of the transformed EU corporation can no longer levy withholding tax, since neither the distributing corporation is a resident of its territory at the time of the profit distribution nor is the shareholder receiving the dividend a resident of its territory [55]. In addition, the prohibition of extraterritorial taxation of dividends (Art. 10 para. 5 OECD-MC 2017) applies to the Member State of departure or former Member State of residence of the corporation that changed its legal form in the present case. The Member State of immigration of the corporation changing its legal form does not levy any withholding tax on dividends unilaterally, i.e. in accordance with national tax law, or does not tax them at the level of the dividend recipient (shareholder).

Thus, the withholding tax on dividends can be completely avoided by retaining profits with a subsequent cross-border homogeneous change of legal form of the EU corporation into another EU corporation. The profit distribution or dividend payment is made later, i.e. at an appropriate time interval after the cross-border change of legal form has taken place, whereby the new Member State of residence or EU Member State of immigration of the corporation that has changed its legal form does not unilaterally levy withholding tax.

Furthermore, the cross-border change of legal form of an EU corporation can also be used to get out of an existing treaty shopping situation [56] where a foreign holding company is interposed. Here, too, the cross-border change of legal form of the distributing EU subsidiary to another EU subsidiary of another EU Member State is a flexible way to end the further intervention of anti-treaty shopping rules and the principal purpose test (PPT).

Graphically, the optimising strategy can be depicted as follows (Fig. 1).

5. Legal stability and recognition

Finally, the question arises as to the legal stability and recognition of the cross-border change of legal form in order to optimise the repatriation of dividends or retained earnings without incurring withholding tax (advocatus diaboli). The case law of the CJEU confirms that the implementation of a cross-border homogeneous change of legal form of corporations within the EU is not abusive [57]. This applies even if the cross-border change of legal form is intended to achieve more favourable legal provisions in the Member

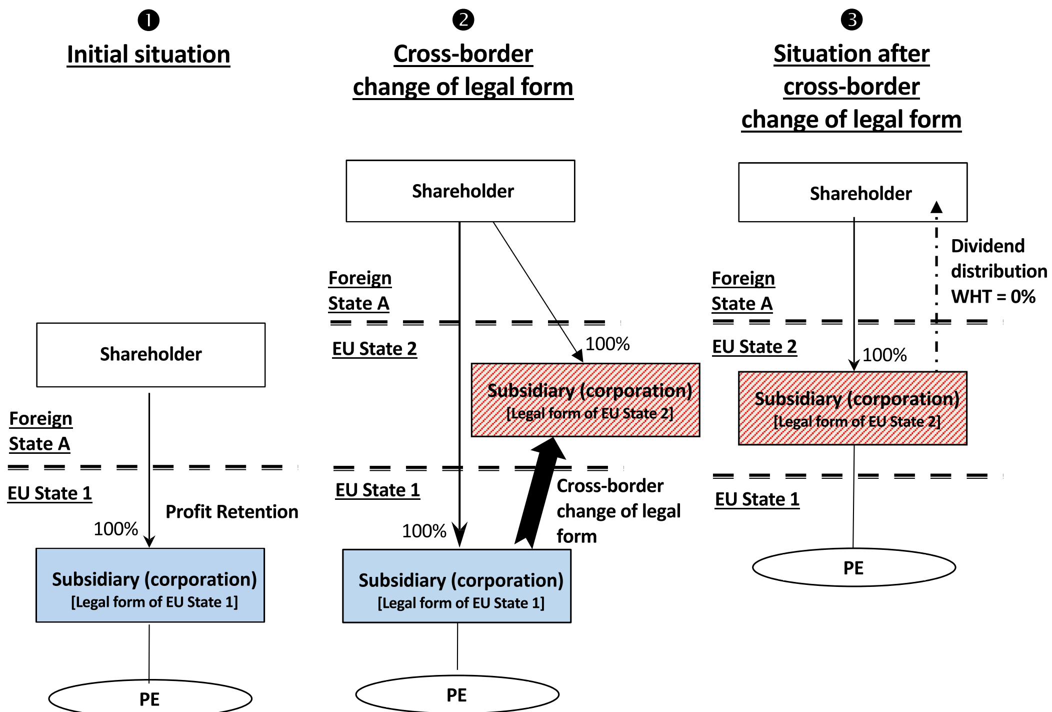

Fig. 1. Cross-border change of the legal form and repatriation of retained profits/dividends (own illustration).

State of immigration and no economic activity is carried out by the EU corporation changing its legal form in the Member State of immigration, as explicitly stated by the CJEU [58].

5.1. CJEU, C-106/16, para. 62

„*the fact that either the registered office or real head office of a company was established in accordance with the legislation of a Member State for the purpose of enjoying the benefit of more favourable legislation does not, in itself, constitute abuse*"

5.2. CJEU, C-106/16, para. 38

„*Equally, a situation in which a company formed in accordance with the legislation of one Member State wants to convert itself into a company under the law of another Member State, with due regard to the test applied by the second Member State in order to determine the connection of a company to its national legal order, falls within the scope of freedom of establishment, even though that company conducts its main, if not entire, business in the first Member State*"

5.3. CJEU, C-106/16, para. 40

„*However, it must be observed that, as the Court has previously held, the fact that either the registered office or real head office of a company was established in accordance with the legislation of a Member State for the purpose of enjoying the benefit of more favourable legislation does not, in itself, constitute abuse (see, to that effect, judgments of March 9, 1999, Centros, C-212/97, EU:C:1999:126, paragraph 27, and of September 30, 2003, Inspire Art, C-167/01, EU:C:2003:512, paragraph 96).*"

The cross-border change of legal form itself is not abusive. The cross-border change of legal form does not lead to a (deemed) distribution of dividends, in particular according to the tax law of the Member State of departure of the EU corporation changing its legal form, so that no dividend payments exist in the former Member State of residence of the EU corporation changing its legal form [59]. Thus, the foreign shareholder of the EU corporation does not avoid any withholding tax on dividend payments, since such payments do not exist in reality and are not triggered due to the cross-border change of legal form. Accordingly, anti-treaty shopping rules are not relevant; the same applies to the Principal Purpose Test (PPT) [60]. Subsequent actual profit distributions of the EU corporation that has changed its legal form, which are the sole object and connecting factor for dividend taxation, only occur after the cross-border change of legal form. At this point in time, however, there is no right to tax the dividend payments in accordance with the national tax law of the Member State of departure of the corporation that has changed its legal form, since neither the distributing company nor the shareholder receiving the dividend have a connecting factor for taxation. Rather, there is a distribution by a foreign corporation to a foreign shareholder which is not subject to taxation in the Member State of departure. A tax claim in respect of these dividends has therefore not arisen in the Member State of departure of the EU corporation that has changed its legal form. Consequently, there is no legal tax basis for the Member State of departure to levy withholding taxes or to tax the dividends paid by the transformed company to its foreign shareholders after the cross-border change of the legal form, even if these dividends originate from retained profits earned by the corporation at the time when it was still resident in the Member State of departure. According to the relevant tax laws, no tax claim of the Member State of departure arises on these dividend payments, so that the foreign shareholder of the corporation changing its legal form does not avoid taxes or withholding taxes on dividends in the company's Member State of departure.

Accordingly, the Member State of departure of the corporation changing its legal form cannot levy withholding tax on dividends under general anti-abuse rules in the present case either, since under the tax laws, a tax claim of this state on dividends of the company changing its legal form did not arise at any time. General anti-abuse rules cannot fictitiously create a statutory tax claim, but presuppose a statutory tax claim that has been circumvented by the taxpayer. Such a statutory tax claim that could be circumvented does not exist in the present case of a cross-border change of legal form with a dividend distribution occurring at a later date after the cross-border change of legal form has taken place. A statutory right of the Member State of departure to tax dividends of the company changing its legal form did not arise at any time in the present case. Rather, the right to tax dividends has the new Member State of residence of the company changing its legal form and the State of residence of the foreign shareholder. For reasons of avoiding double taxation of distributed profits, it is therefore also necessary that the company's Member State of departure no longer has the right to tax dividends of the company after the cross-border change of legal form has taken place (prohibition of extraterritorial taxation, Art. 10 (5) OECD-MC).

The Member State of departure could only (hypothetically) tax if it had legally implemented a withholding tax on profit withdrawals from the permanent establishments remaining on its territory (so-called branch profits tax). However, this is a different tax situation than the dividend payment by the now foreign company (after the change of legal form has taken place) and is not avoided by the taxpayer, i.e. the shareholder of the EU corporation changing its legal form, through a cross-border change of legal form. However, almost all EU and EEA States do not have a branch profits tax in their national law (e.g. Italy, Austria, Germany). Furthermore, the double taxation agreements (DTAs) between the EU States do not permit the levying of a branch profits tax (Art. 7, 10 OECD-MC). Finally, the freedom of establishment (Art. 49 TFEU) also precludes the levying of a branch profits tax as an additional tax burden regarding the relationship between the Member State of departure and the Member State of immigration of the corporation changing its legal form, if the Member State of departure does not levy a branch profits tax on profit withdrawals from permanent establishments of corporations in purely domestic situations [61], which is the rule [62]. In the present case (Fig. 1), an indirect taxation of the dividends of the EU corporation changing its legal form by levying a branch profits tax by the Member State of departure fails.

From the point of view of tax abuse, the Member State of departure could only levy a withholding tax on dividends of the corporation that has changed its legal form if the cross-border change of legal form is only formal or short-term (pro forma structure [63]), i.e. not permanent, if a distribution is made shortly after the change of legal form has taken place and, in addition, immediately after the distribution, a new change of legal form of the corporation is made back to the Member State of departure or origin within a short period of time (pro forma). In this case, and only in such a case, the cross-border change of legal form would only have taken place formally or would have been interposed and would not have to be recognised. The situation is different, however, if the taxpayer does not only carry out the cross-border change of legal form temporarily, but maintains the achieved target structure for a longer period of time (permanent structure). This is also the rule. In such a case, tax abuse is not given and the Member State of departure has no possibility to tax dividend payments of the EU corporation changing its legal form.

Overall, it can be concluded that the cross-border homogeneous change of legal form between cor-porations in the EU represents a stable and flexible option for optimising the taxation of dividends and the repatriation of retained profits from corporations without a withholding tax burden. The cross-border change of legal form and its benefits are protected by the freedom of establishment (Art. 49 TFEU). This is confirmed by settled case law of the CJEU. There is no (tax) abuse at hand if the cross-border change of the legal form is not reversed in the short term and the target structure is maintained for a certain period of time. This is the rule. This is also possible without restrictions, since after the change of legal form has taken place, a structure has now been achieved that is optimal with regard to dividend taxation and withholding tax burden.

6. Analysis of the tax benefit

The tax saving effect of the cross-border change of legal form with subsequent dividend distribution of the retained earnings will be described in the following. Compared to an ongoing constant annual profit distribution, the company's cross-border change of legal form with subsequent profit distribution of the retained earnings results in the following tax cash value advantage (TCVA):

$$TCVA = \int_0^T \left(T_{\sum Div} - T_{\sum change\ of\ legal\ form}\right) \bullet e^{-\ln(1+i_s)\bullet t} \quad mit\ e = \sum_{k=0}^{\infty} \frac{1}{k!}$$

The corresponding primitive function (F) is:

$$= \left[\frac{1 - e^{-\ln(1+i_s)\bullet T}}{ln(1+i_s)}\right] \bullet \left(T_{\sum Div} - T_{\sum change\ of\ legal\ form}\right)$$

The sum of the withholding tax burden in the case of ongoing constant annual dividend distributions and no cross-border change of legal form (Fig. 1, initial situation) is defined as follows: $T_{\sum Div}$.

The term $T_{\sum change\ of\ legal\ form}$ stands for the withholding tax burden on dividends in the case of a cross-border change of legal form (Fig. 1, situation after cross-border change of legal form), which is 0. Hence, withholding taxes can be completely avoided by the cross-border change of legal form with subsequent profit distribution. Therefore, the difference between $T_{\sum Div} - T_{\sum change\ of\ legal\ form}$ is $T_{\sum Div}$.

Transaction costs can be excluded, since the ongoing operation of domestic or foreign subsidiaries in the EU makes little difference. The costs and fees for a cross-border change of legal form itself (registration) are also not significant.

The formula (TCVA) assumes continuous periodic income tax savings by avoiding dividend payment to the foreign shareholder ($T_{\sum Div}$), a steady rate of interest at the applicable after-tax rate i_s, and the time interval [0; T]. T is the date of the cross-border change of legal form, with subsequent profit distribution of the retained earnings by the corporation after having conducted the cross-border change of legal form. The time interval [0; T] indicates the period of profit retention in the foreign subsidiary which undergoes a cross-border change of legal form. The formula (TCVA) specifies the cash value of the tax savings or the tax benefit obtained by repatriation of profits from a foreign corporation through a cross-border change of legal form with subsequent profit distribution of the retained earnings. It contains the application of integral to continuous cash flows with a steady interest rate and, in conjunction with the e-function (growth function), enables the present value of the aforementioned income tax benefit to be determined for a specific time interval (present value with a steady interest rate).

In a nutshell, profit repatriation by using the cross-border change of legal form of the EU subsidiary with subsequent profit distribution of the retained earnings enables to receive significant tax savings (avoidance of withholding taxes).

7. Application to U.S. Shareholders (case study)

In the following, the strategy of using the cross-border change of legal form of the EU subsidiary to avoid withholding taxes on dividend distributions is transferred to U.S. shareholders. This tax planning strategy is particularly suitable for U.S. shareholders of European corporations to avoid the problem of treaty shopping [64], which has been significantly strengthened by the introduction of the principal purpose test (PPT) in all EU Member States according to the Anti-Tax-Avoidance-Directive (ATAD). For U.S. shareholders of foreign subsidiaries, in particular for U.S. corporations, optimization of withholding taxes on the dividends of foreign subsidiaries is an important issue. However, a withholding tax is generally levied on dividends of foreign subsidiaries in the foreign country of residence. For the U.S. shareholder, such a foreign withholding tax regularly leads to an additional tax burden and liquidity disadvantages. Therefore, the cross-border change of the legal form of the EU corporation prior dividend distribution can be a tax planning

solution for U.S. shareholders to completely avoid withholding tax on cross-border dividend payments. After the cross-border change of legal form has been carried out [65], the retained earnings can be distributed without incurring withholding tax. Moreover, a U.S. corporate shareholder can participate in the 100% dividend received deduction (Sec. 245A IRC). By combining the tax planning strategy of the cross-border change of legal form of the EU subsidiary with the 100% dividend exemption, corporate U.S. shareholders can thus repatriate dividends from all EU and EEA states without incurring any tax burden and, in particular, completely avoid foreign withholding tax. Accordingly, the dividend income of a U.S. corporation with a shareholding of at least 10% in a foreign corporation is generally not subject to corporate income taxation in the U.S. Pursuant to Sec. 245A IRC, the U.S. corporation receiving the dividend can claim a 100% dividends received deduction (DRD) (participation exemption) if it holds at least 10% of the distributing EU corporation. A further prerequisite for the DRD is that the U.S. corporation receiving the foreign dividends complies with a holding period requirement. Due to the DRD (Sec. 245A IRC), a U.S. corporation can receive dividends from a German corporation without being taxed with U.S. corporate income tax in the U.S. if it holds a minimum shareholding of at least 10%.

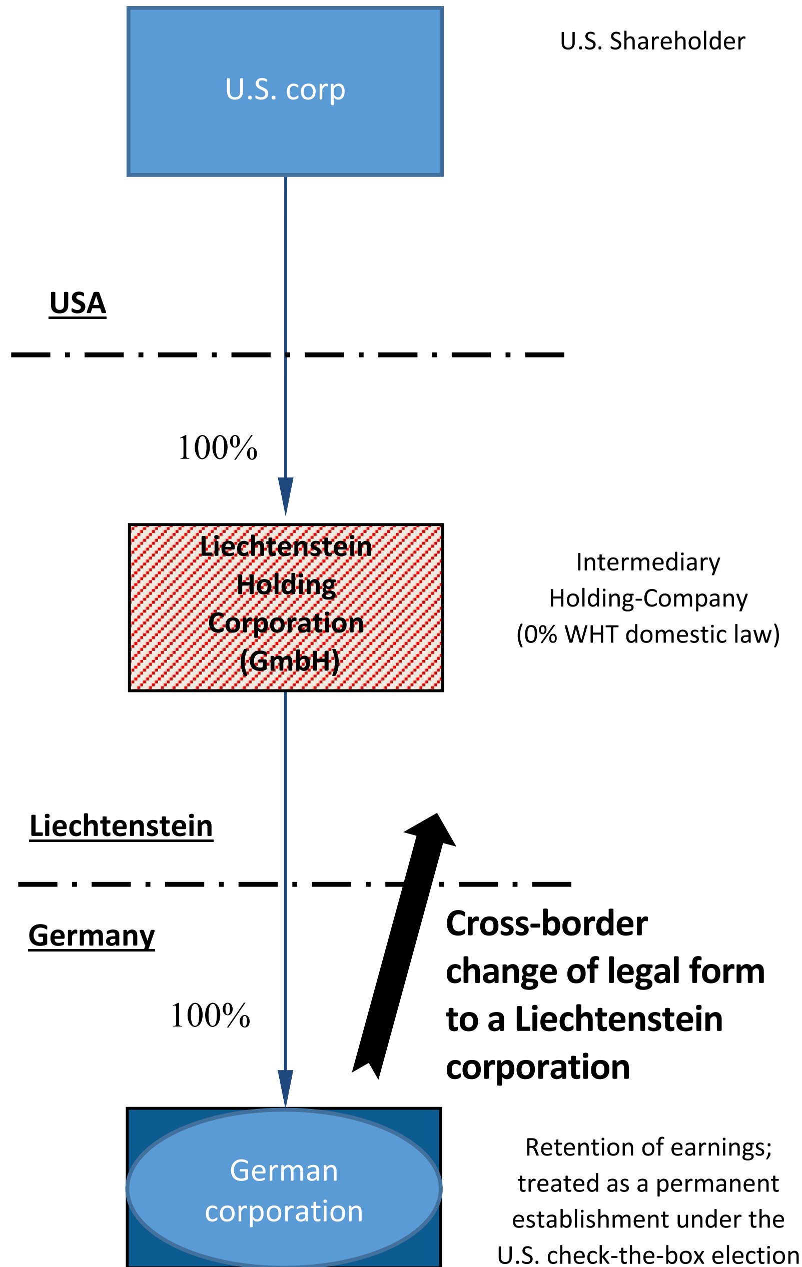

Fig. 2. Initial U.S. tax-optimized structure for applying the cross-border change of legal form (own illustration).

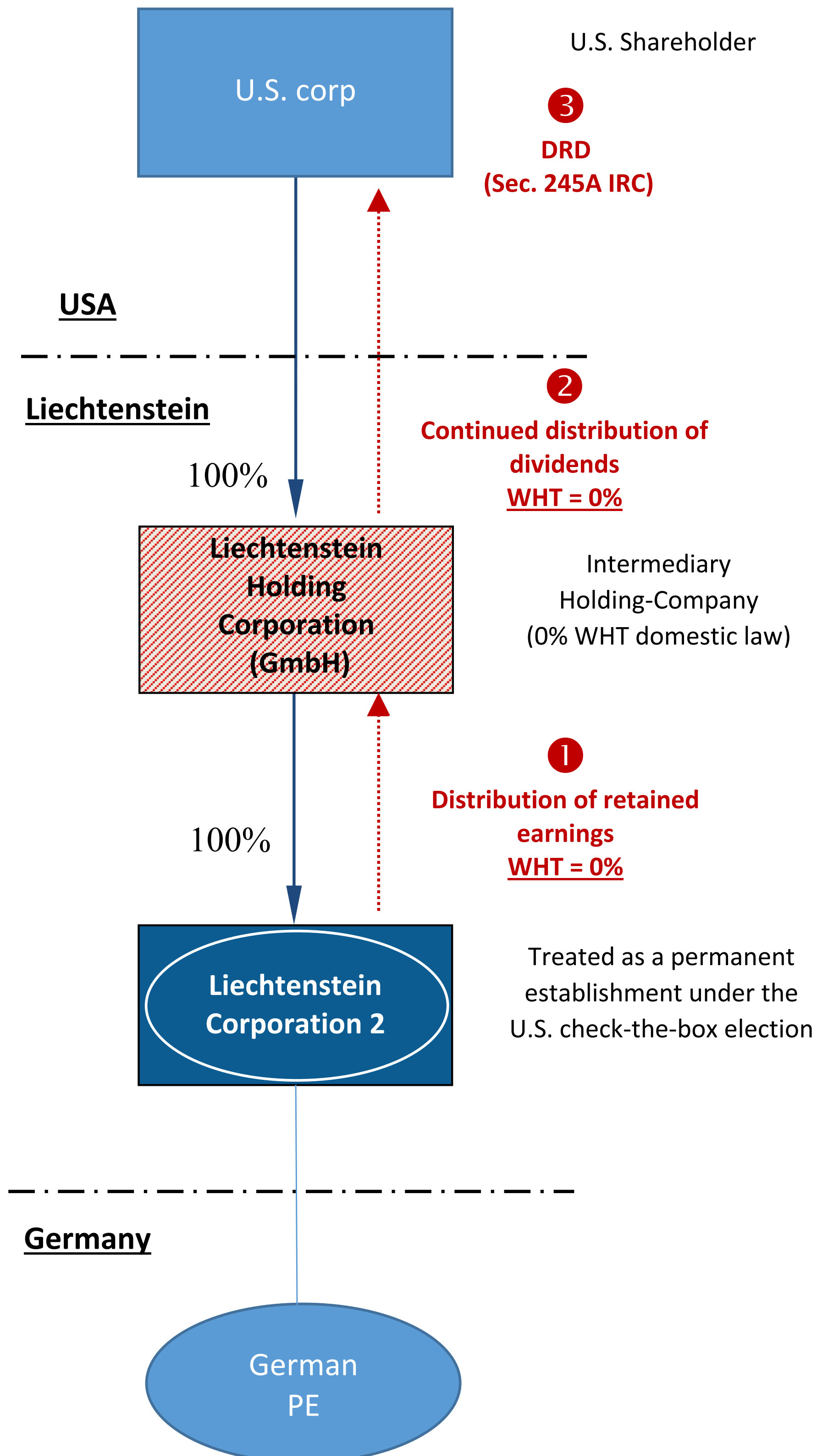

Fig. 3. U.S. tax-optimized structure after cross-border change of legal form (.

Now a concrete example is shown, how the cross-border change of legal form can be used to optimise the withholding tax burden on dividends. A U.S. parent company invests in a German corporation [66] (shareholding 100%). Under German tax law, a withholding tax of 25% is generally levied on dividend payments to the U.S. parent. According to the USA-Germany Income Tax Treaty [67], the withholding tax (WHT) can be reduced to 15% or 5%. To avoid German WHT on dividends, a Liechtenstein holding company (corporation, GmbH [68]) has been interposed. Liechtenstein does not levy WHT on dividend payments. According to the Liechtenstein-Germany Tax Treaty, the German WHT on dividends can be reduced to 0% if the Liechtenstein holding corporation holds at least 10% of the voting shares in the German corporation directly during an uninterrupted period of at least twelve months [69]. However, if the German corporation distributes its profits to the Liechtenstein holding company, no withholding tax reduction is granted on dividend payments. Due to the German anti-treaty shopping rules including the Principal Purpose Test (PPT), there is an unmitigated deduction of 25% German withholding tax on dividends. Therefore, the German corporation initially retains its profits. For U.S. tax purposes, the German corporation will be treated as a disregarded entity under the check-the-box election [70] from the beginning and can therefore be considered as a permanent establishment or division of the Liechtenstein holding corporation [71]. The initial U.S. tax-optimized structure can depict as follows (Fig. 2).

The German corporation retains its profits for the desired period of time. To repatriate the retained earnings without WHT, the German corporation carries out a tax-neutral cross-border change of legal form into a Liechtenstein corporation (see in details 4.). Accordingly, the German corporation cumulatively moves its statutory seat/registered office and its place of management to Liechtenstein and assumes the legal form of a Liechtenstein corporation/GmbH (cross-border change of legal form). The permanent establishment of the German corporation, changing its legal form, remains in Germany. After the cross-border change of legal form, a Liechtenstein corporation is given with a German permanent establishment. For U.S. tax purposes, this resulting Liechtenstein corporation is also treated as a disregarded entity under the check-the-box election from the very beginning. As a result, nothing has changed from the initial structure considering U.S. taxation. In this respect, only the former Liechtenstein company ("Holding") with a German permanent establishment (PE) still exists. The cross-border change of legal form is therefore tax-neutral for U.S. tax purposes. Furthermore, there is also no deemed distribution of profits. However, for German and Liechtenstein tax purposes there is a two-tier Liechtenstein structure given after the change of legal form, whereby the new Liechtenstein subsidiary, which is the German corporation that changed its legal form, has a German permanent establishment. After the cross-border change of legal form, the following tax structure results (Fig. 3).

In the course of the cross-border change of legal form, the retained earnings were "transferred" to the Liechtenstein Corporation 2 without any tax effect. After the cross-border change of legal form, the Liechtenstein corporation (GmbH) can now distribute the retained profits to the Liechtenstein holding company. Withholding tax is not levied here according to domestic tax law and the dividends are not included in the tax base of the Liechtenstein holding company as the recipient (dividend exemption). Regarding U.S. taxation, the dividend income of the Liechtenstein holding company does not exist because the distributing subsidiary, the Liechtenstein GmbH, is treated as a permanent establishment or disregarded entity under the check-the-box regulations. Thus, Subpart F [72] income is not given at the level of the Liechtenstein holding company. Therefore, U.S. CFC taxation [73] is inapplicable [74]. The Liechtenstein holding company may retain the dividends received and distribute them to the U.S. shareholder without deduction of withholding tax. According to domestic tax law of Liechtenstein, dividend payment is not subject to withholding tax. Pursuant to Sec. 245A IRC, the U.S. corporation receiving the dividend payment can claim a 100% dividends received deduction (DRD).

Overall, this tax strategy allows foreign dividends to be repatriated to the level of U.S. shareholders without triggering any withholding tax. Moreover, fully tax-neutral repatriation of foreign dividends and retained earnings from EU and EEA subsidiaries is possible. In principle, this tax strategy is universally applicable to investments in subsidiaries throughout the EU and EEA. Moreover, it solves the problem of treaty shopping, which does not occur with this strategy. Thus, this tax planning strategy may solve the problem of tax-optimized dividend repatriation, which is a major problem when investing in foreign subsidiaries.

8. Summary and conclusions

The strategy, developed in this article for the first time, may solve the problem of tax-optimized dividend repatriation, which is a major problem in international tax law and when investing in foreign subsidiaries. It offers a unique solution to a fundamental tax problem.

The strategy of using the cross-border change of legal form of EU and EEA subsidiaries allows foreign dividends to be repatriated to the level of U.S. shareholders without triggering any withholding tax. In combination with the 100% dividends received deduction (DRD), a fully tax-neutral repatriation of foreign dividends and retained earnings from EU and EEA subsidiaries is possible. Furthermore, the problem of treaty shopping does not exist.

The cross-border change of legal form between corporations within the EU can be used for the tax-optimized repatriation of dividends. This has been worked out and tested for the first time in this article. By means of a cross-border change of legal form of the EU corporation prior to distribution to another foreign EU corporation with subsequent dividend distribution after the cross-border change of legal form has taken place, the taxation of dividends or retained earnings can be completely avoided, in particular with withholding tax. This structuring option is universally applicable (entire EU and EEA area; shareholders from third countries, EU and EEA states). This strategy has legal stability and is recognised for tax purposes.

Moreover, the cross-border change of legal form of an EU corporation into another foreign EU corporation can also be used to get out of an existing treaty shopping situation where a foreign holding company is interposed. Here, too, the cross-border change of legal form of the distributing EU subsidiary into another EU subsidiary of another EU Member State is a flexible way to end the further intervention of anti-treaty shopping rules and the principal purpose test (PPT).

Overall, the cross-border change of legal form of corporations within the EU represents a flexible and interesting new transformation option for companies, which contains potential. The cross-border change of legal form within the EU is therefore likely to open new opportunities and possibilities beyond the cross-border merger [75,76].

In principle, it should be difficult or impossible for Member States to impose a dividend taxation or withholding tax on (deemed) profit distributions in regard to the cross-border change of legal form between corporations within the EU, as no such taxation takes place in comparable domestic cases of a change of legal form (Art. 49 TFEU).

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Author contribution statement

Thomas Kollruss: Conceived and designed the experiments; Performed the experiments; Analyzed and interpreted the data; Contributed reagents, materials, analysis tools or data; Wrote the paper.

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No data was used for the research described in the article.

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Declaration of competing interest

The authors declare that they have no known competing financial interests or personal relationships that could have appeared to influence the work reported in this paper.

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[1] If, in A Purely Domestic Case, Income Expenses Are Taken into Account to Reduce Taxation, the Source State Must Also Grant the Same Treatment in Cross-Border Constellations when Levying the Withholding Tax (Taxation on A Net Basis) on the Basis of Primary Law (Art. 49 TFEU, Art. 63 TFEU). See CJEU, Judgment of 24 February 2022, C- 257/20, Viva Telecom Bulgaria, ECLI:EU:C:2022:125, Para. 88; CJEU, Judgment of 26 February 2019, C-115/16, C-118/16, C-119/16 and C-299/16, N Luxembourg 1, ECLI:EU:C:2019:134.
[2] Art. 10, para. 2 OECD-MC (e.g. in the case of natural persons as shareholders who are resident in the other contracting state or if there is no qualified shareholding in the distributing corporation given).
[3] 96/EU, Art. 10 para. 2 lit. a) OECD-MC; Art. 5 Parent-Subsidiary Directive, 2011.
[4] For example, Art. 29 para. 9 OECD-MC 2017 or Art. 7 para. 1 MLI (Multilateral Instrument) in case of reduction of withholding tax due to a bilateral tax convention on income and on capital (DTA, Double Tax Agreement).
[5] Treaty shopping refers to the interposition of a foreign holding company (conduit entity interposed in the structure of the group between the company that pays dividends and the company in the group which is the beneficial owner) with DTA relief or application of the Parent-Subsidiary Directive by a person who would not be entitled to a withholding tax reduction if he held a direct interest in the distributing corporation. On treaty shopping, see also CJEU, judgment of 26 February 2019, C-116/16 and C-117/16, T Danmark/Y Denmark, ECLI:EU:C:2019:135, para. 100; Park, Sung Jae/Lee, Kyu-Min/Yang, Jae-Suk "Navigating optimal treaty-shopping routes using a multiplex network model", PLoS One (2021).
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[12] In the Case of a Change of Legal Form, the Legal Entity Is Identical under Civil Law and There Is No Transfer of Assets. In the Case of a Merger, There Is a Transfer of Assets to Another Legal Entity as a Whole as Legal Successor (Universal Successor), the Transferring Legal Entity Ceases to Exist without Liquidation. See on Cross-Border Mer- Gers Siems, Mathias .M.: SEVIC: beyond Cross-Border Mergers, European Business Organization Law Review 2007, P. 307; Papadopoulos, Thomas: Cross-Border Mergers: EU Perspectives and National Experiences, Springer, 2019.

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