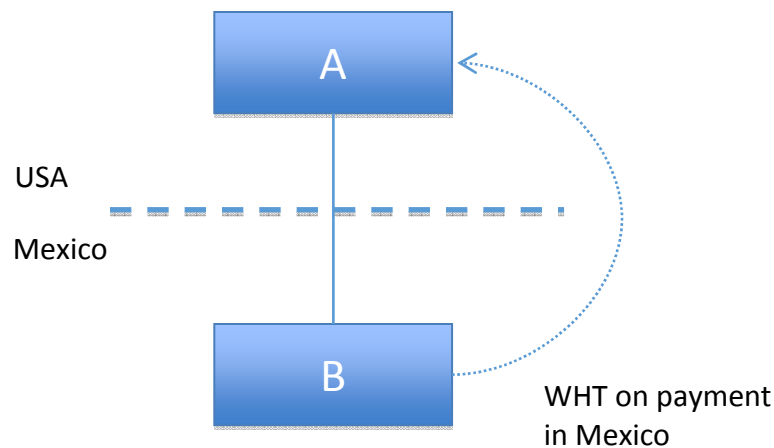


Treaty overriding. Dividends Case

Mag. Manuel Hallivis Pelayo

Treaty Overriding. Dividends Case



Art. 10, Mexico-USA DTT establishes a maximum rate of 5% of the gross amount of dividends

- Art. 152 of Mexican Income Tax Law: 5% should be withheld after applying a factor of 1.5385

Background:

- “B” pays dividends to “A”
- Mexico levies WHT on dividends
- “B” withheld 5% after applying a factor of 1.5385 on the gross amount of dividends to “A” (Art. 152)
- “A” filed a Refund Request before Mexican Tax Authorities
 - Tax Authorities rejected it
 - Grounds: Art. 152 of Income Tax Law should be applied

- “A” filed a lawsuit before Mexican Federal Tax Court

Issue:

- “A” argues that WHT should have been only 5%, since the relevant DTT establishes a **maximum** 5% WHT of the **gross amount of dividends**

- **Authorities** argue that **Art. 152 should be applied** because of the reforms to the Law,

- In order to reconstruct the taxable base. Because if this factor is not applied, authorities say that the dividends only represent 65% of the gross income, because previously a corporate tax rate of 35% had been deducted

Background

A.- Art. 10.2 of relevant DTT:

- Withholding of 5% of the gross amount of the dividends

“10. 1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

10. 2. Such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident, and according to the laws of that State. However, if the beneficial owner of the dividends is a resident of the other Contracting State, except as provided in paragraph 3, the tax so charged shall not exceed: a) 5 percent of the gross amount of the dividend if the beneficial owner is a company which owns at least 10 percent of the voting stock of the company paying the dividends.; b....”

B.- Art. 152 of Income Tax Law:

- The withholding should be done after applying a factor of 1.5385:

•“...Enterprises which distribute dividends or profits referred to in this section, should withhold the tax that is the result of applying a 5% rate on the amount that results from multiplying the dividends or profits distributed by the factor of 1.5385 and give the taxpayers to whom they make the payments referred to in this paragraph, a certification in which the amount of the dividends or profits distributed and the tax withheld is mentioned.”

C.- Art. 3(2), DTT:

- “As regards the application of the Convention at any time by a Contracting State, *any term not defined* therein shall, unless the context otherwise requires...”
 - tax law meaning prevails over other meanings

Key issues

- Whether or not “B” should have withheld the 5% of the gross amount of the dividends ***after applying*** a 1.5385 factor *or* ***without applying it***

Methodology to use *lex fori*?

- Should we use the Vienna convention first?
- Steps to do so?
- Should we always use domestic law?
- Is this a case of treaty overriding?

Questions

Tax treaty

- *To which extent is Article 10.2 of the DTT applicable?*

Article 3(2) MCOUDE

¿How and when should we use Article 3(2)?

Mexican domestic law

- The court holds that DTT should be applied first and if it gives us the solution, there is no need to apply Art. 152 of domestic law

Methodology of Mexican Court

After having established that the present case is within the scope of the tax treaty, the Mexican Court took the following approach:

- a. Consider: VCLT (find definitions and special references in the tax treaty)
- b. Art. 10.2 establishes a WHT of **5% of the gross amount of the dividends**

C. ¿use of Article 3(2) of the tax treaty (*lex fori*)?

- *Use of the **commentary on article 10** of the OECD Model Tax Convention (Paragraph 2)*
 - “... On the other hand, a lower rate (5%) is expressly provided in respect of dividends paid by a subsidiary company to its parent company. If a company of one of the States owns directly a holding of at least 25 per cent in a company of the other State, it is reasonable that payments of profits by the subsidiary to the foreign parent company should be taxed less heavily to avoid recurrent taxation and to facilitate international investment. The realisation of this intention depends on the fiscal treatment of the dividends in the State of which the parent company is a resident (cf. paragraphs 49 a 54 of the Commentary on Articles 23 A and 23 B)”

- ***There is no need to go to domestic law since the answer was fully given by the DTT***

Conclusion:

There is no need to go to domestic law as all the answers are in the DTT

Only 5% of the gross amount of the dividends is to be withheld

Conclusion

Methodology to use Art 3(2):

- first use VCLT
 - following Arts. 31 & 32

Use *Lex Fori* only when there is an *undefined term*

Although there was some room for interpretation, regarding “gross amount”, In this case there was no undefined term, but different terms:

- *Domestic Law : “dividends distribuibles”*
- *DTT : “gross amount of dividends”*

Conclusion: no grounds to apply Art. 152 of the domestic income tax law so,

*the denial to grant a refund **is not** legal*

Key issues

If the relevant tax treaty has a solution: use it

We need to use domestic law (Art. 3(2)) *only* when there is an *undefined* term in the DTT

Opinion

OECD-Commentaries are part of the context only if those Commentaries were issued before the tax treaty was signed (*static approach*)

Although every case is different, it is necessary to follow the standard methodology

When interpreting any relevant provision, we should:

1. First interpret the tax treaty using the VCLT

2. If there is an undefined term, we should use Article 3(2)

a. Starting with the domestic tax laws

b. If necessary, go to any other applicable domestic law

Precedents

V-TA-2aS-56, Income Tax Law, RTFJFA, 5ª época, Año IV, Tomo II, No. 40, abril 2004

- Case: 14542/02-17-02-6/669/03-S2-08-02
- Other precedents or cases in the same direction:
 - 13690/02-17-06-1/606/03-S2-08-02
 - V-TA-2aS-149, RTFJFA, 5ª época, Año VII, No. 74, febrero de 2007,
 - V-P-1aS-218, RTFJFA, 5ª época, Año IV, No. 44, agosto de 2004