



Univ.-Prof. DDr. Georg Kofler, LL.M. (NYU)

# **EC Tax Law**

Wednesday, 25 November 2009, 15:30 – 18:45, MT 226

Thursday, 26 November 2009, 15:30 – 18:45, MT 128

Friday, 27 November 2009, 15:30 – 18:45, BA 9910



# Overview

- **Introduction**
- **Milestones in European Tax Policy**
- **Fundamental Freedoms and Direct Taxation**
- **Secondary Community (Tax) Law**
  - Parent-Subsidiary-Directive
  - Merger Directive
  - Interest-Royalties-Directive
  - Arbitration Convention
- **Tax Harmonization Projects**
  - HST
  - CCCTP
- **Harmful Tax Competition**



# **Part I**

## **Introduction**



**European Commission**



**Council**



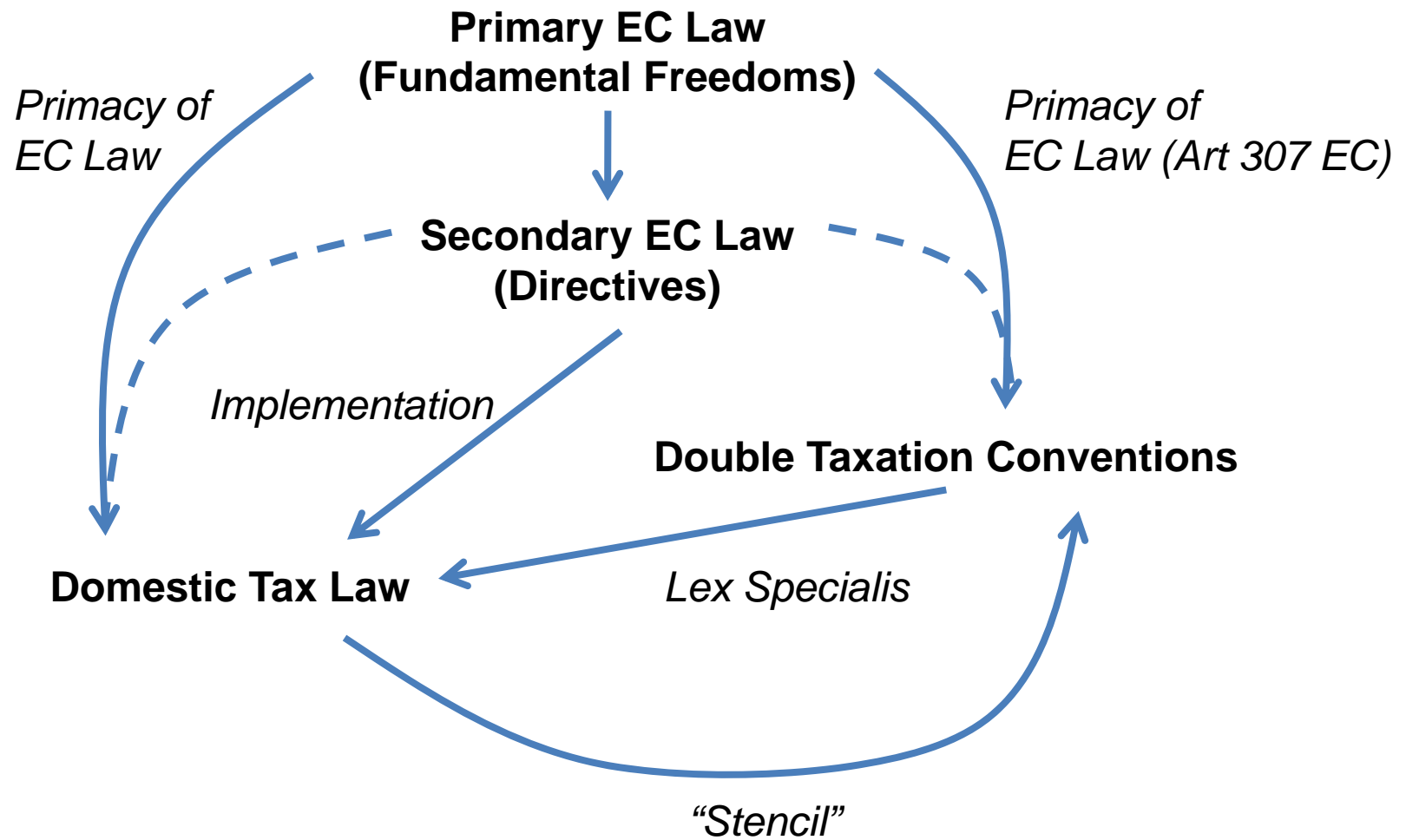
**European Parliament**



**Court of Justice**



# Overview





# Overview

- **Direct and Indirect Taxation**
  - **Indirect Taxation** → Customs Union (Art 23 et seq EC – now Art 28 EC), prohibition of custom duties (Art 25 EC – now Art 30 EC), and prohibition of direct and indirect discrimination against foreign products (Art 90 EC – now Art 110 EC); harmonization under **Art 93 EC** (now Art 113 EC)
  - **Direct Taxation** → No harmonization program, but **Art 94 EC** (now Art 115 EC)
- **EC Law and Direct Taxation**
  - **Fundamental Freedoms**
    - Free Movement of Workers (Art 39 EC – now Art 45 EC)
    - Freedom of Establishment (Art 43 EC – now Art 49 EC)
    - Freedom to Provide Services (Art 49 EC – now Art 56 EC)
    - Free Movement of Capital (Art 56 EC – now Art 63 EC) — Between the Member States and between Member States and Third Countries!
  - **Directives**
    - Parent-Subsidiary-Directive
    - Merger Directive
    - Interest-Royalties-Directive
    - Savings Directive
    - Directives on Mutual Assistance and Recovery of Tax Claims



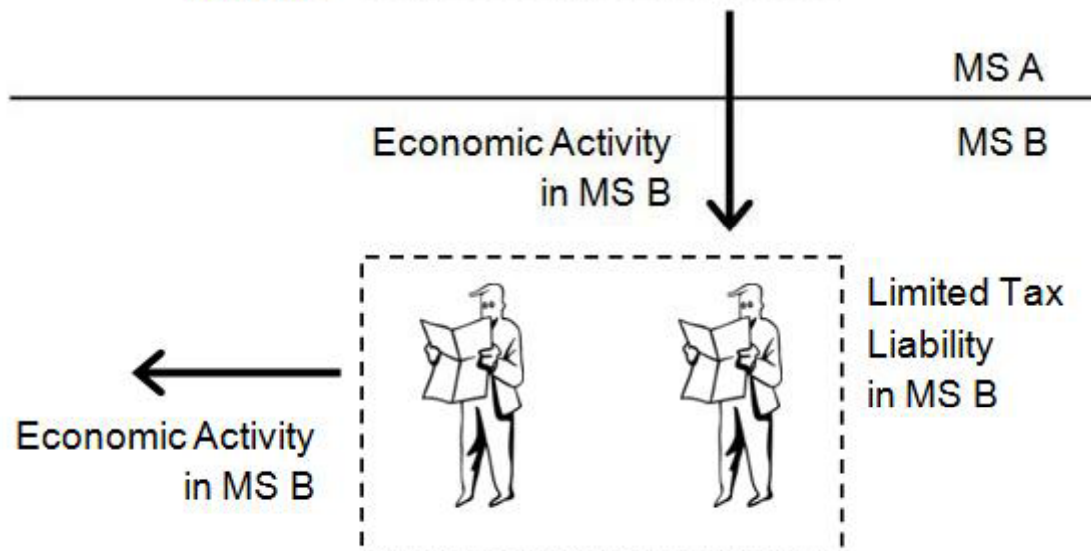
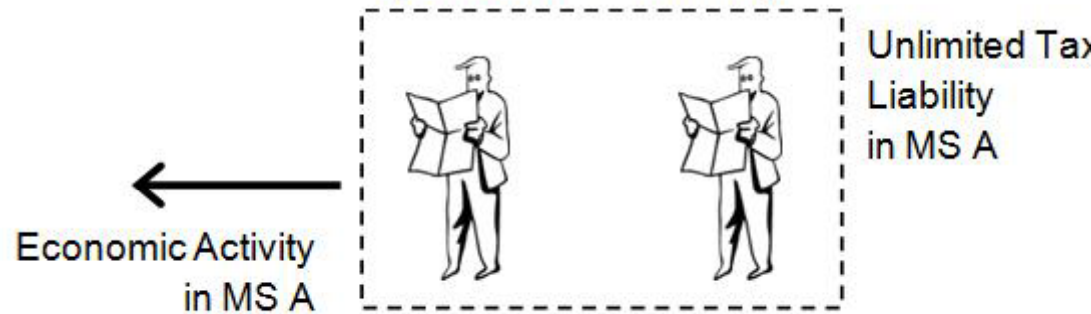
# Overview

- **Fundamental Freedoms and Direct Taxation**
  - The Fundamental Freedoms
    - are directly applicable in the Member States,
    - confer rights to individuals and companies,
    - take precedence over domestic legislation to the extent of any inconsistency,
    - and not only operate “negatively” by superseding national law, but also “positively” by granting taxpayers benefits denied to them in breach of Community law
  - **Infringement — The Test Used by the European Court of Justice**
    - Personal and Territorial Scope?
    - Discrimination (and Restriction)?
    - Justification and Proportionality?
  - **Impact**
    - ECJ and Domestic Courts
    - *Acte Clair*
    - “Retroactivity” and Domestic Procedural Law



# Basics – Discrimination

Pair of Comparison from the Perspective of the Residence State  
(„Outbound“-Situation)



Pair of Comparison from the Perspective of the Source State  
(„Inbound“-Situation)





# Basics – Inbound Situations

- **Disadvantageous Treatment of Non-Residents by the Source State**
  - Identification of a Pair of Comparison and the Criterion of Comparison (*tertium comparationis*) = “Equality in a Box” (“Kästchengleichheit”)
  - *Ad personam*-Comparison (→ Competition!)
- **Vertical Issues**
  - Obligation of the Source State to grant non-residents equal treatment with residents, insofar the former are subjected to its taxing jurisdiction, and even if they are Source State nationals = **Prohibition of Vertical Discrimination = Obligation to Grant National Treatment**
  - *Subjective* Ability to Pay (e.g., *Schumacker*, *Wallentin*, *D*)
  - *Objective* Ability to Pay
    - Companies (*Avoir Fiscal*, *Saint-Gobain*, *CLT-UFA*, *Denkavit Internationaal*)
    - Individuals (*Gerritse*, *Conijn*, *Scorpio*)
- **Horizontal Issues**
  - Obligation of the Source State to treat two different cross-border situations equally? **Prohibition of Horizontal Discrimination**
  - *Inbound*-Most-Favored-Nation-Treatment (*D*, *Bujara*, *ACT Group Litigation*)



# Basics – Outbound Situations

- **Disadvantageous Treatment of Residents by the Residence State**
  - Identification of a Pair of Comparison and the Criterion of Comparison (*tertium comparationis*)
  - *Ad rem*-Comparison
- **Vertical Issues**
  - Guideline: Equal treatment has to be granted if foreign-source income is included in the tax base → **Tax Base Fragmentations?**
  - Issues
    - Foreign-Source Income (*Lenz, Manninen, Meilicke*)
    - Deductions (*Bachmann etc, Bosal, Marks & Spencer*)
    - Exit Taxation (*X und Y, Hughes de Lasteyrie du Saillant, N*)
- **Horizontal Issues**
  - Obligation of the Residence State to treat two different cross-border situations equally? **Prohibition of Horizontal Discrimination**
  - *Outbound-Most-Favored-Nation-Treatment* (*De Graaf, Cadbury Schweppes, Columbus Container Services*)



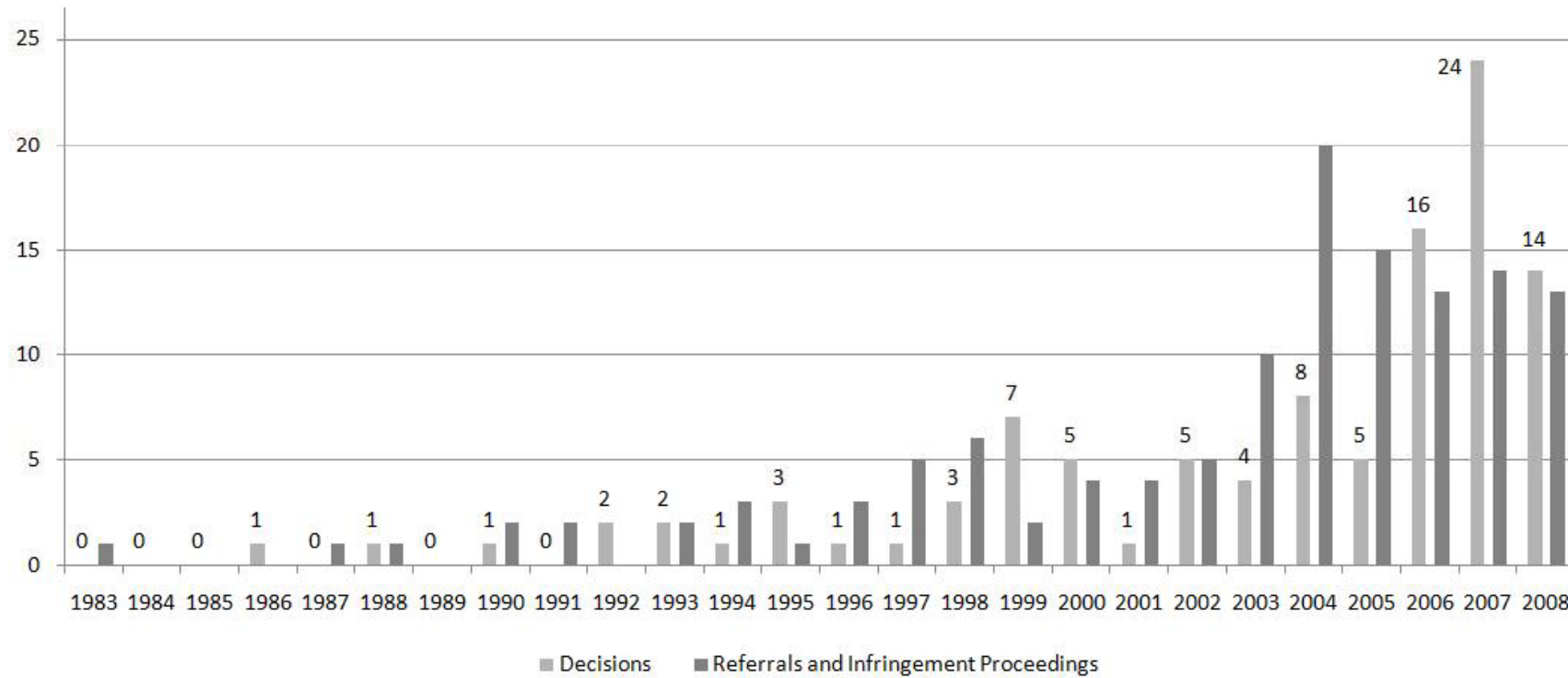
## **Part II**

# **Some Statistics**



# Relevance of the Fundamental Freedoms

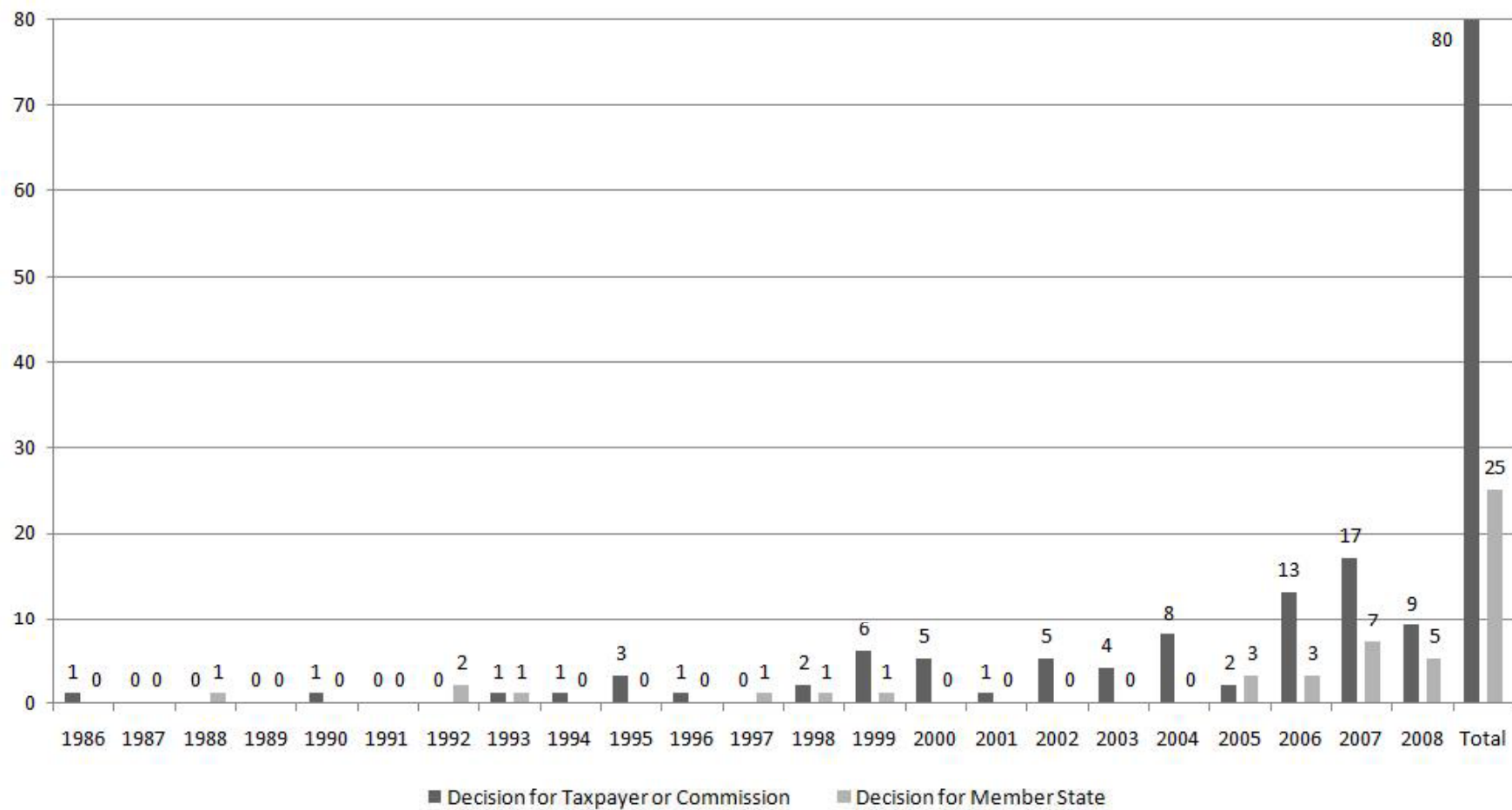
**Graph 1:** Number of (pending) direct tax cases before the ECJ as of 1 January 2009





# Relevance of the Fundamental Freedoms

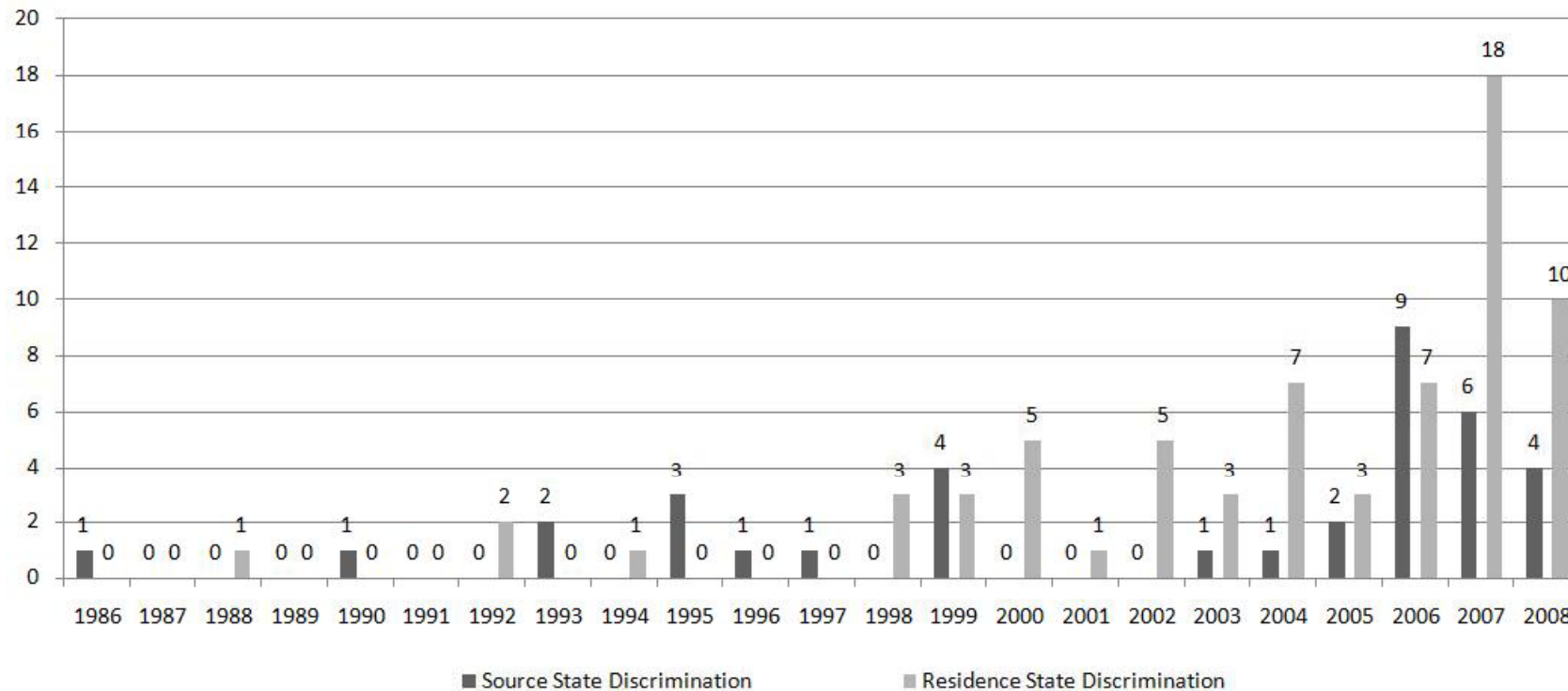
**Graph 2:** Success rate – Taxpayers 76%, Member States 24%





# Relevance of the Fundamental Freedoms

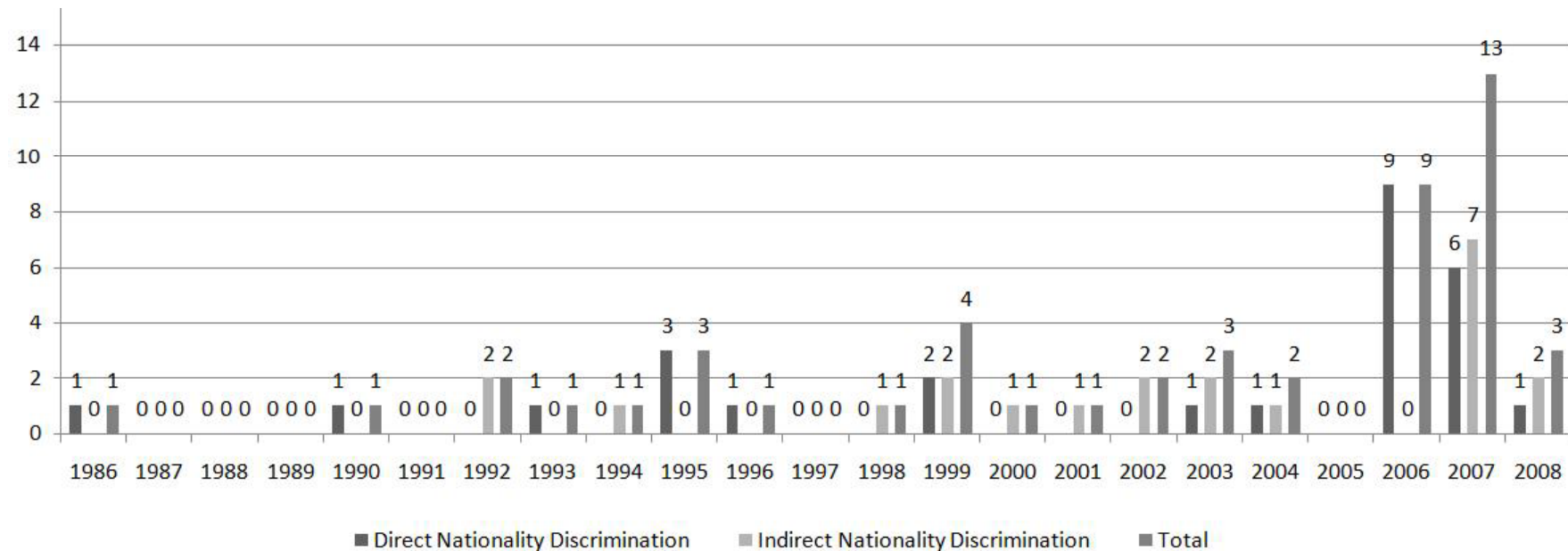
**Graph 3:** Source and Residence State Discrimination





# Relevance of the Fundamental Freedoms

**Graph 4:** Direct and Indirect Discrimination





## **Part III**

# **Milestones in European Tax Policy**





# European Tax Policy

- **Directives**
  - Parent-Subsidiary-Directive
  - Merger Directive
  - Interest-Royalties-Directive
  - Savings Directive
  - Directives on Mutual Assistance and Recovery of Tax Claims (extended to direct taxes with effect of mid-2002)
- **Current Tax Policy**
  - No need for broad harmonization of Member States' tax systems. → Provided that Community rules are respected, Member States are free to choose the tax systems that they consider most appropriate and according to their preferences.
  - Proposal for Community action in the tax field would take full account of the principles of subsidiarity and proportionality. → Many tax problems might, in fact, simply require better co-ordination of national policies. → **Co-Ordination**
  - Main priority for tax policy that of addressing the concerns of individuals and businesses operating within the Internal Market by focusing on the elimination of tax obstacles to all forms of cross-border economic activity, in addition to continuing the fight against harmful tax competition. → **Code of Conduct, JTPF, CCCTB**
- Double Taxation → **Art 293 EC?**



## Milestones – 1963 to 1969

**The EEC Reports on Tax Harmonization.** The Report of the Fiscal and Financial Committee and the Reports of the Sub-Groups A, B and C (1963) (**Neumark Report**)

**Programme for the Harmonisation of Direct Taxes**, Bulletin Supp 8/1967

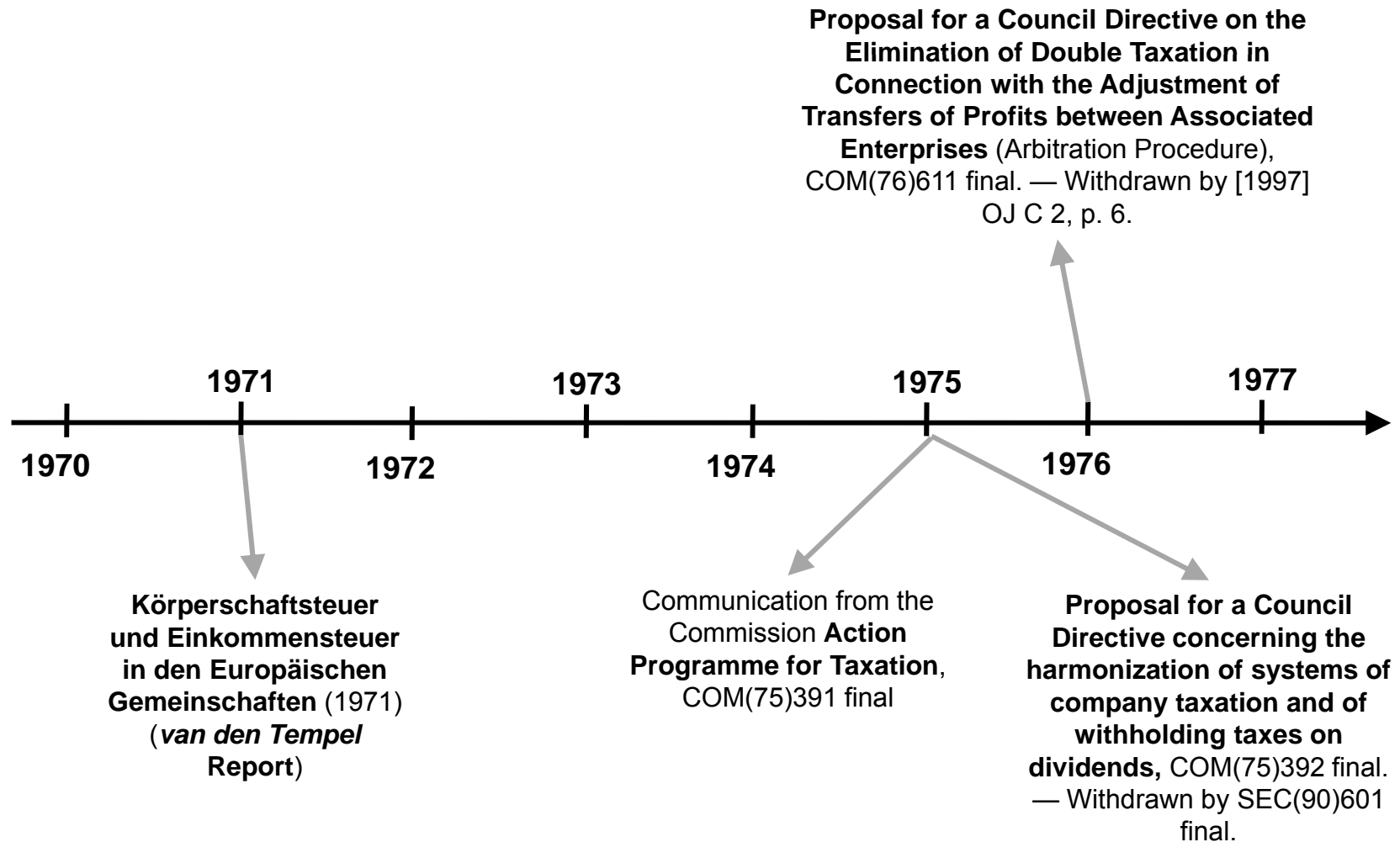


**The Development of a European Capital Market** – Report of a Group of Experts appointed by the EEC Commission (1966) (**Segré Report**)

**Pre-Draft of a Multilateral Tax Treaty** (11.414/XIV/68-D)



## Milestones – 1970 to 1977



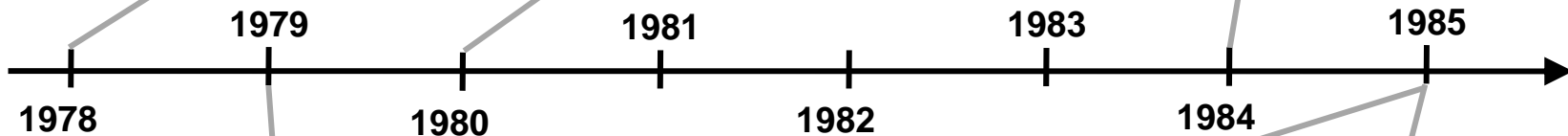


## Milestones – 1978 to 1985

**Proposal for a Council Directive on the application to collective investment institutions of the Council Directive concerning the harmonization of systems of company taxation and of withholding taxes on dividends, COM(1978)340 final. — Withdrawn on 8 April 1993, [1993] OJ C 228, p. 13.**

**Report on the Scope for Convergence of Tax Systems, COM(80)139 final, Bulletin Supp 1/80**

**Communication from the Commission on Community Action to Combat International Tax Evasion and Avoidance, COM(84)603 final**



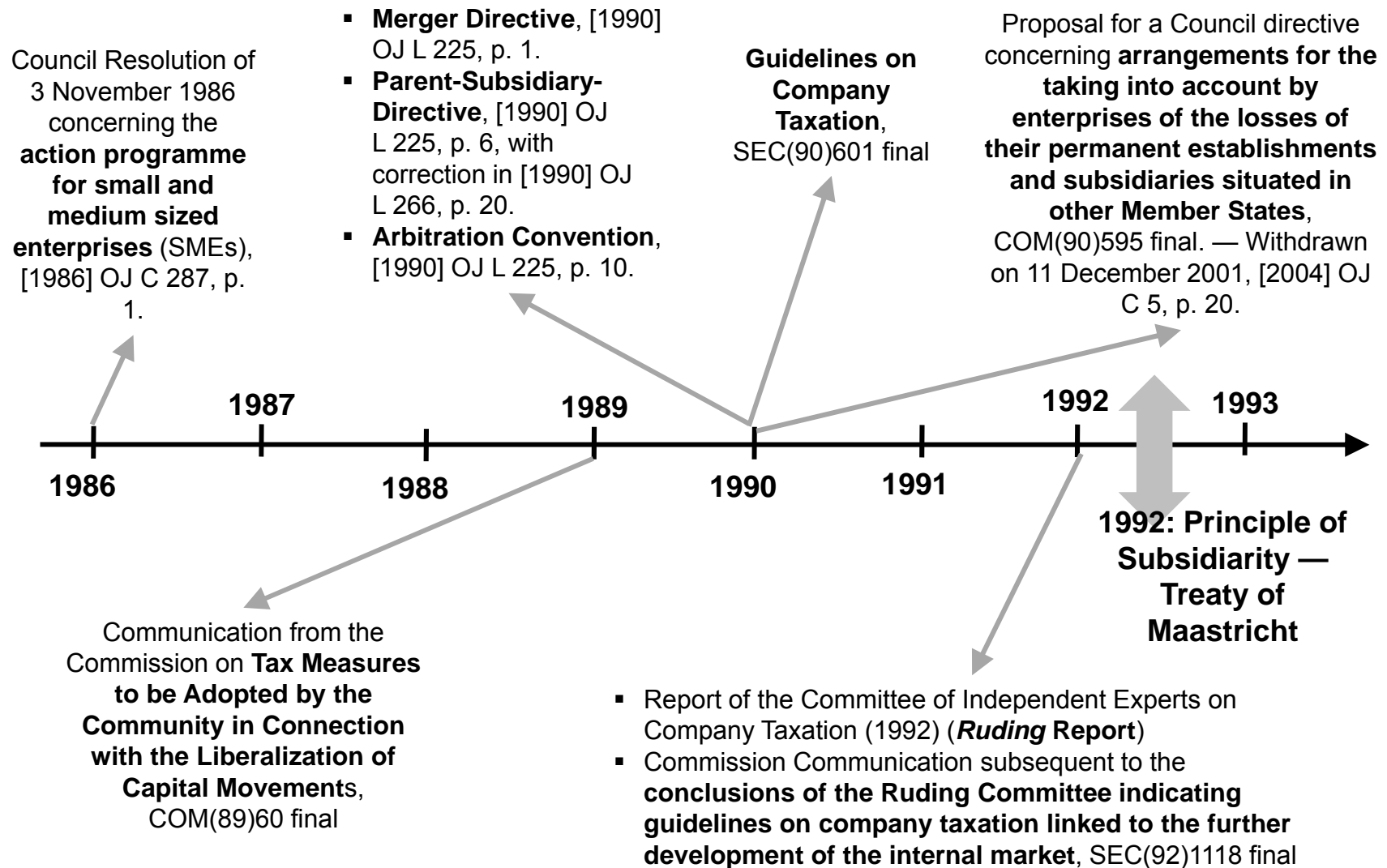
**Proposal for a Council Directive concerning the harmonization of income taxation provisions with respect to freedom of movement for workers within the Community, COM(1979)737 final. — Withdrawn on 9 September 1992.**

**Proposal for a Directive of the Council on the harmonization of the laws of the Member States relating to tax arrangements for the carry-over of losses of undertakings, COM(1984)404 final, amended through COM(85)319 final. — Withdrawn on 21 November 1996, [1997] OJ C 2, p. 6.**

**Communication from the Commission on Fiscal Measures Aimed at Encouraging Cooperation Between Undertakings of Different Member States, COM(85)360 final**

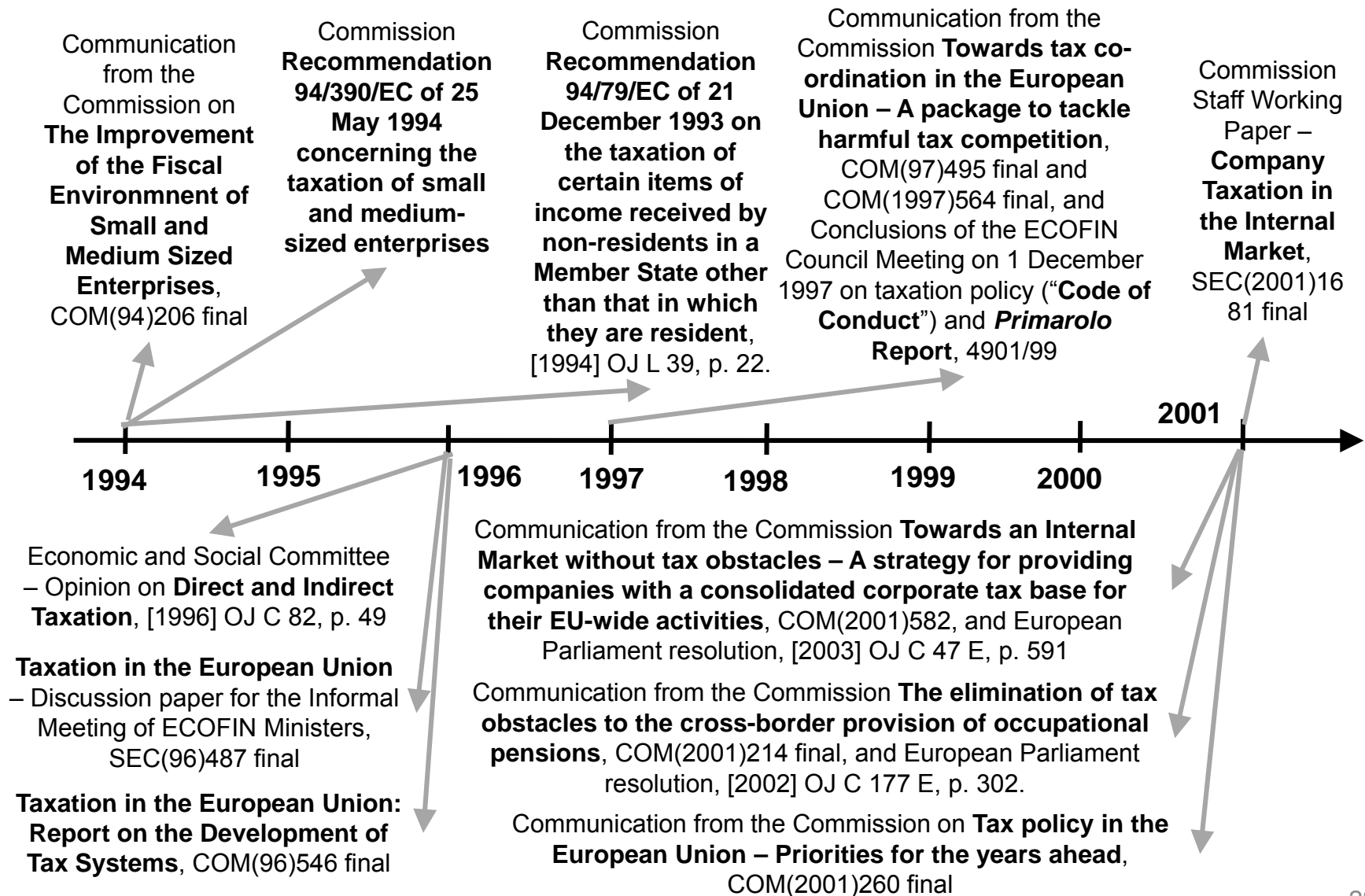


# Milestones – 1986 to 1993



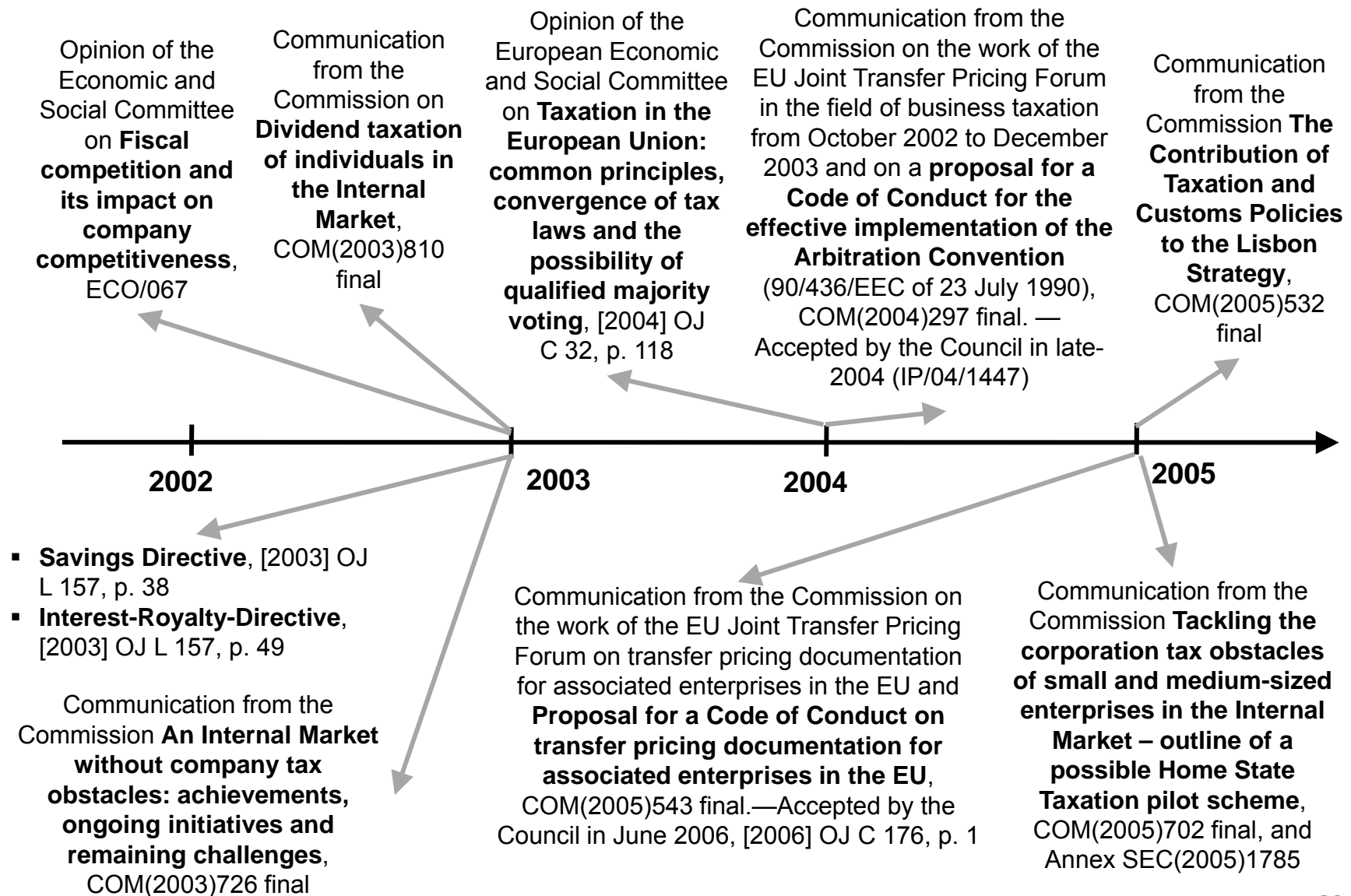


## Milestones – 1994 to 2001



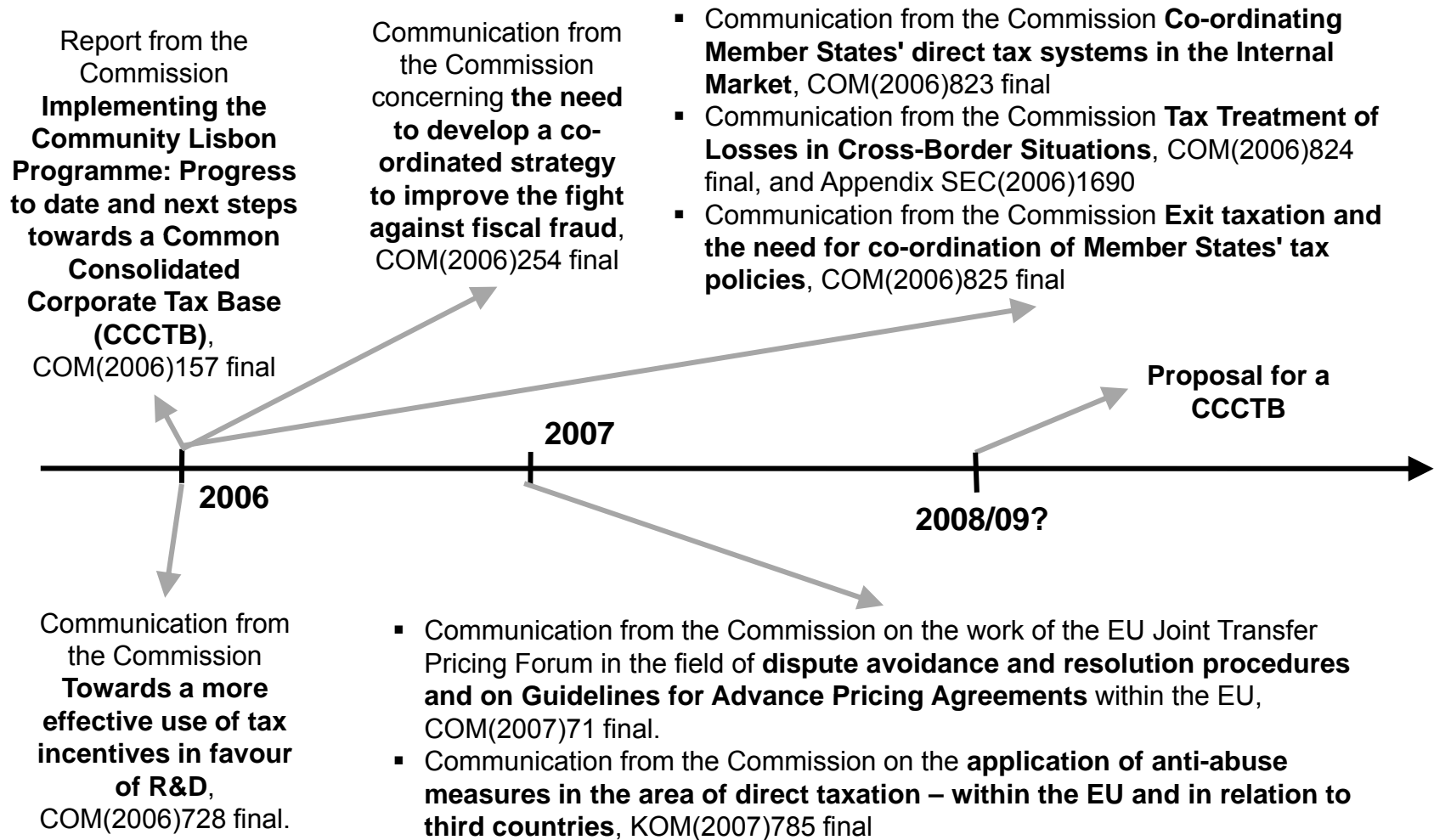


## Milestones – 2002 to 2005





## Milestones – 2006 to 2008





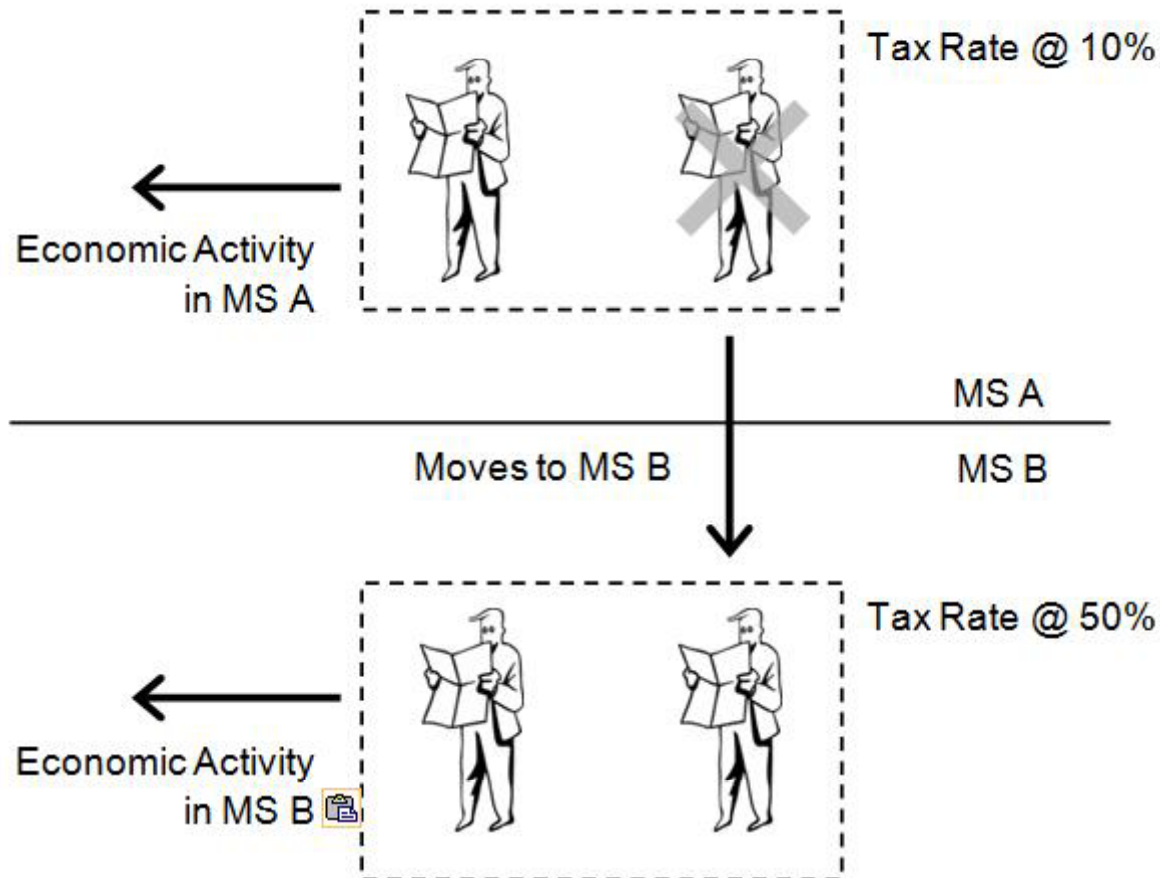


# **Part IV**

## **The Fundamental Freedoms – Disparity, Discrimination, Restriction**



# Disparities

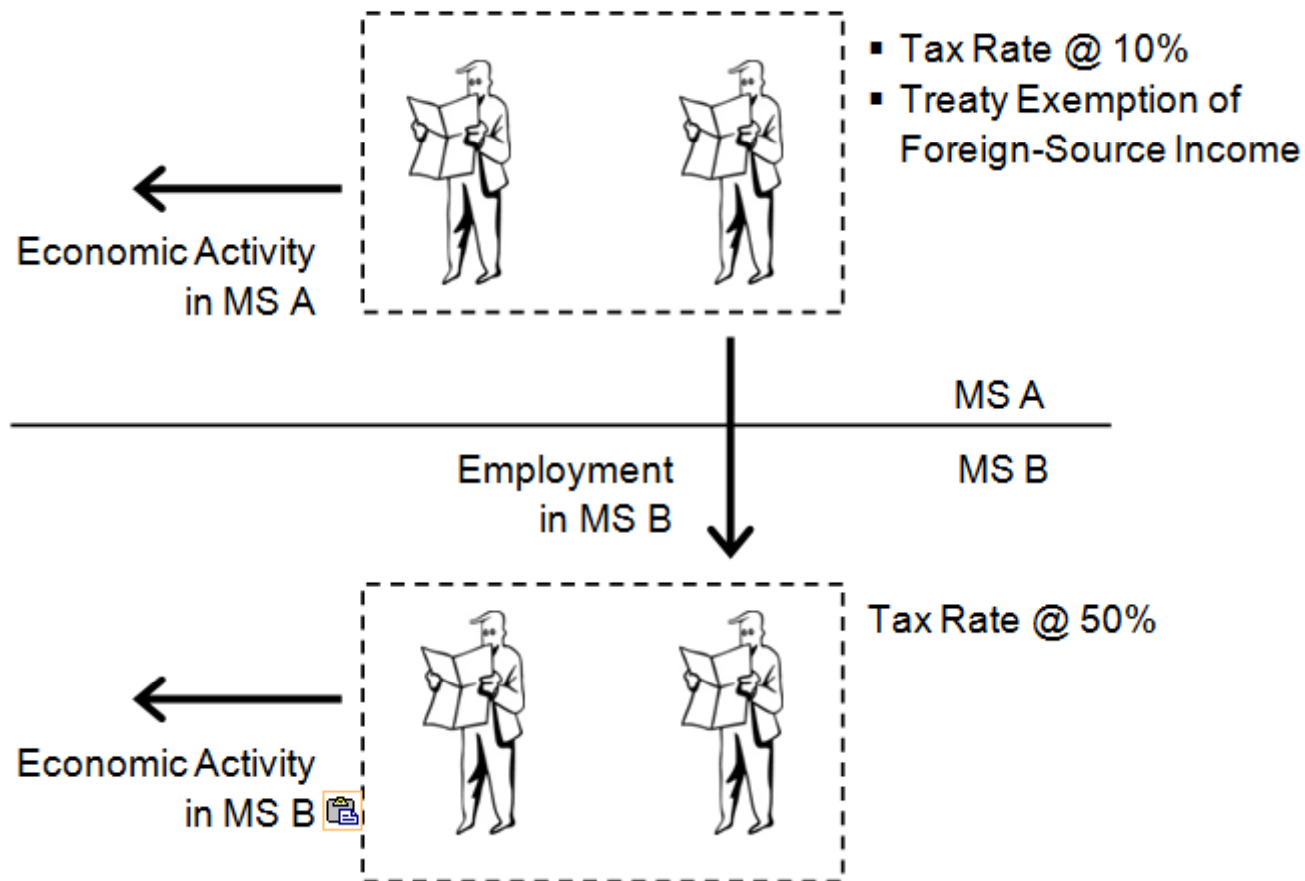


- Different Tax Rates, Tax Bases → Rule of Thumb: Hypothetically equalize all tax systems!
- Distributive Rules in Double Taxation Conventions
- Carve-Out: Disadvantage as compared to purely internal situation?
- Disparities vs (Quasi-)Restriction → Double Burden as Disparity?
- What about "Consistency"?



# Disparities

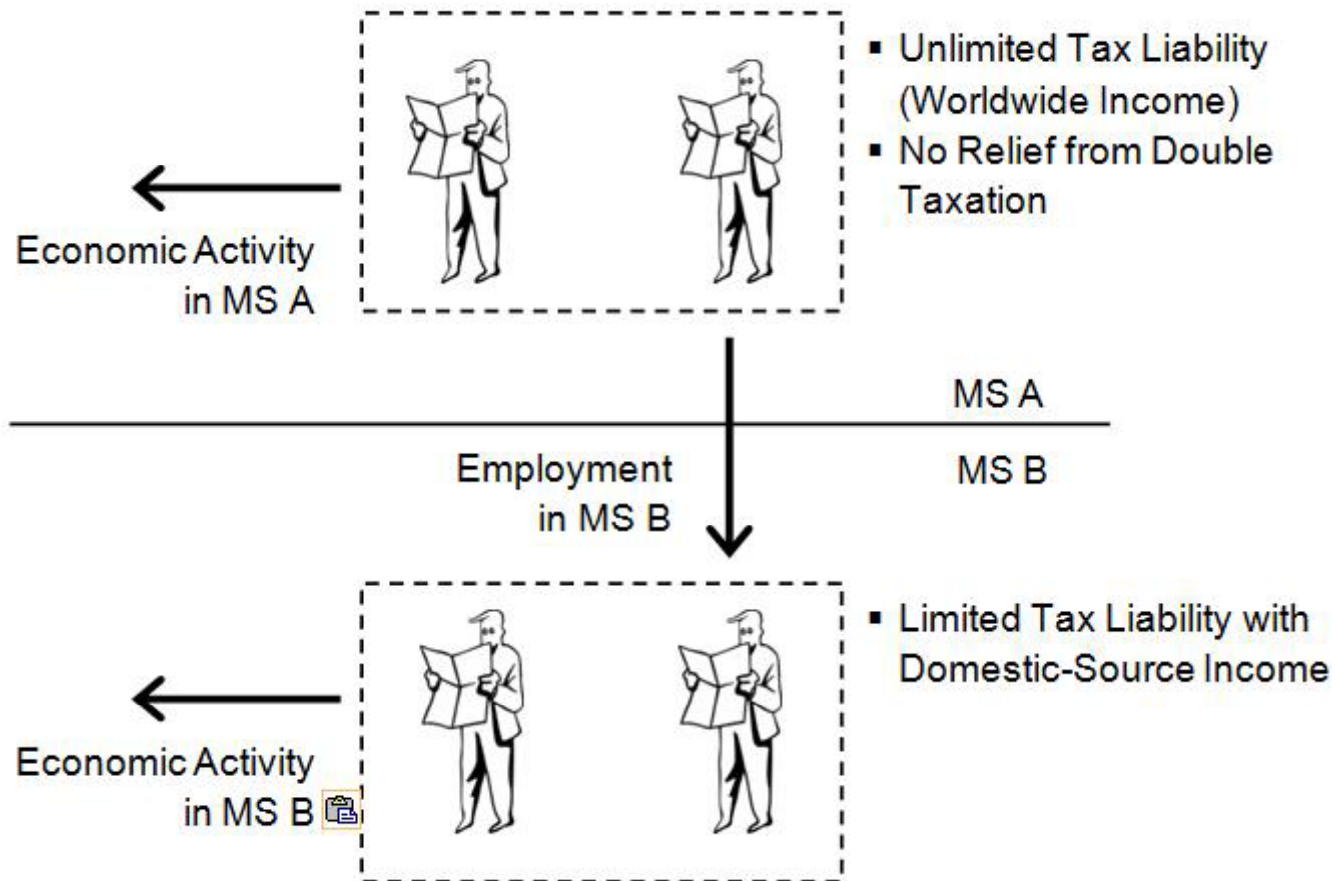
- **Tax Treaty Allocation** — ECJ, 12 May 1998, C-336/96, **Gilly** [1998] ECR I-2793





# Double Taxation: Disparity?

- Double Taxation as “Quasi-Restriction”?





# Double Taxation: Disparity?

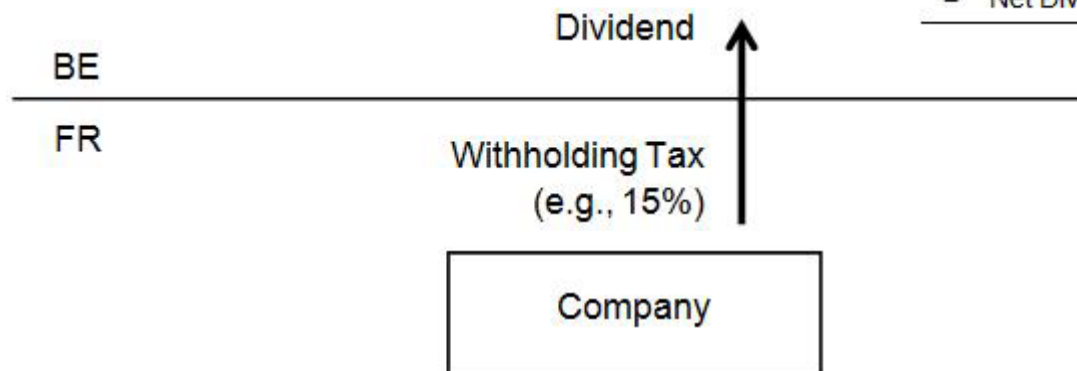
- **Art 293 EC**
  - “Member States shall, so far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals: [...] the ***abolition of double taxation within the Community***, [...]”
- **Restriction?**
  - **European Commission** (OJC 225 E/87 [8. 8. 2000] and Petition in *Schuler*)
  - ECJ Case Law on
    - **Direct Taxation** (*Gilly*, *AMID*, *Schumacker*, *Bosal*, *Merida*, *Safir*, *Lankhorst-Hohorst*)
    - **Indirect Taxation** (e.g., *Schul*, *Lindfors*)
    - **Social Security** (e.g., *Kemmler*, *Guiot*, *Sehrer*)
  - **Issues**
    - Requirement of Harmonization?
    - Principle of Mutual Recognition?
    - Prohibited Double Burden?
    - Equal Treatment of Different Situations?
  - Judicial Self-Restraint? → Swiss Constitution and US Supreme Court Case Law on the *Commerce Clause*



# Double Taxation: Disparity?

- **No Prohibition of Juridical Double Taxation** → ECJ, 14 November 2006, C-513/04, *Kerckhaert-Morres* [2006] ECR I-10967

- Taxation of Foreign and Domestic Dividends @ 25%
- Deduction for Foreign Withholding Tax (no Credit)



	Domestic Dividend	Inbound Dividend
Gross Dividend	100	100
./. Withholding Tax	—	(15)
= Tax Base in Belgium	100	85
./. Tax (25%)	(25)	(21,25)
./. Credit for Foreign Withholding Tax	—	—
= Tax in Belgium	25	21,25
= Overall Tax	25	36,25
= Net Dividend	75	63,75

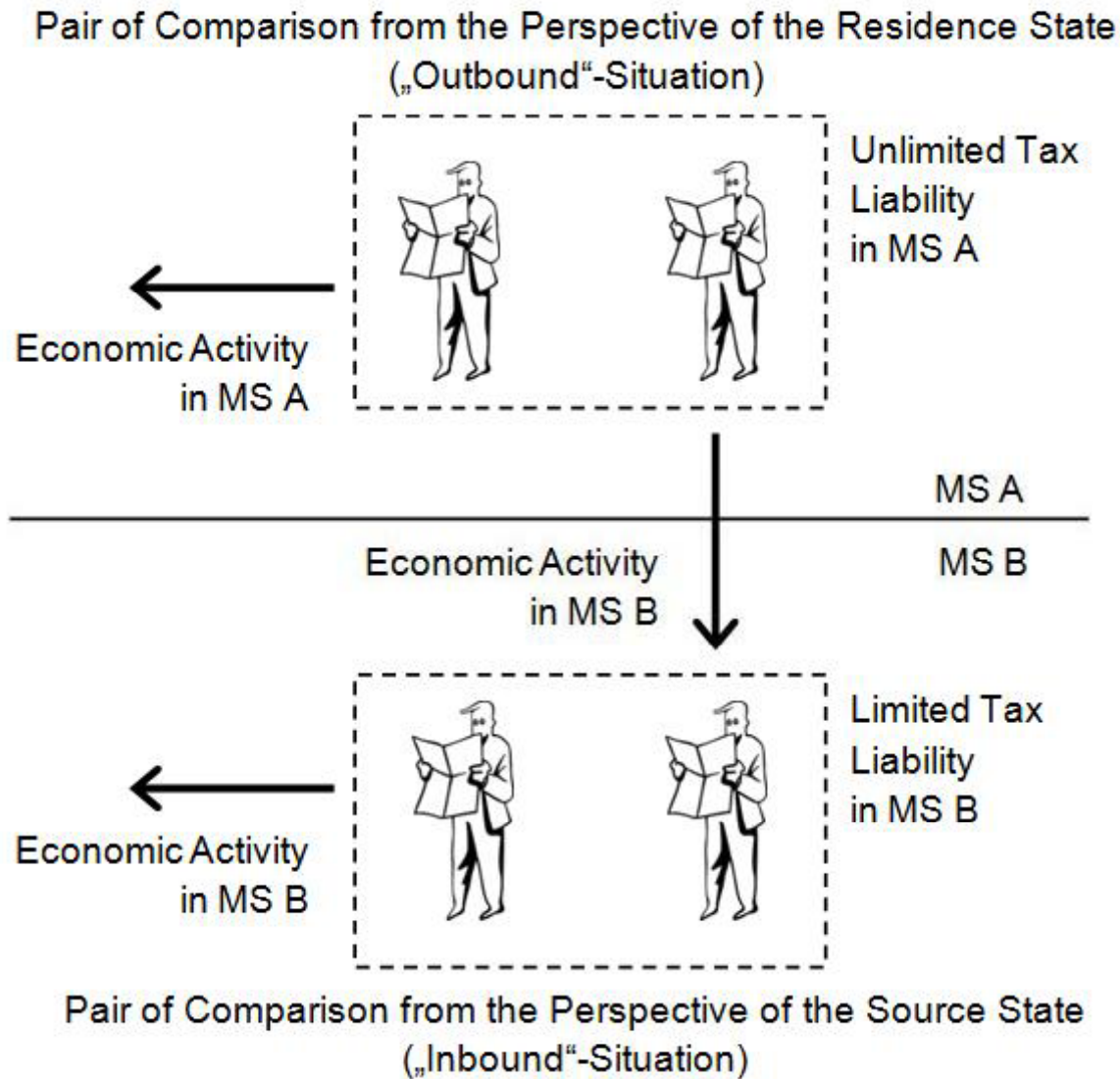


# Double Taxation: Disparity?

- **ECJ**
  - **No Prohibition of Juridical Double Taxation** → ECJ, 14 November 2006, C-513/04, **Kerckhaert-Morres** [2006] ECR I-10967, ECJ, 12 February 2009, C-67/08, **Margarete Block**, and ECJ, 16 July 2009, C-128/08, **Damseaux**
  - Pending Case
    - C-307/08, **Commission v. Belgium**
- ***Which Member State would have to Refrain from Taxation?***
  - Joint Liability of the Member States involved?
  - Identify the Infringing State → Efficiency, Equity, OECD-MC, existing DTC network, Treaty Override
  - Justification and Art 293 EC
  - Procedural Issues



# Inbound Situations

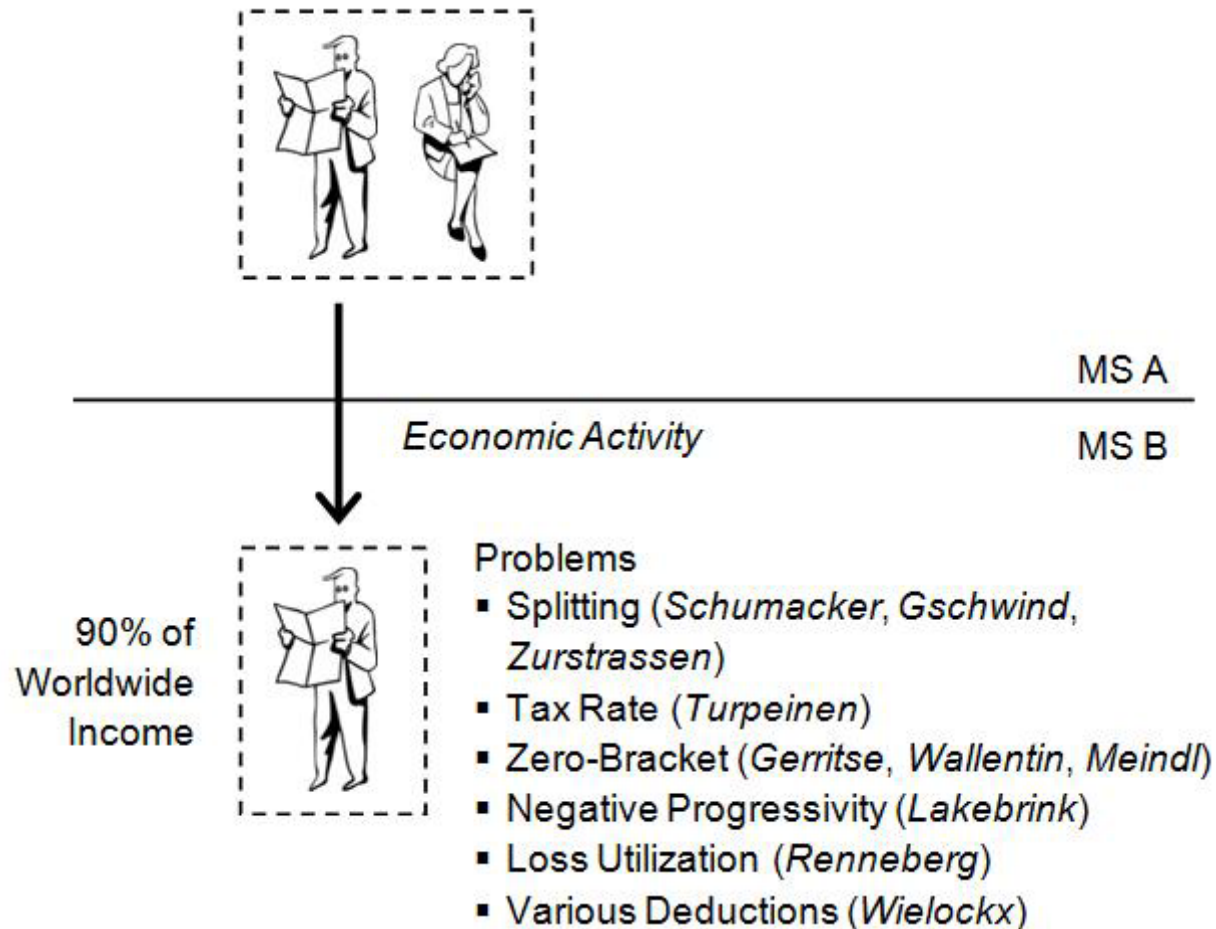






# Inbound Situations: Subjective Ability to Pay

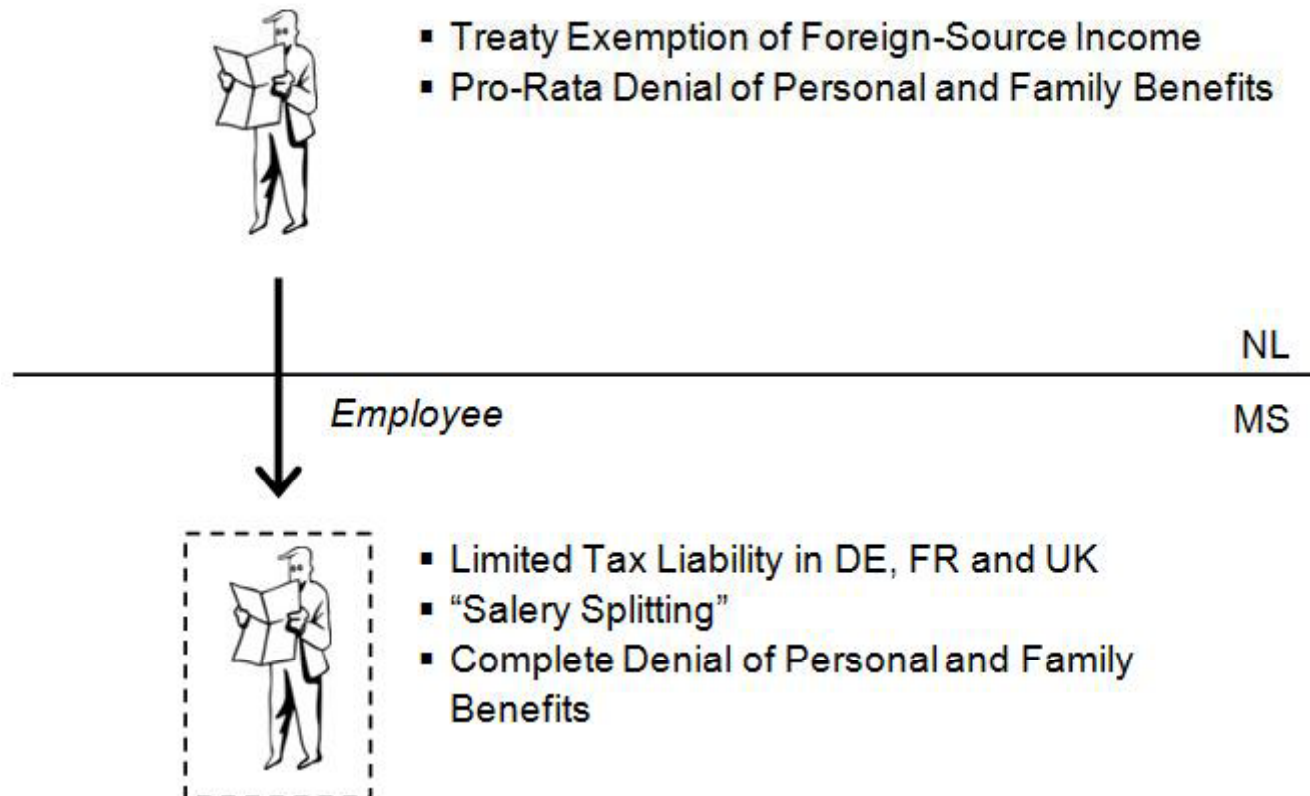
- **Subjective Ability to Pay** — ECJ, 14 February 1995, C-279/93, **Schumacker** [1995]  
ECR I-225 → *Impact of DTCs?*





# Inbound Situations: Subjective Ability to Pay

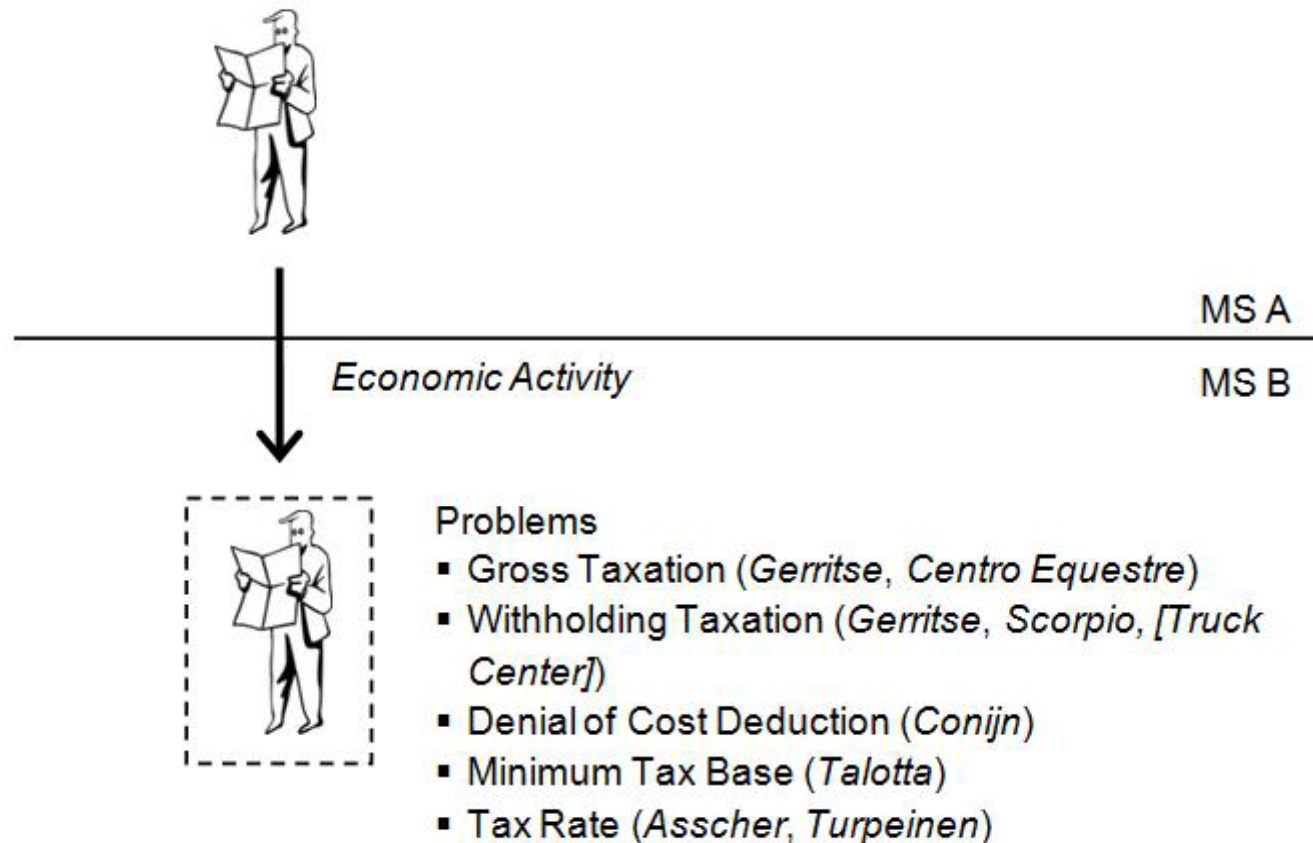
- **Personal and Family Circumstances: Subjective Ability to Pay** — ECJ, 12 December 2002, C-385/00, **De Groot** [2002] ECR I-11819 → **Fractional Taxation?**





# Inbound Situations: Objective Ability to Pay

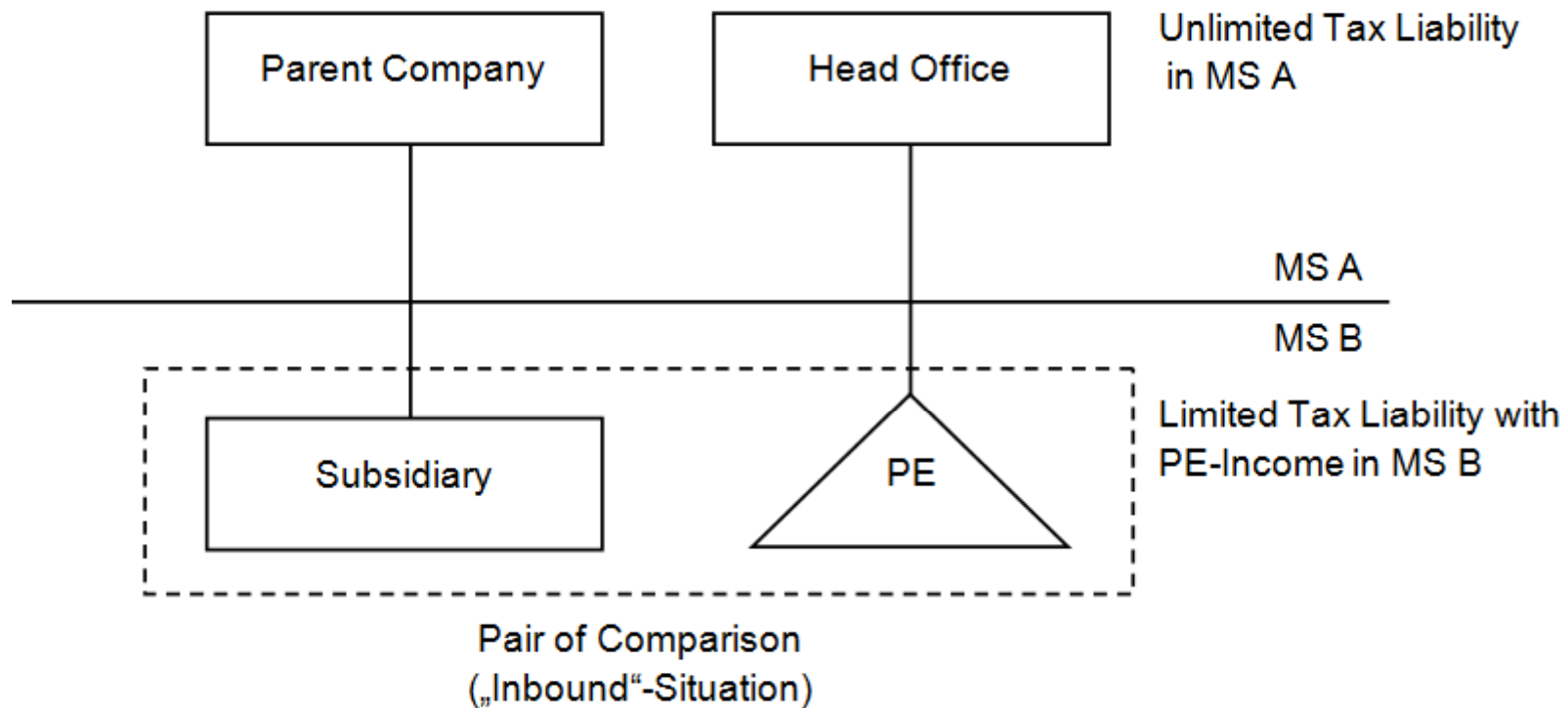
- **Business Expenses: Objective Ability to Pay** — ECJ, 12 June 2003, C-234/01, **Gerritse** [2003] ECR I-5933, and ECJ, 6 July 2006, C-346/04, **Conijn** [2006] ECR I-6137





# Inbound Situations: Companies

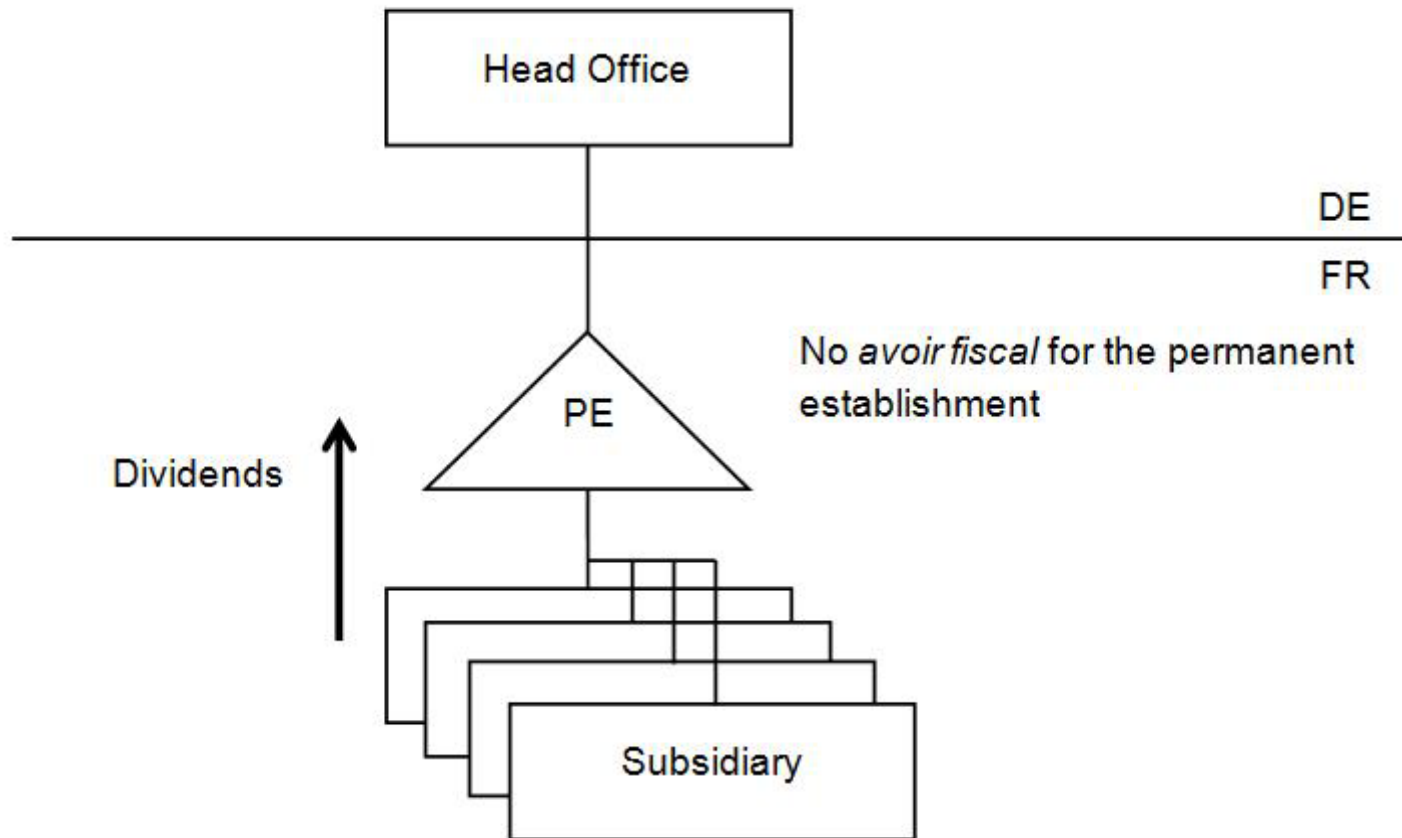
- **Permanent Establishments** — Business Expenses, Tax Benefits, Tax Rate





# Inbound Situations: Companies

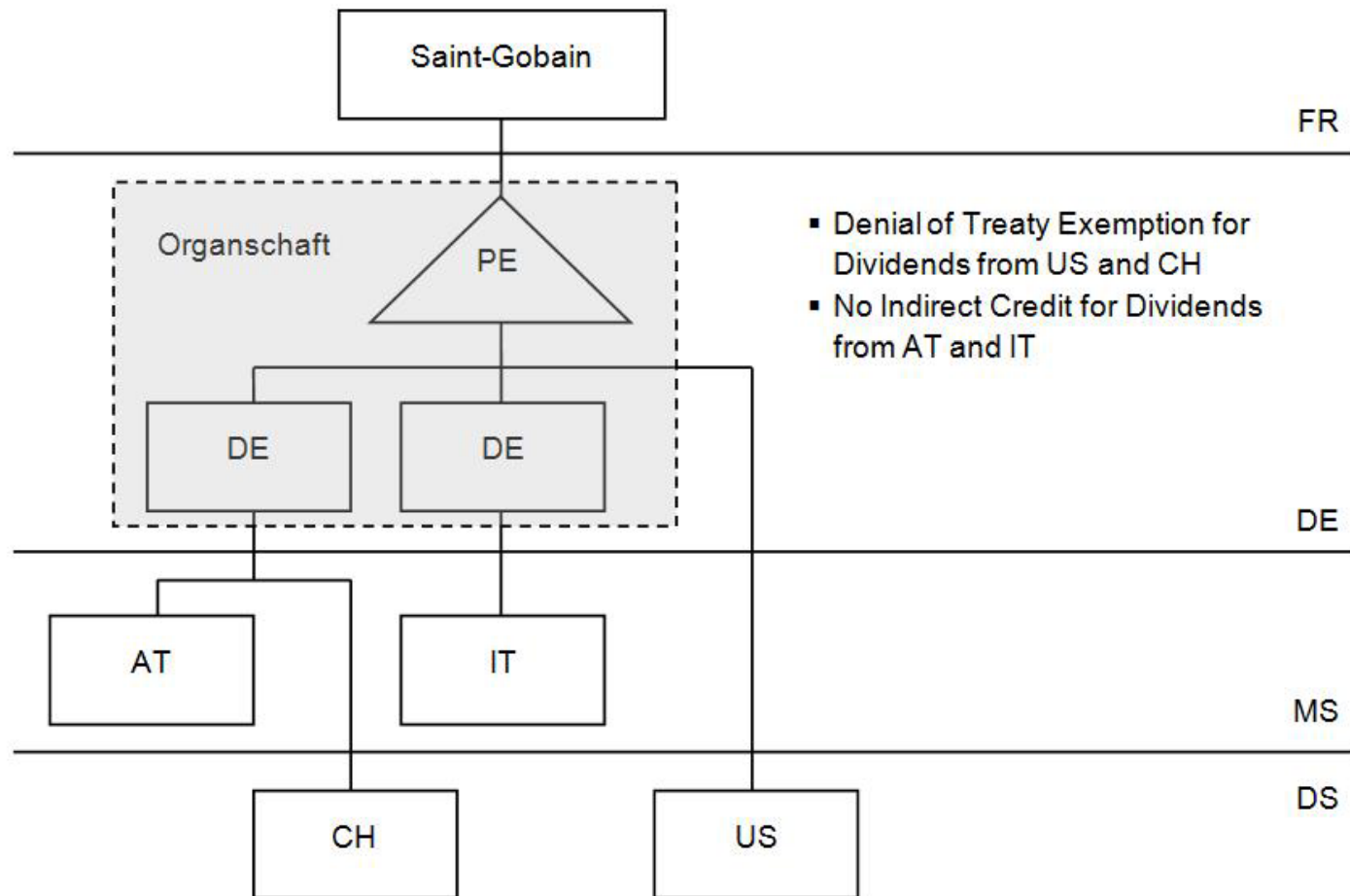
- **Business Expenses and Tax Benefits** — ECJ, 28 January 1986, 270/83, *Commission v. France* („**Avoir fiscal**“) [1986] ECR 273





# Inbound Situations: Companies

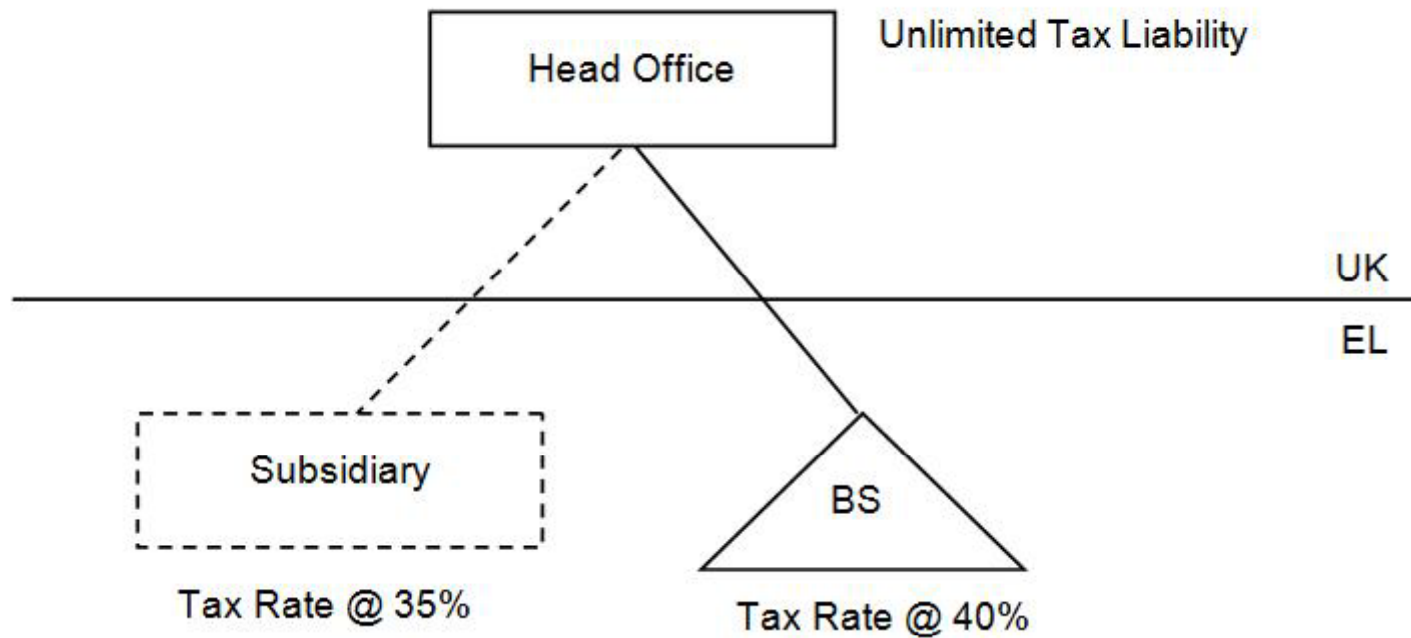
- **Tax Treaty Benefits** — ECJ 21 September 1999, C-307/97, ***Saint-Gobain*** [1999] ERC I-6161





# Inbound Situations: Companies

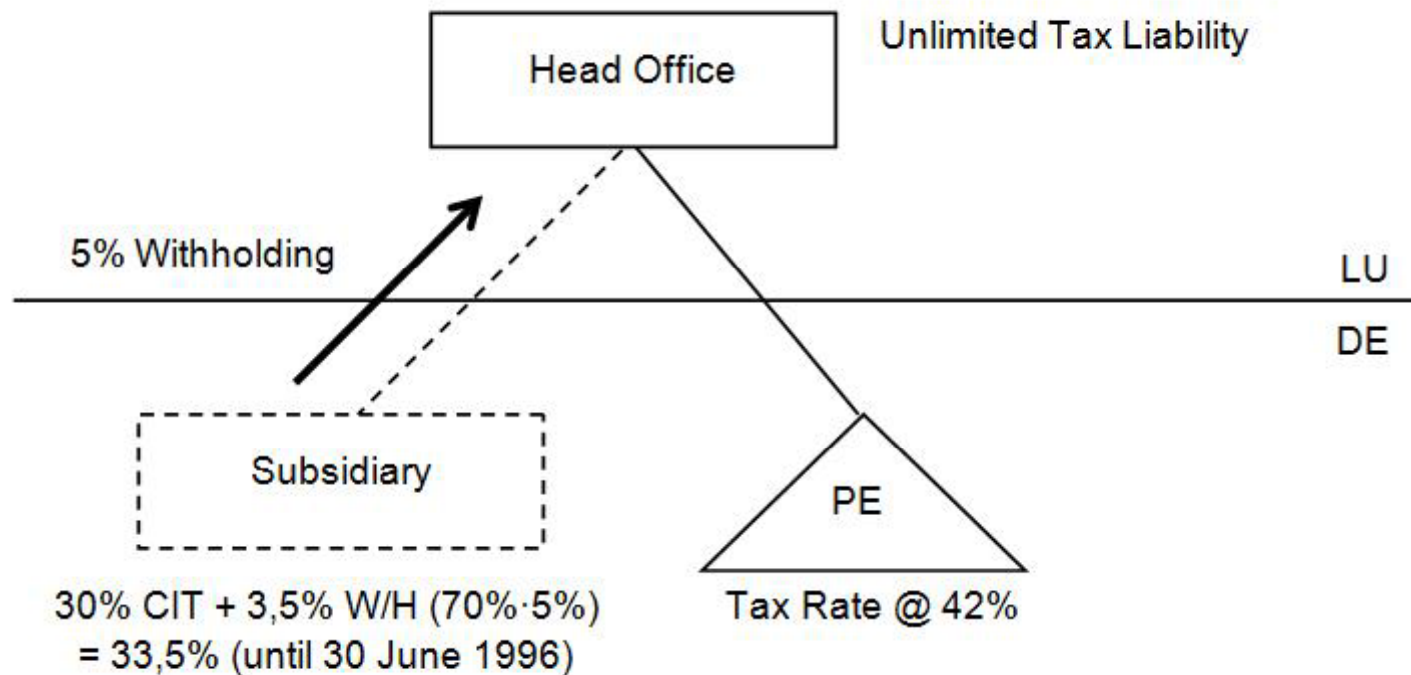
- **Tax Rate** — ECJ, 29 April 1999, C-311/97, *Royal Bank of Scotland* [1999] ECR I-2651





# Inbound Situations: Companies

- **Tax Rate** — ECJ, 23 February 2006, C-253/03, **CLT-UFA** [2006] ECR I-1831 → **Pair of Comparison?**

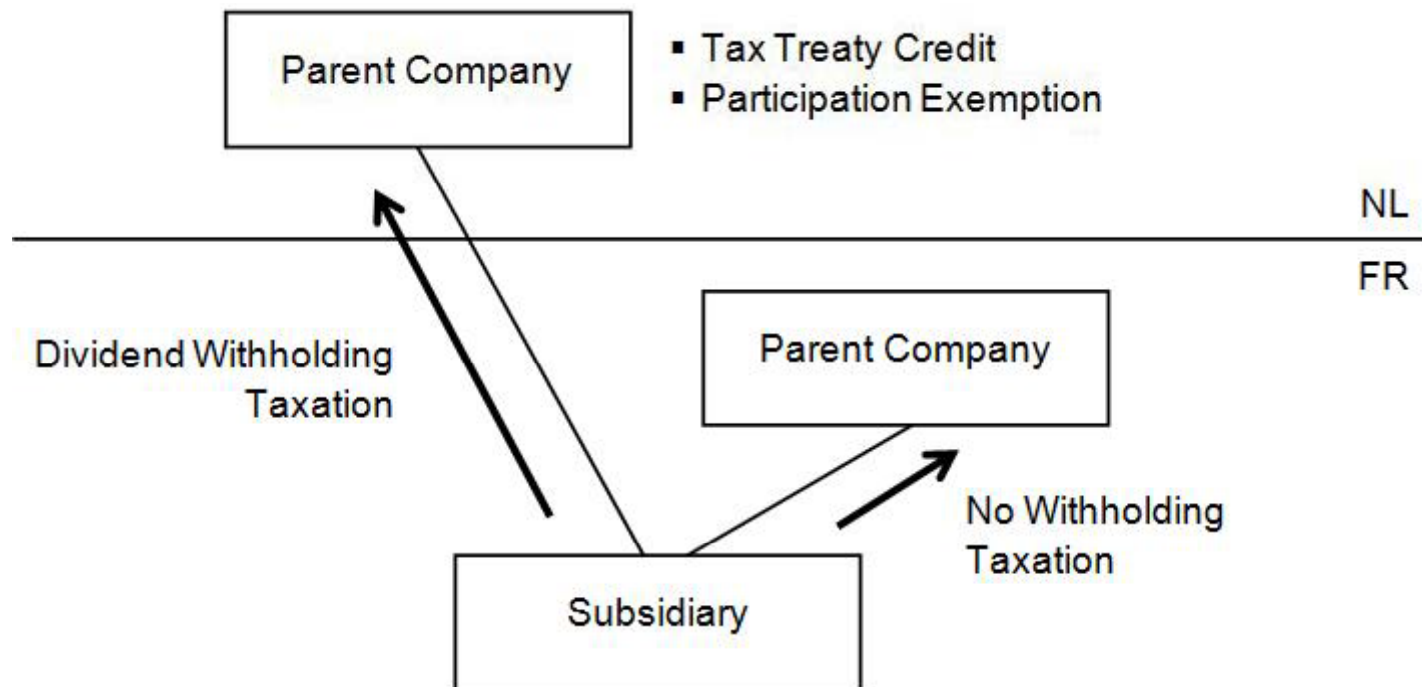






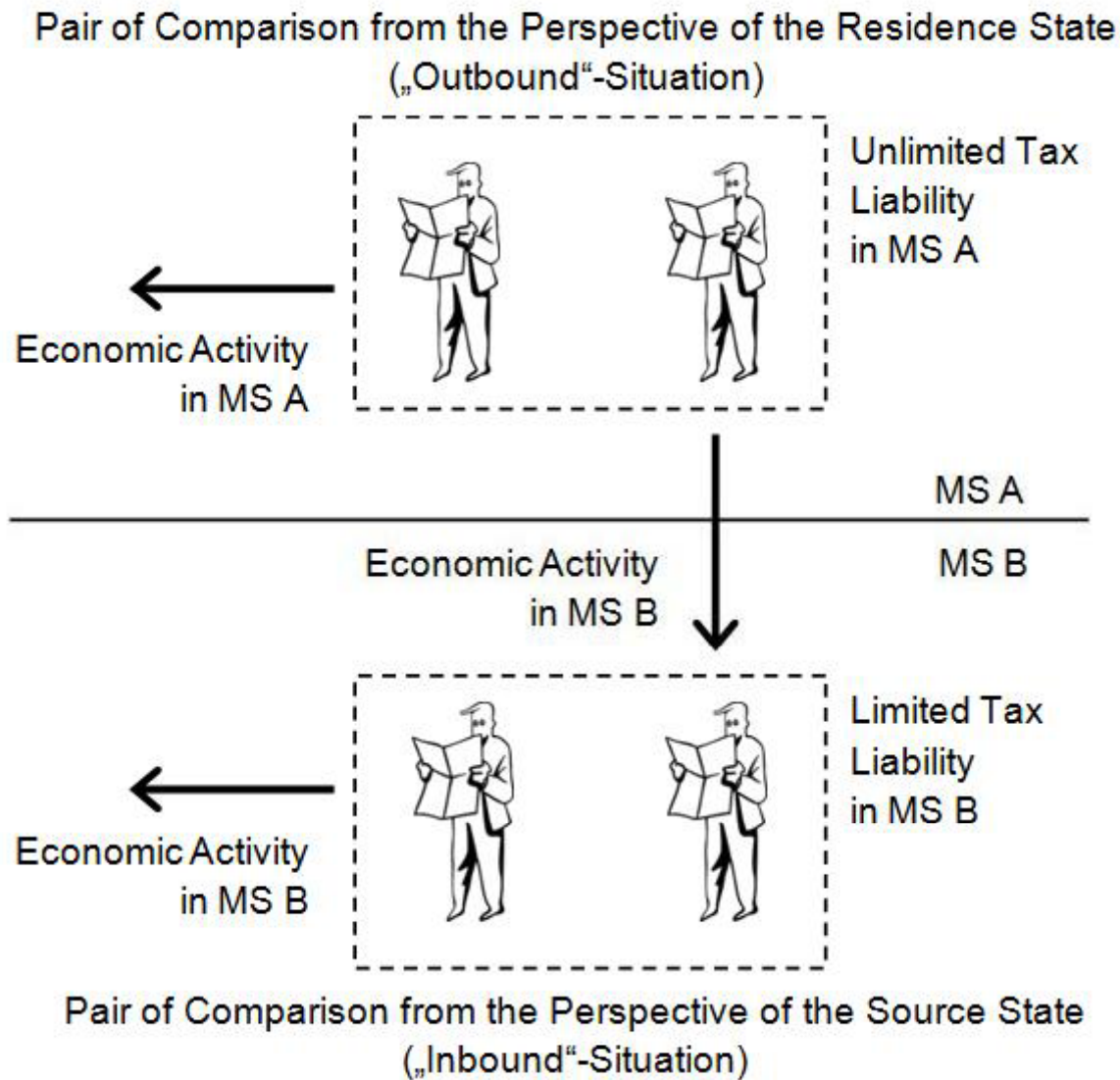
# Inbound Situations: Companies

- **Tax Rate, Economic Double Taxation and Treaty Relief** — “Equality in a Box”, but DTC Obligations → ECJ, 14 December 2006, C-170/05, *Denkavit Internationaal*, [2006] ECR I-11949, and ECJ, 8 November 2007, C-379/05, *Amurta* [2007] ECR I-9569 → **Cross-Border Compensation?**





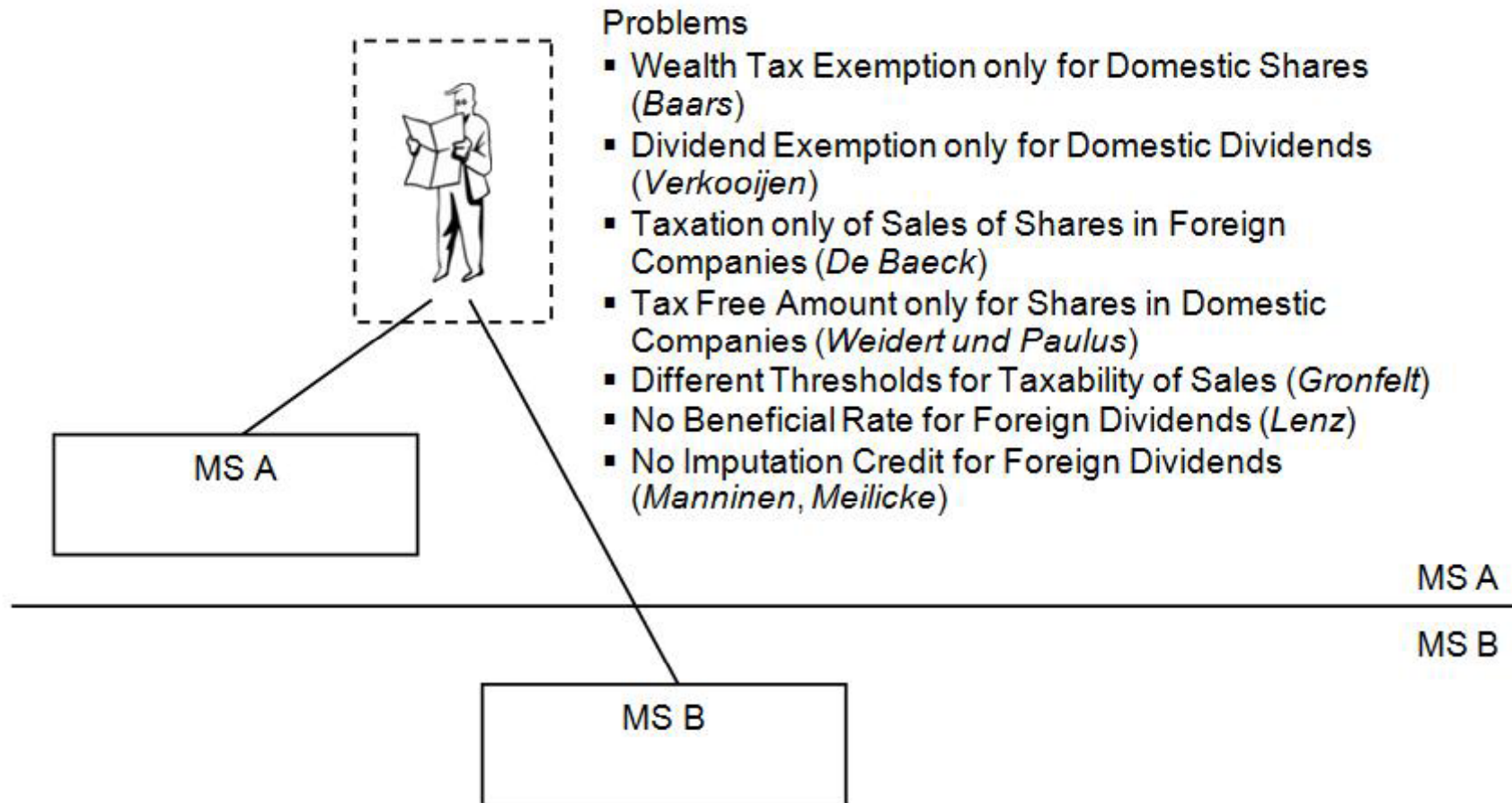
# Outbound Situations





# Outbound Situations

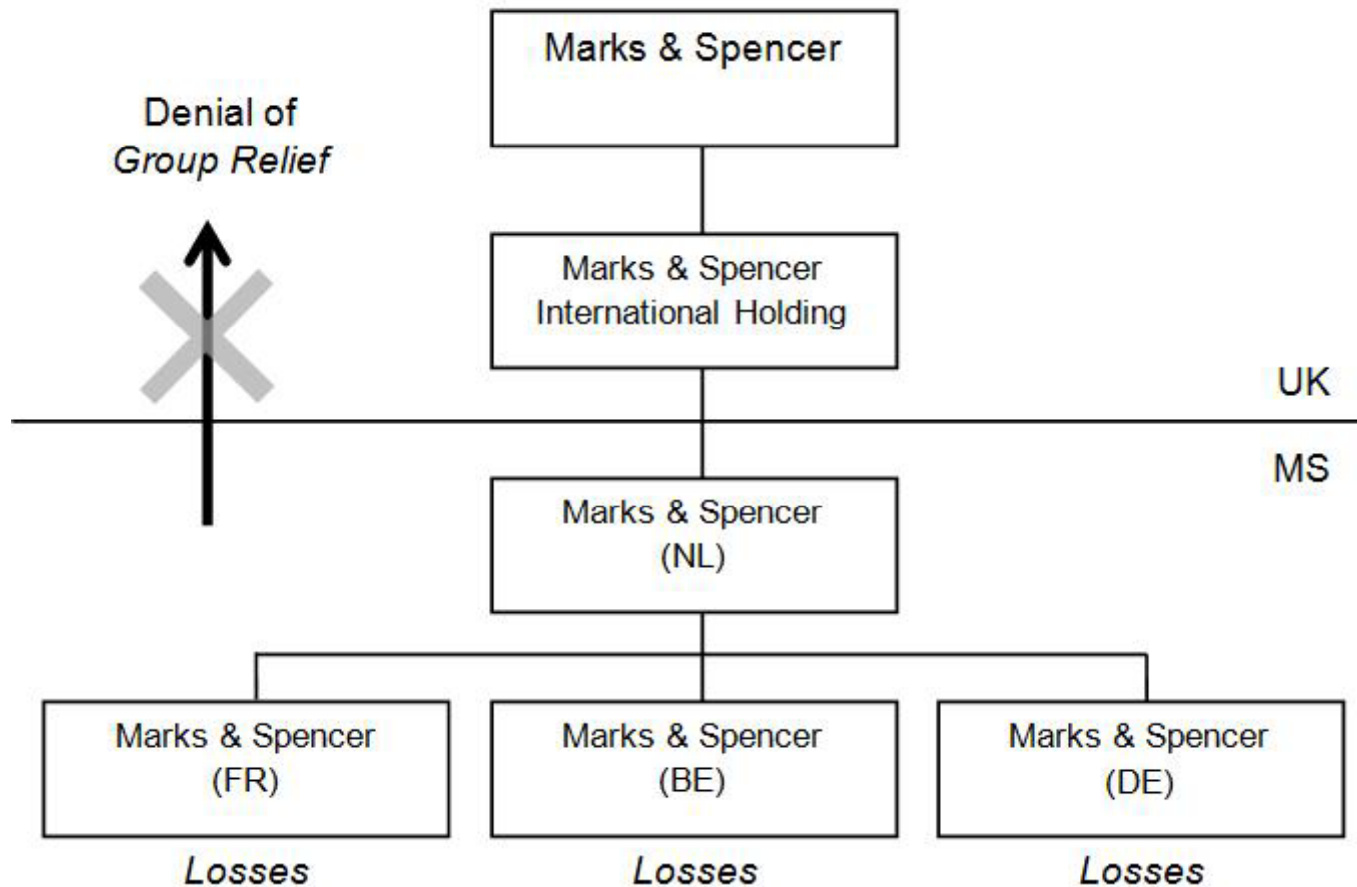
- Holdings in Foreign Companies





# Outbound Situations

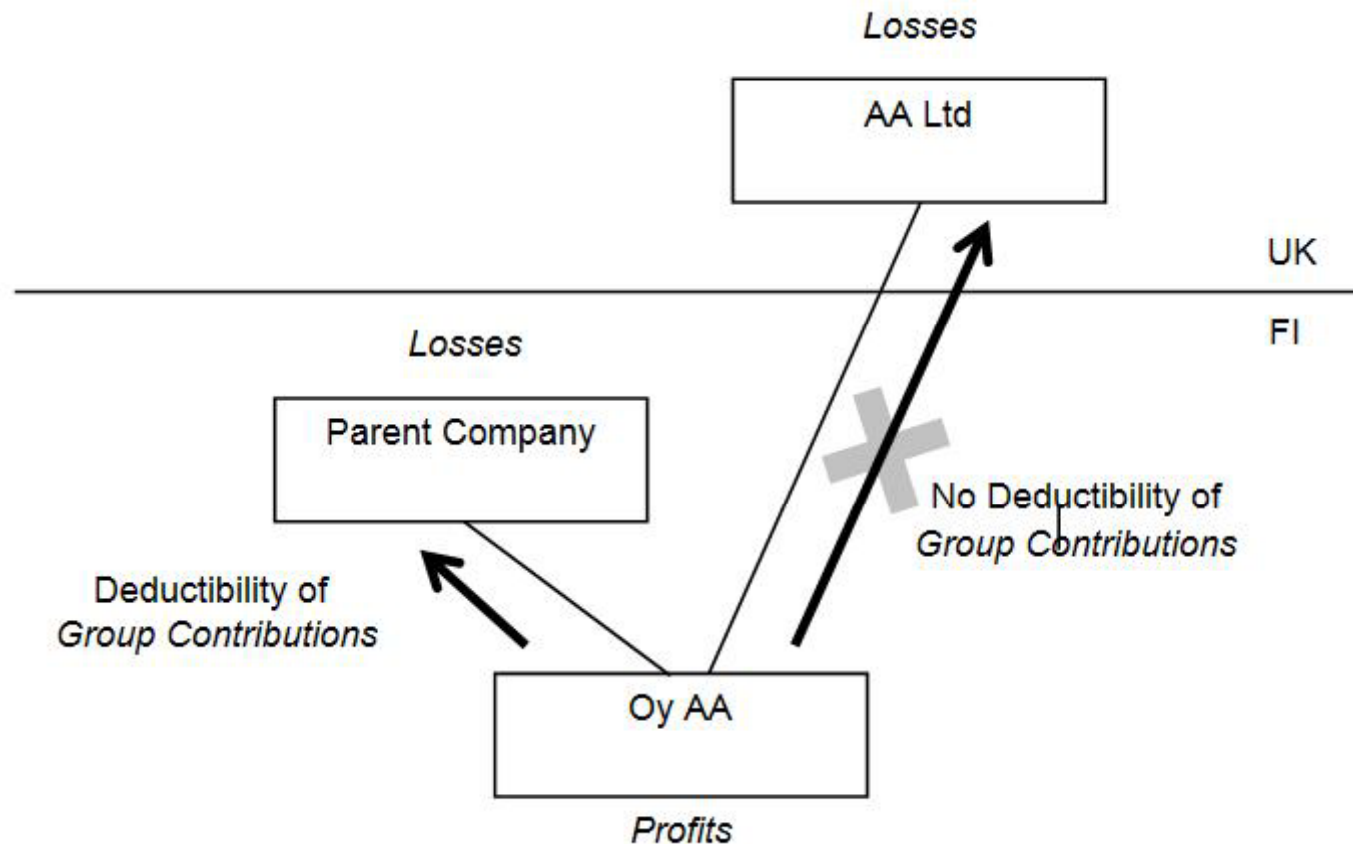
- **Cross-Border Loss Relief and Subsidiaries** — ECJ, 13 December 2005, C-446/03, *Marks & Spencer* [2005] ECR I-10837





# Outbound Situations

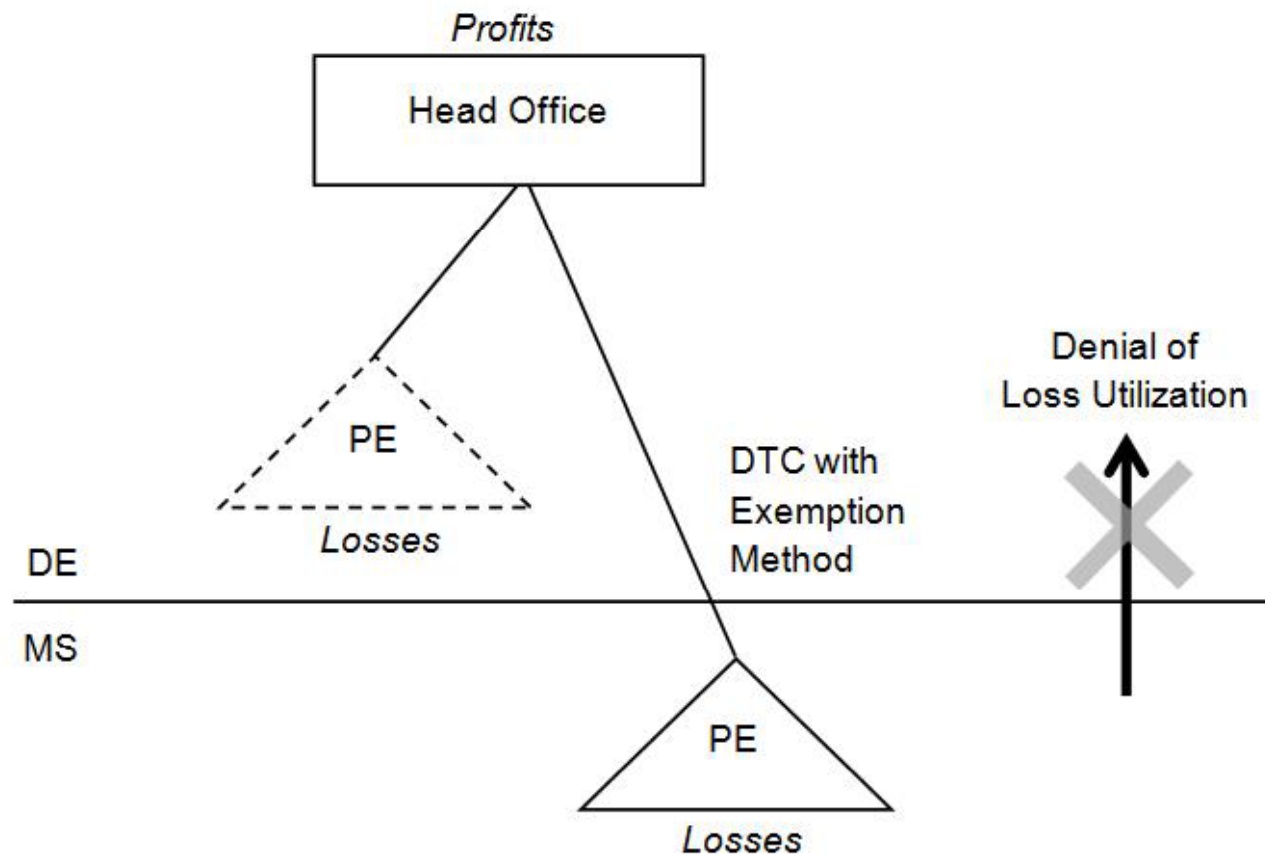
- **Cross-Border Loss Relief and Subsidiaries** — ECJ, 18 July 2007, C-231/05, **Oy AA** [2007] ECR I-6373





# Outbound Situations

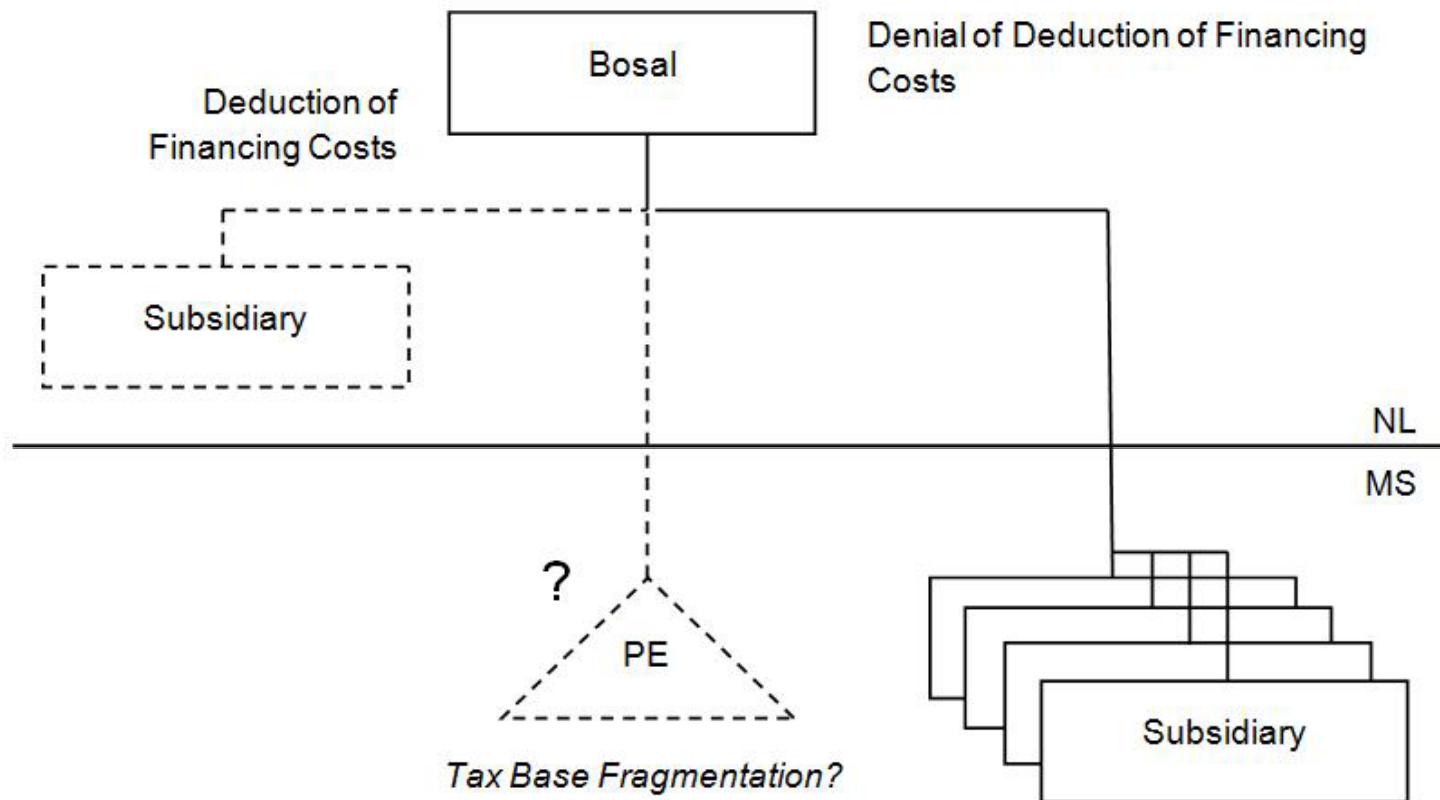
- **Cross-Border Loss Relief and Permanent Establishments** — ECJ, 15 May 2008, C-414/06, *Lidl Belgium*
- **Recapture of Losses** — ECJ, 23 October 2008, *Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt GmbH*





# Outbound Situations

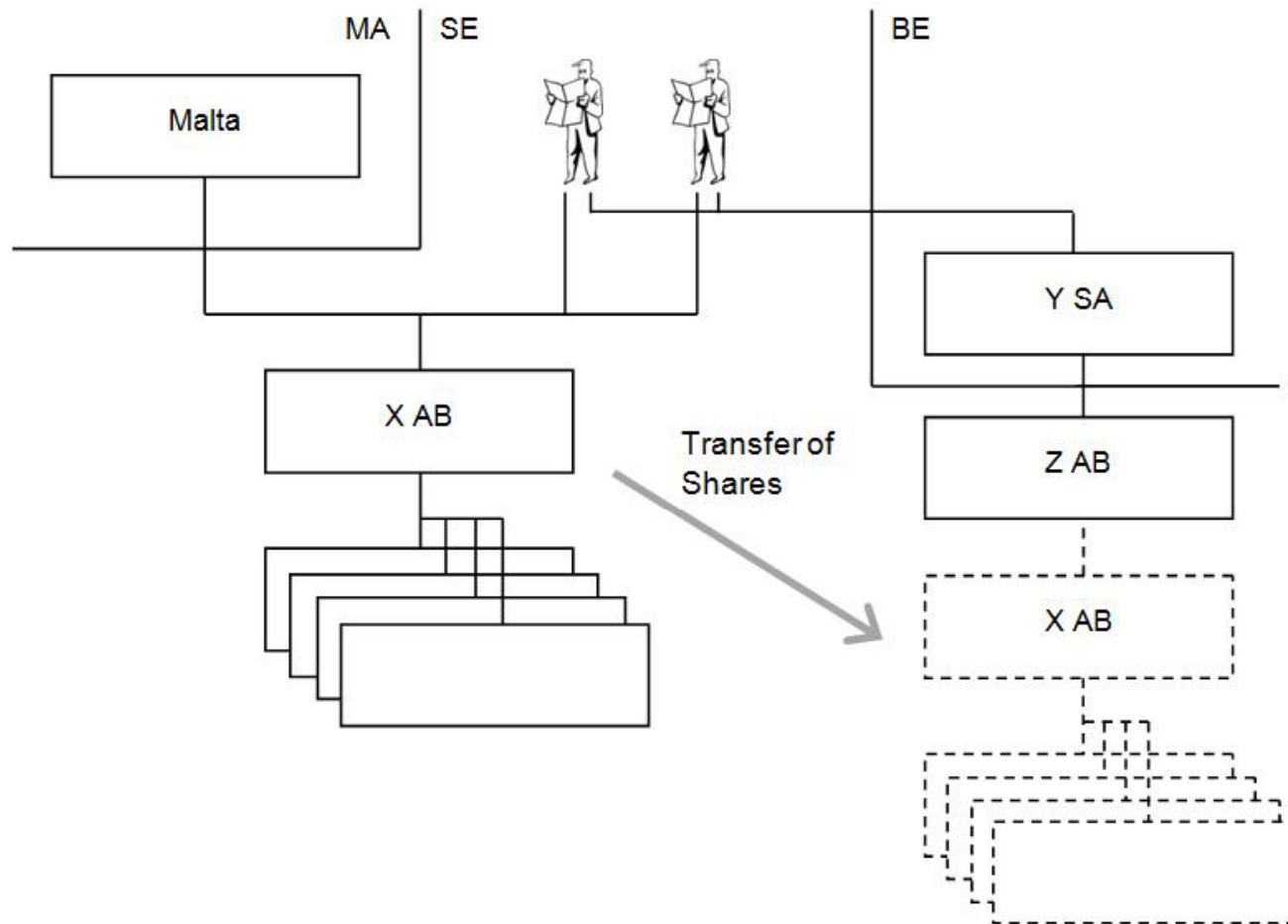
- **Financing Costs and Exempt Income** — ECJ, 18 September 2003, C-168/01, **Bosal** [2003] ECR I-9409, and ECJ, 23 February 2006, C-471/04, **Keller Holding** [2006] ECR I-2107 → **Symmetry and “Tax Base Fragmentations”?**





# Outbound Situations

- **Exit Taxation: Transfer of Shares and Nonrecognition Treatment** — ECJ, 21 November 2002, C-436/00, *X and Y* [2002] ECR I-10829

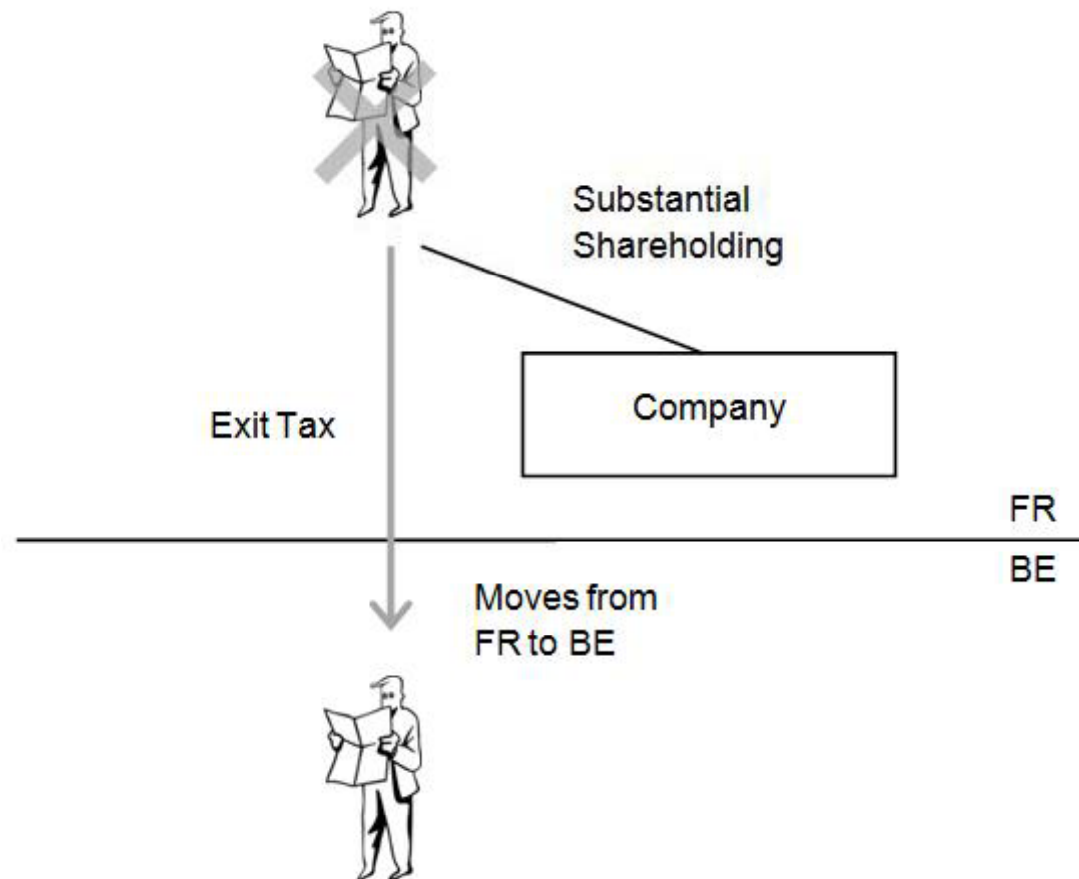






# Outbound Situations

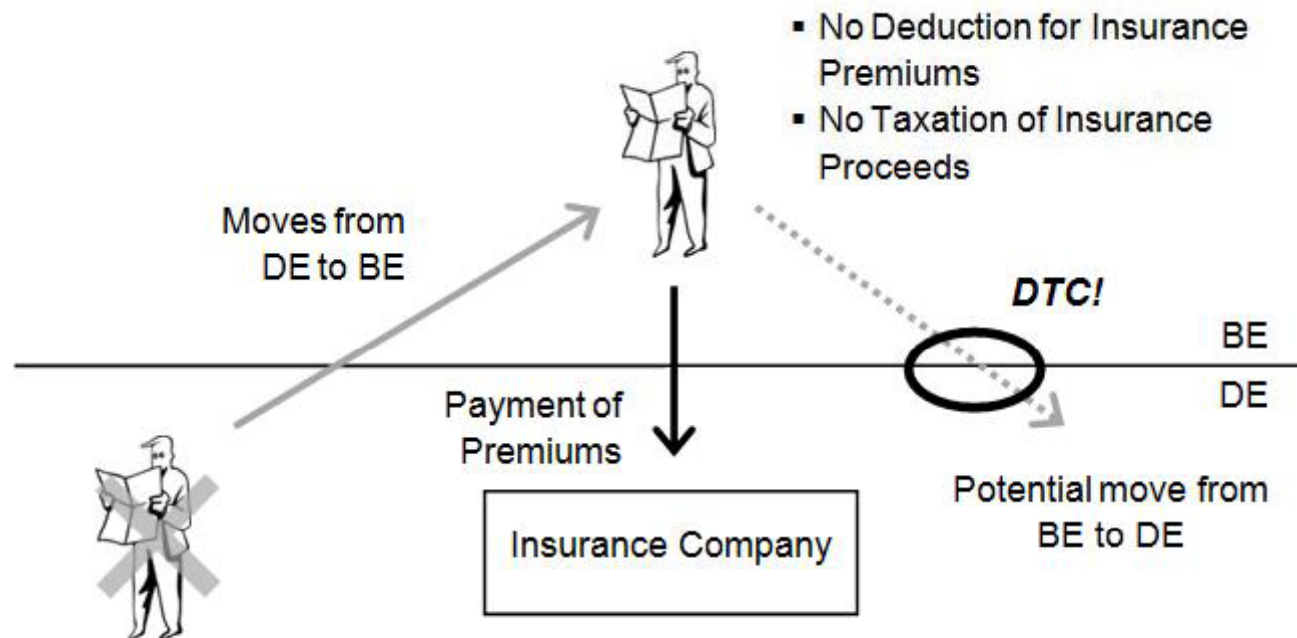
- **Exit Taxation: Shares Held by Individuals** — ECJ, 11 March 2004, C-9/02, *Hughes de Lasteyrie du Saillant* [2004] ECR I-2409, and ECJ, 7 September 2006, C-470/04, *N* [2006] ECR I-7409





# Justifications

- **Coherence of the Tax System** — ECJ, 28 January 1992, C-204/90, **Bachmann** [1992] ECR I-249, and ECJ 28 January 1992, C-300/90, **Commission v. Belgium** [1992] ECR I-305 → **Macro-Coherence!** (ECJ, 11 August 1995, C-80/94, **Wielockx** [1995] ECR I-2493)



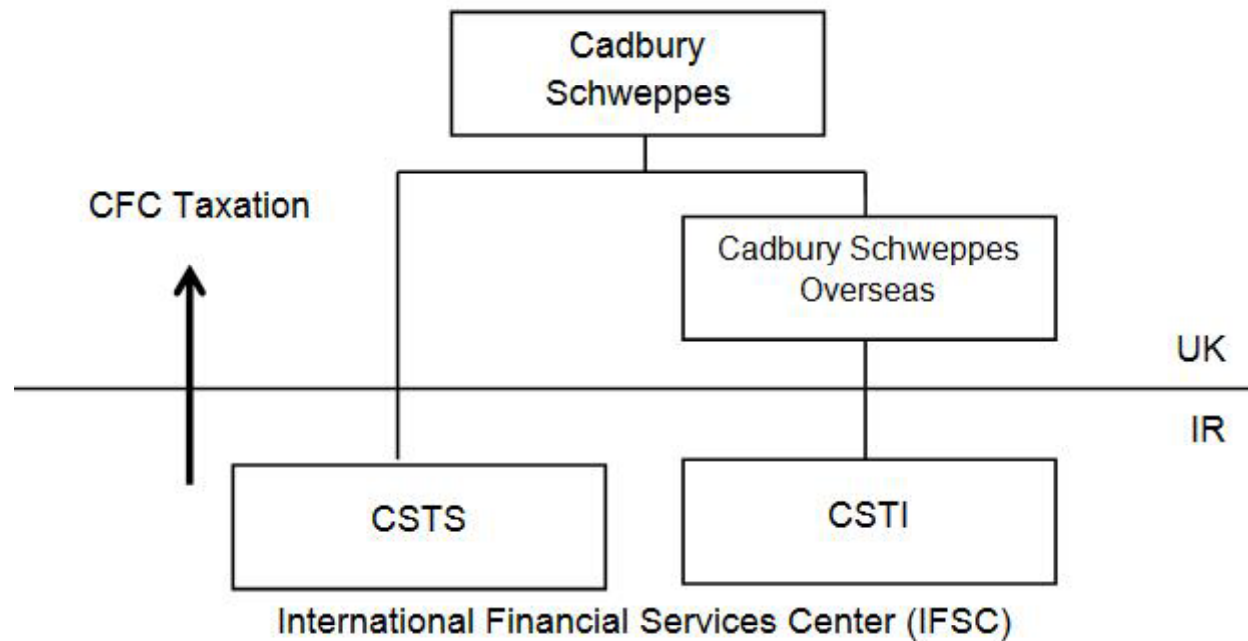


- 
- The diagram illustrates the Utilization of Losses and Recapture. A horizontal line separates the Domestic Excess (DE) region above from the After Tax (AT) region below. In the DE region, a box labeled 'Head Office' is connected to a dashed triangle labeled 'PE' with 'Losses' below it. In the AT region, a solid triangle labeled 'PE' with 'Losses' below it is connected to the 'Head Office' box. An arrow points upwards from the AT side, labeled 'Utilization of Losses and Recapture'.



# Justifications

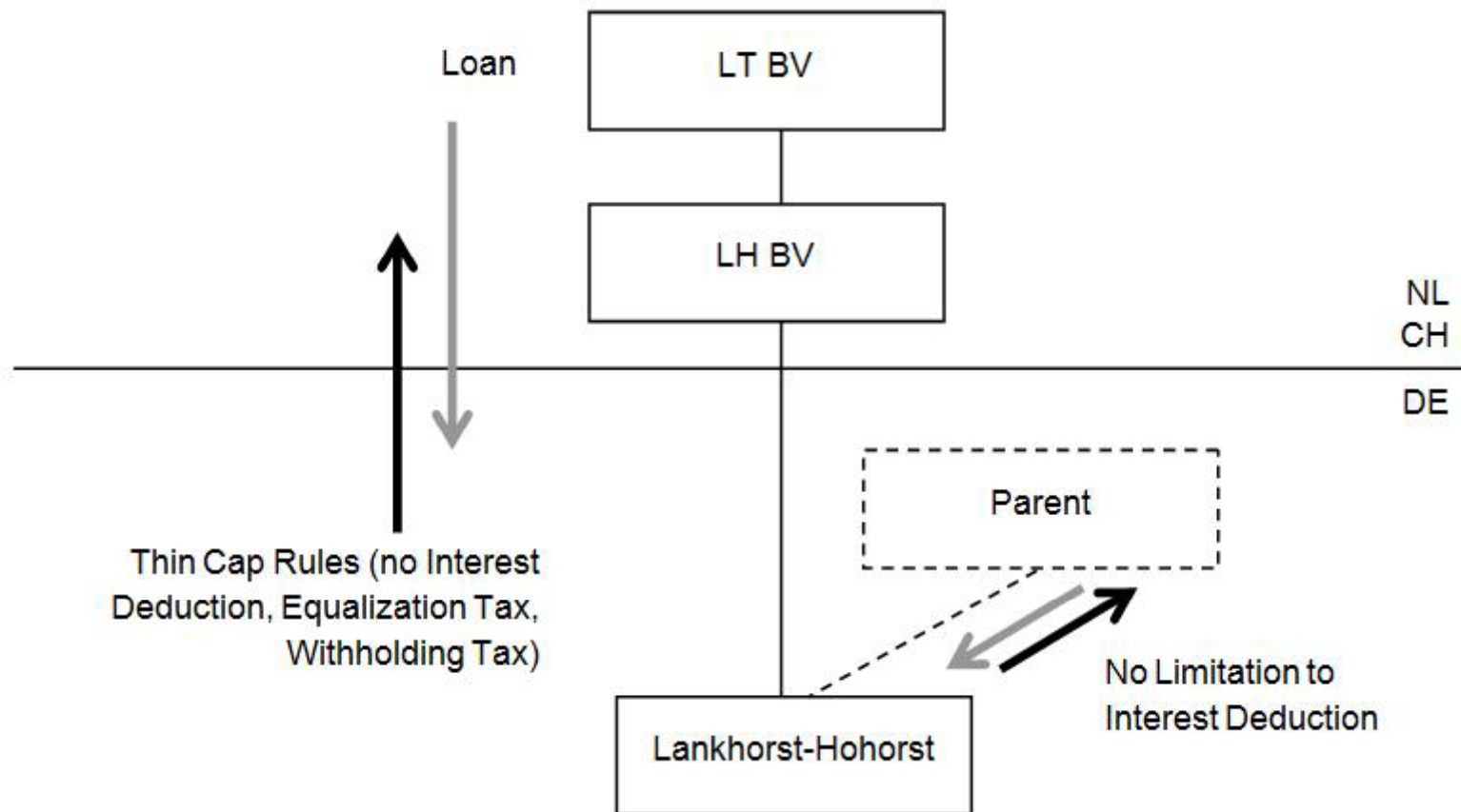
- **Anti-Avoidance: CFC Rules** — ECJ, 12 September 2006, C-196/04, **Cadbury Schweppes** [2006] ECR I-7995





# Justifications

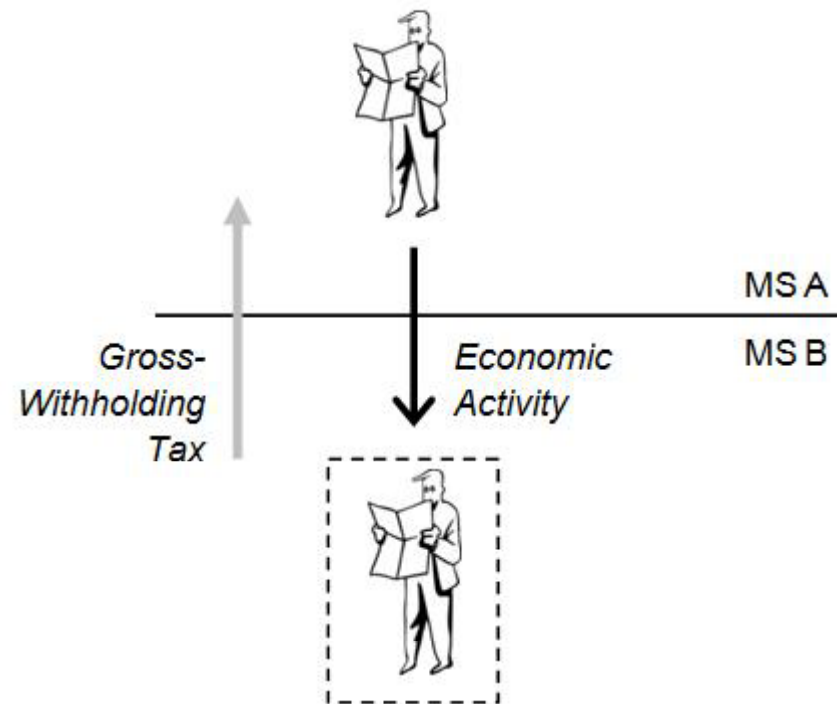
- **Anti-Avoidance: Thin Cap Rules** — ECJ, 12 December 2002, C-324/00, *Lankhorst-Hohorst* [2002] ECR I-11779, and ECJ, 13 March 2007, C-524/04, *Thin Cap Group Litigation* [2007] ECR I-2107





# Justifications

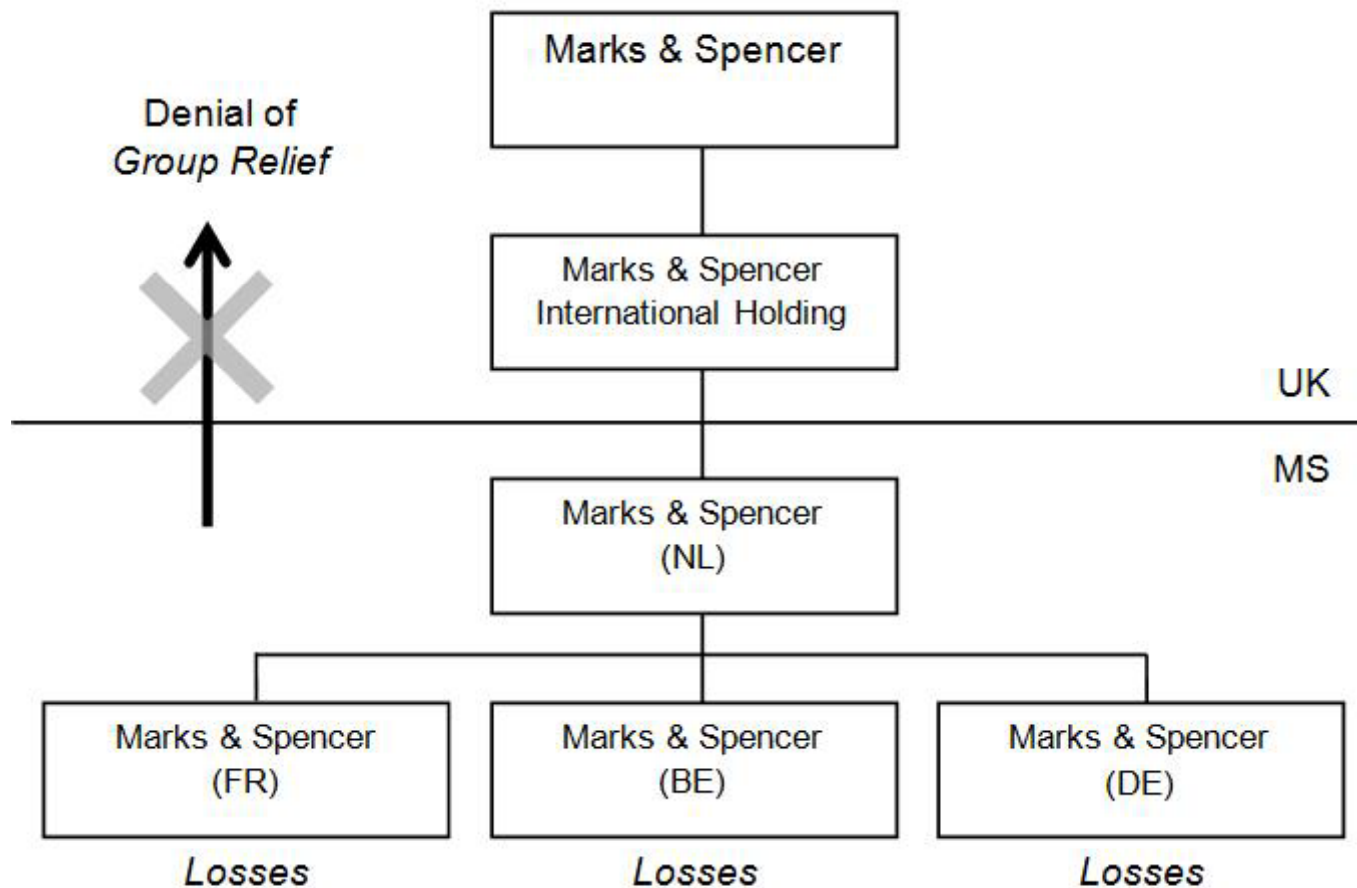
- **Effectiveness of Tax Collection** — ECJ, 3 October 2006, C-290/04, **Scorpio** [2006] ECR I-9461 → **Impact of Recovery Directive?**





# Justifications

- **Balanced Allocation of Taxing Rights (“Inter-Nation Equity”)** — ECJ, 5 July 2005, C-376/03, *D* [2005] ECR I-5821, and ECJ, 13 December 2005, C-446/03, *Marks & Spencer* [2005] ECR I-10837





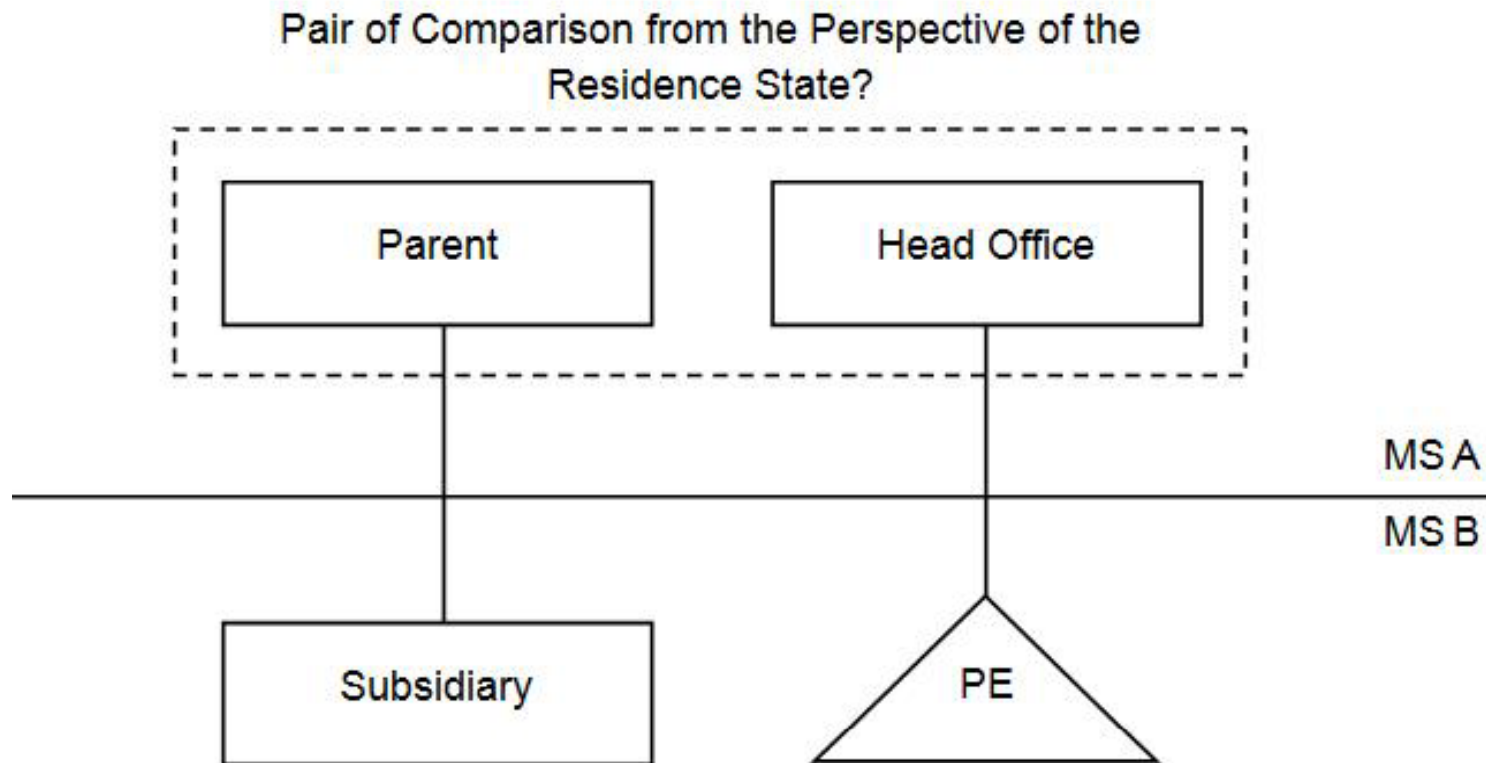
# Recent Dogmatic Issues

- **Horizontal Discrimination**
  - **Neutrality of the Legal Form**
  - **“Most Favored Nation Treatment”**
- **Symmetry and Tax Base Fragmentations**
- **Internal Consistency versus Discrimination**
- **“Single Country” versus “Overall Approach”**
  - **Factual Situations and Comparability** (*Schumacker, Marks & Spencer, Manninen*)
  - **Cross-Border Compensation**





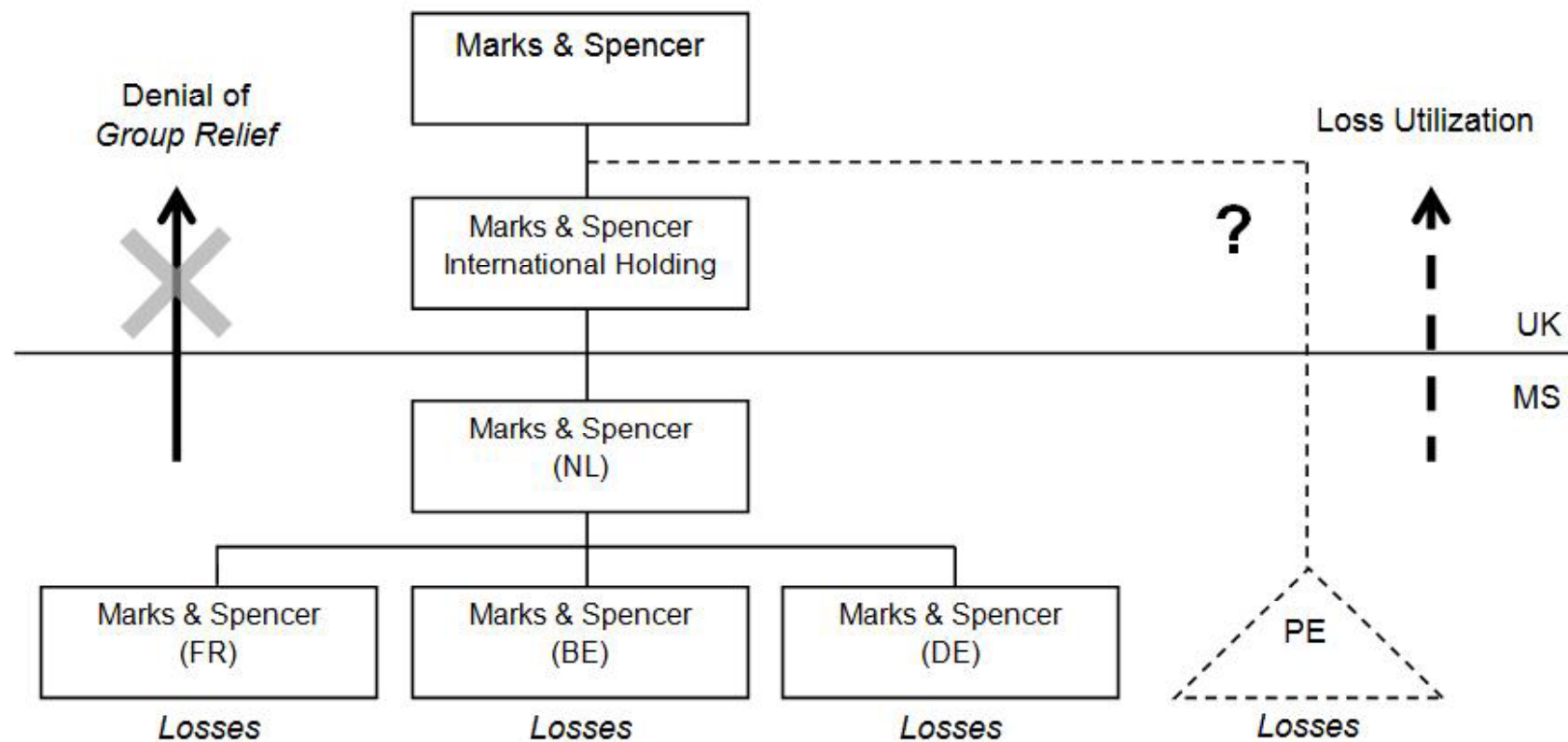
# Recent Issues: Neutrality of the Legal Form





# Recent Issues: Neutrality of the Legal Form

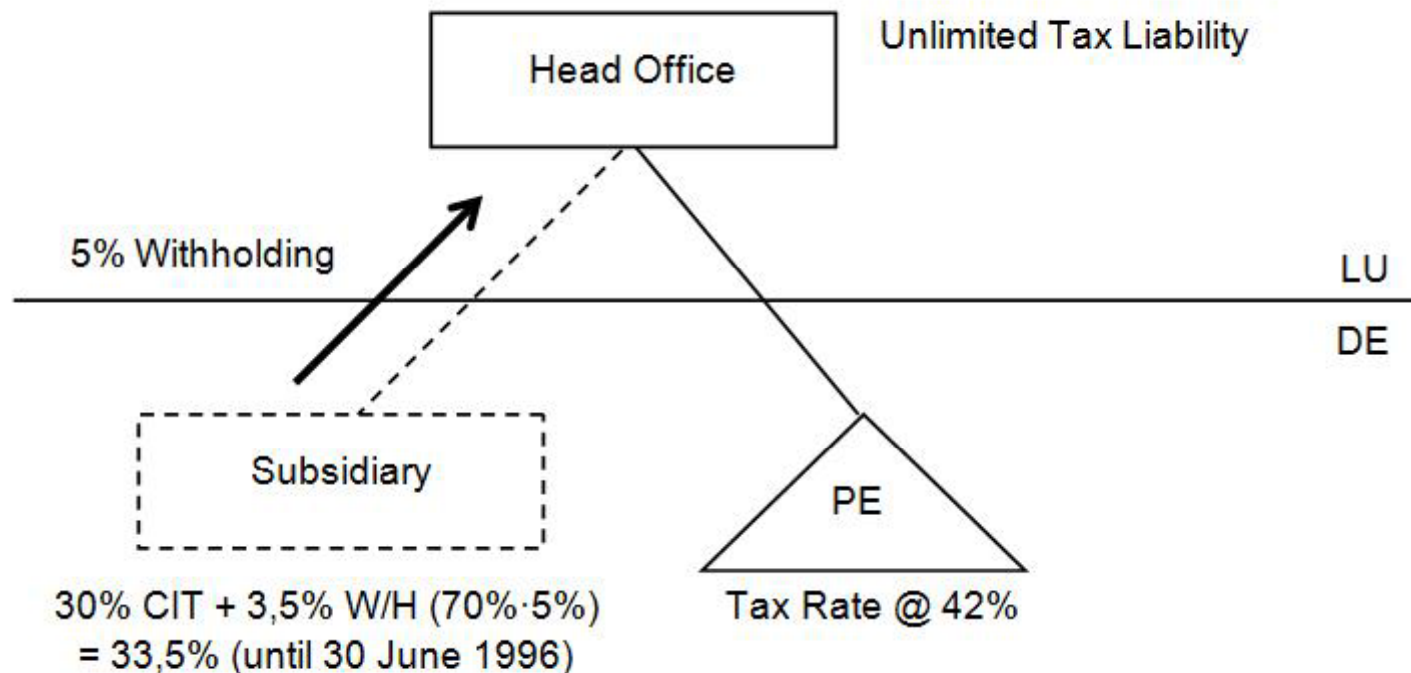
- **Comparison Between Foreign PE and Foreign Subsidiary** → Rejected (?) by ECJ, 13 December 2005, C-446/03, **Marks & Spencer** [2005] ECR I-10837





# Recent Issues: Neutrality of the Legal Form

- **Comparison Between Foreign PE and Foreign Subsidiary** → Accepted (?) by ECJ, 23 February 2006, C-253/03, **CLT-UFA** [2006] ECR I-1831





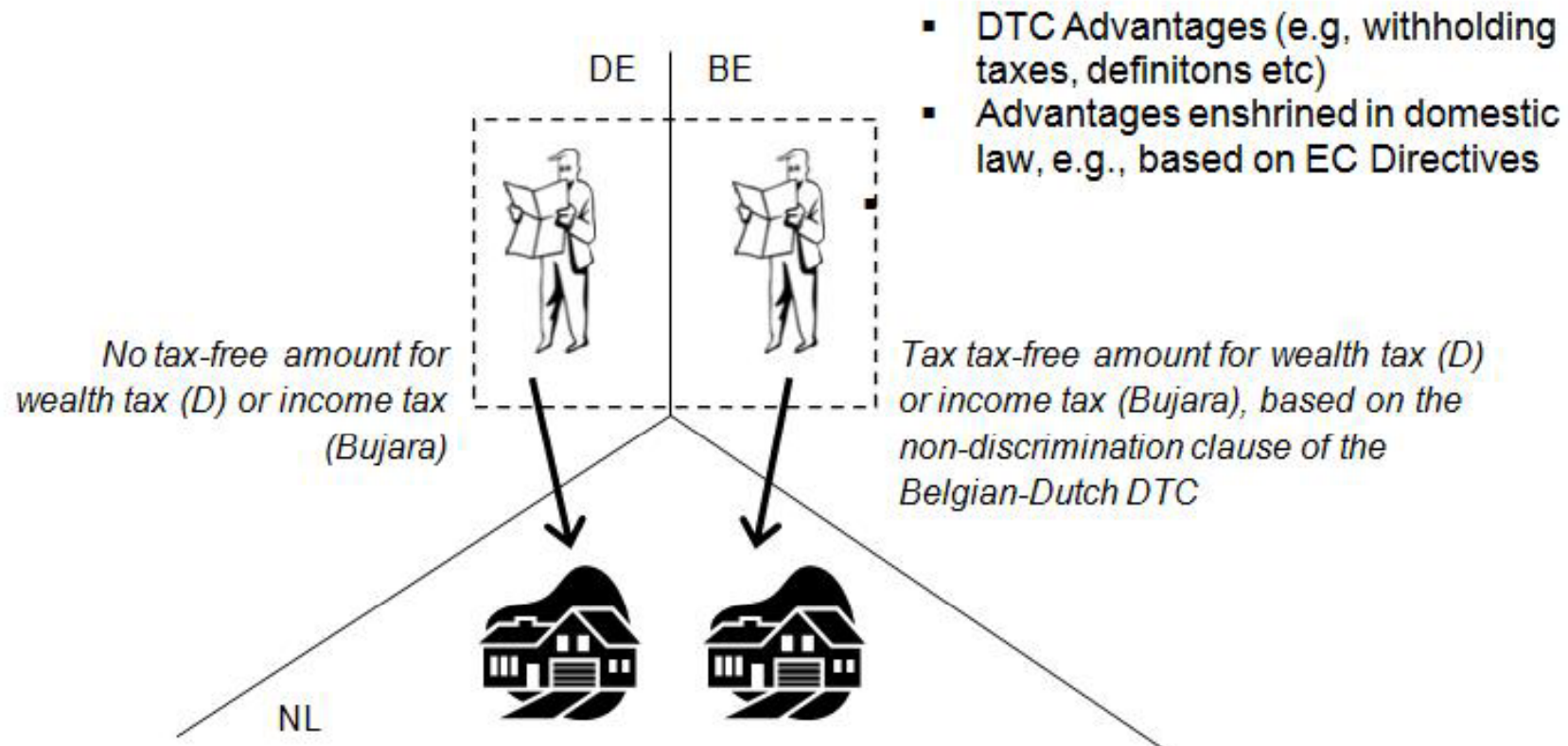
# Recent Issues: Most Favored Nation Treatment

- **Vertical versus Horizontal Discrimination**
  - **Vertikal Comparison** → Compare Cross-Border Situation with a Domestic Situation
  - **Horizontal Comparison** → Compare two Different Cross-Border Situations
    - Inbound Situations
      - “Most-Favored Nation Treatment” and “Community Preference”: Double Taxation Conventions (*D*, *ACT Group Litigation*)
      - Domestic Law (*Cadbury Schweppes*, *Columbus Container Services*)
    - Outbound Situations



# Recent Issues: Most Favored Nation Treatment

- **Inbound-Most-Favored Nation Treatment** — ECJ, 5 July 2005, C-376/03, **D** [2005] ECR I-5821, and ECJ, 27 October 2005, C-8/04, **Bujara** [not in force] → What about Community Preference?





# Recent Issues: Most Favored Nation Treatment

- **Inbound-Most-Favored Nation Treatment** — ECJ, 12 December 2006, C-374/04, **ACT Group Litigation**, [2006] ECR I-11673

	UK Individual	UK-Company	NL-Company	DE-Company
Dividend	100	100	100	100
+ Credit	11,1	—	5,5	—
= DTC Refund	—	—	0,27	—
= Net	100 + 11,1	100	100,27	100

UK

UK

UK

UK

UK

UK

UK

UK

UK

UK

NL

UK

DE

UK

DE

Dividend

↑

UK

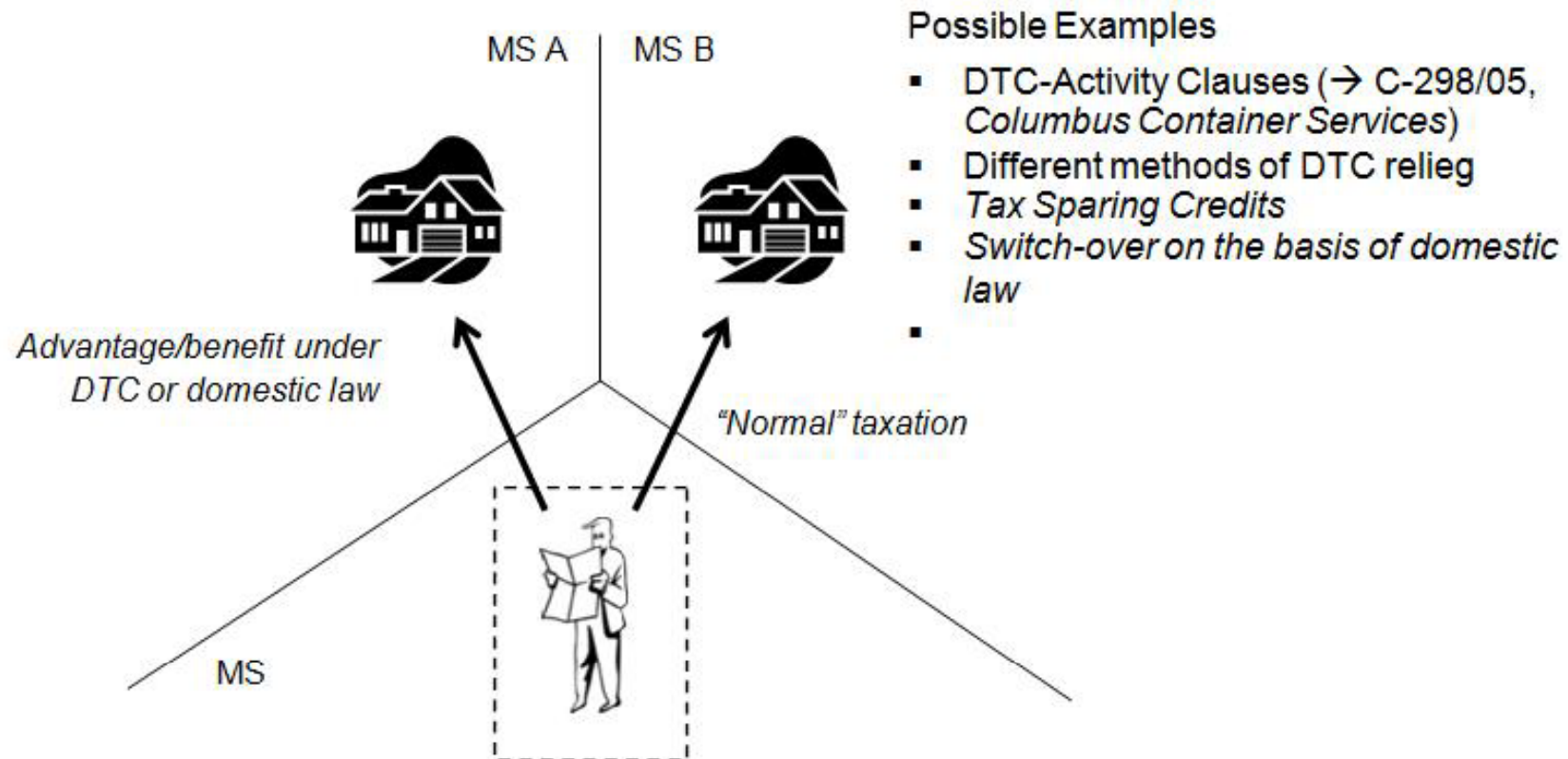
NL

DE



# Recent Issues: Most Favored Nation Treatment

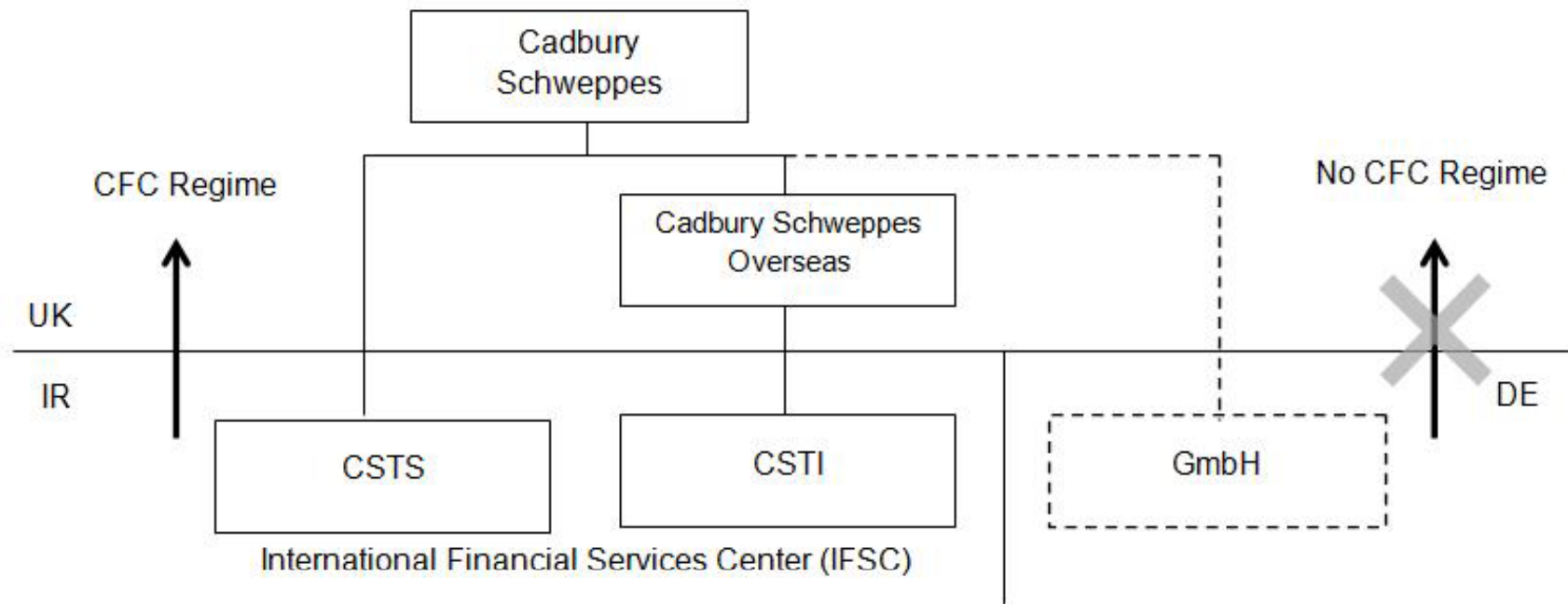
- **Outbound-Most-Favored Nation Treatment**





# Recent Issues: Most Favored Nation Treatment

- **Outbound-Most-Favored Nation Treatment under Domestic Law** — ECJ, 12 September 2006, C-196/04, **Cadbury Schweppes**, [2006] ECR I-7995

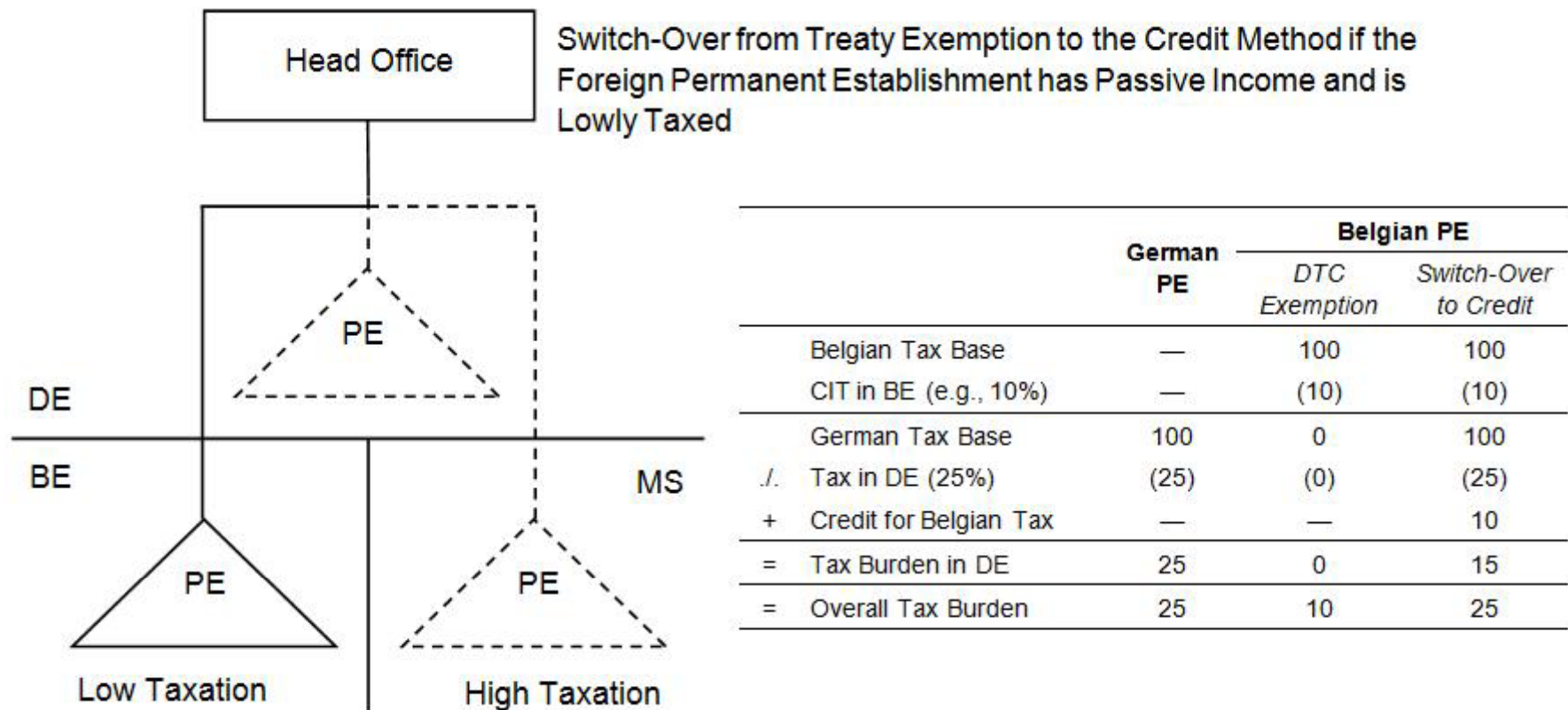






# Recent Issues: Most Favored Nation Treatment

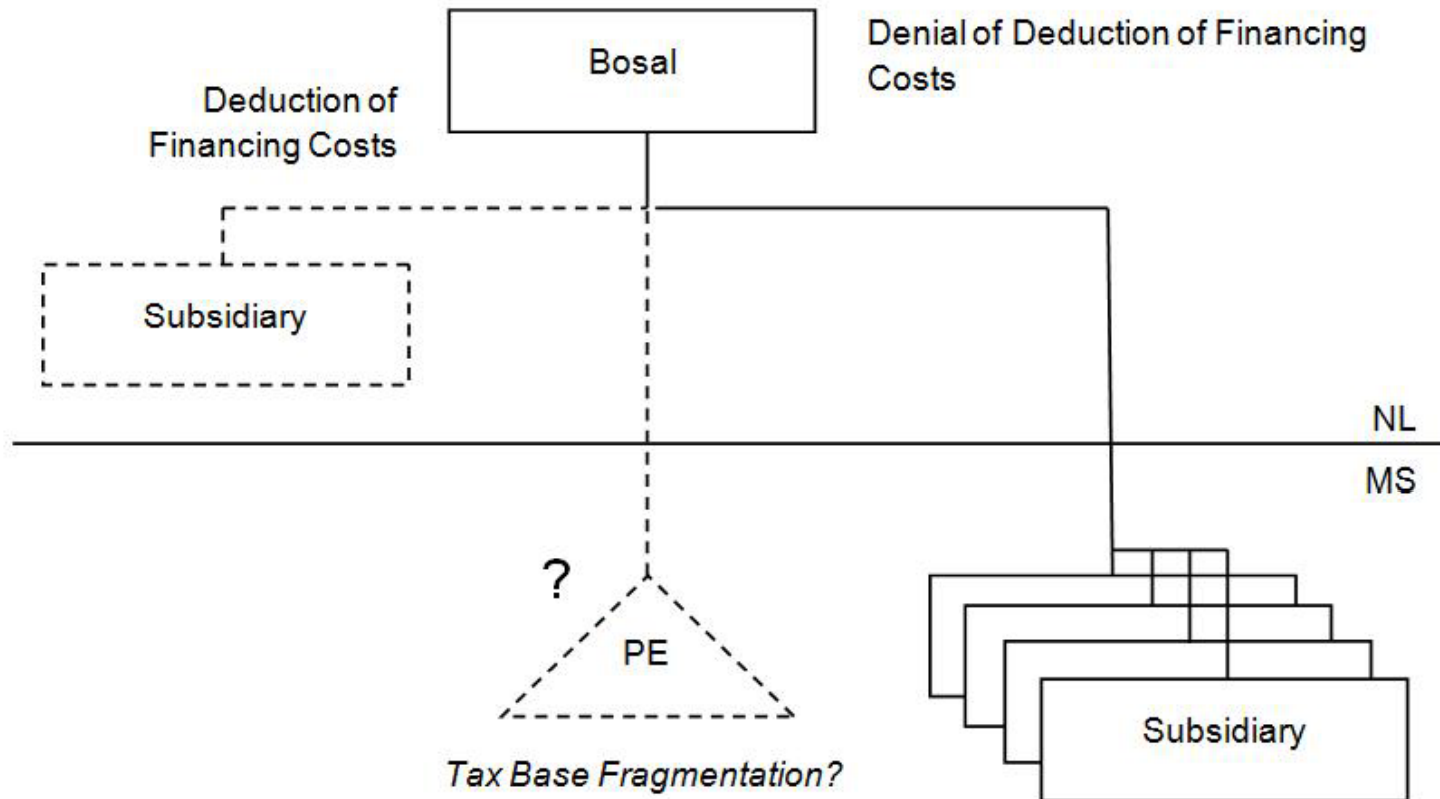
- **Outbound-Most-Favored Nation Treatment under Tax Treaty Law** — ECJ, 6 December 2007, C-298/05, **Columbus Container Services** [2007] ECR I-10451





# Recent Issues: Tax Base Fragmentations

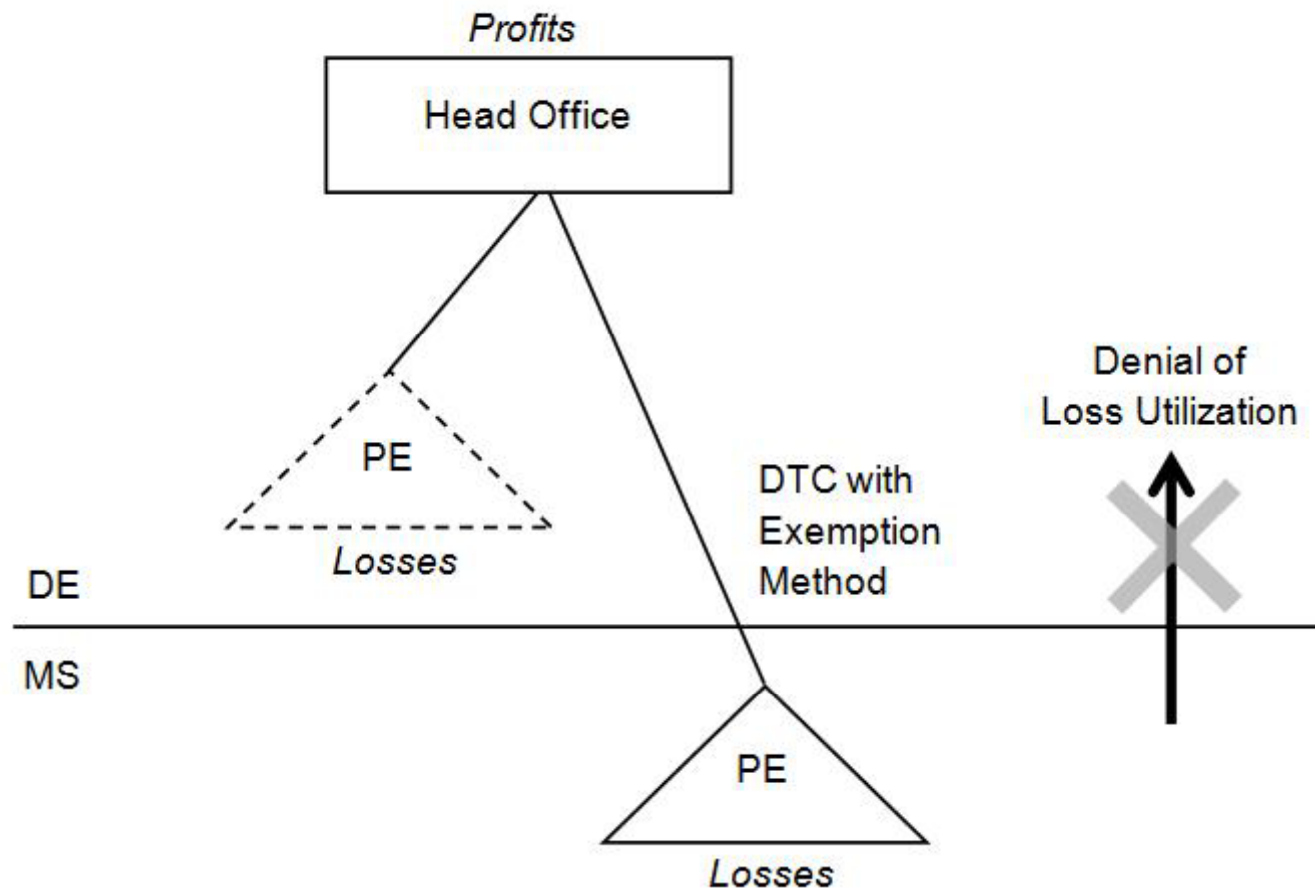
- **Financing Costs and Exempt Income** — ECJ, 18 September 2003, C-168/01, **Bosal** [2003] ECR I-9409





# Recent Issues: Tax Base Fragmentations

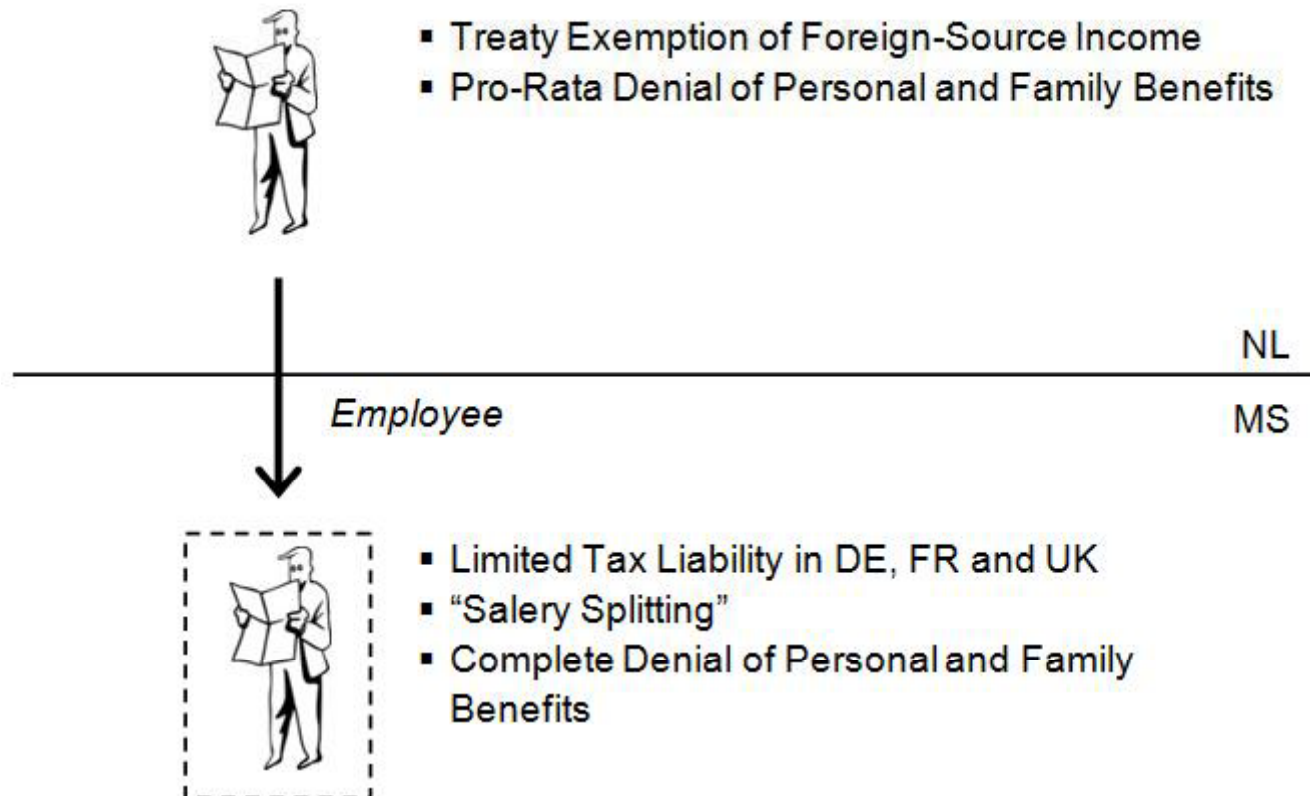
- **Cross-Border Loss Relief and Permanent Establishments** — ECJ, 15 May 2008, C-414/06, *Lidl Belgium*





# Recent Issues: Internal Consistency

- **Internal Consistency versus Discrimination** — ECJ, 12 December 2002, C-385/00, *De Groot* [2002] ECR I-11819





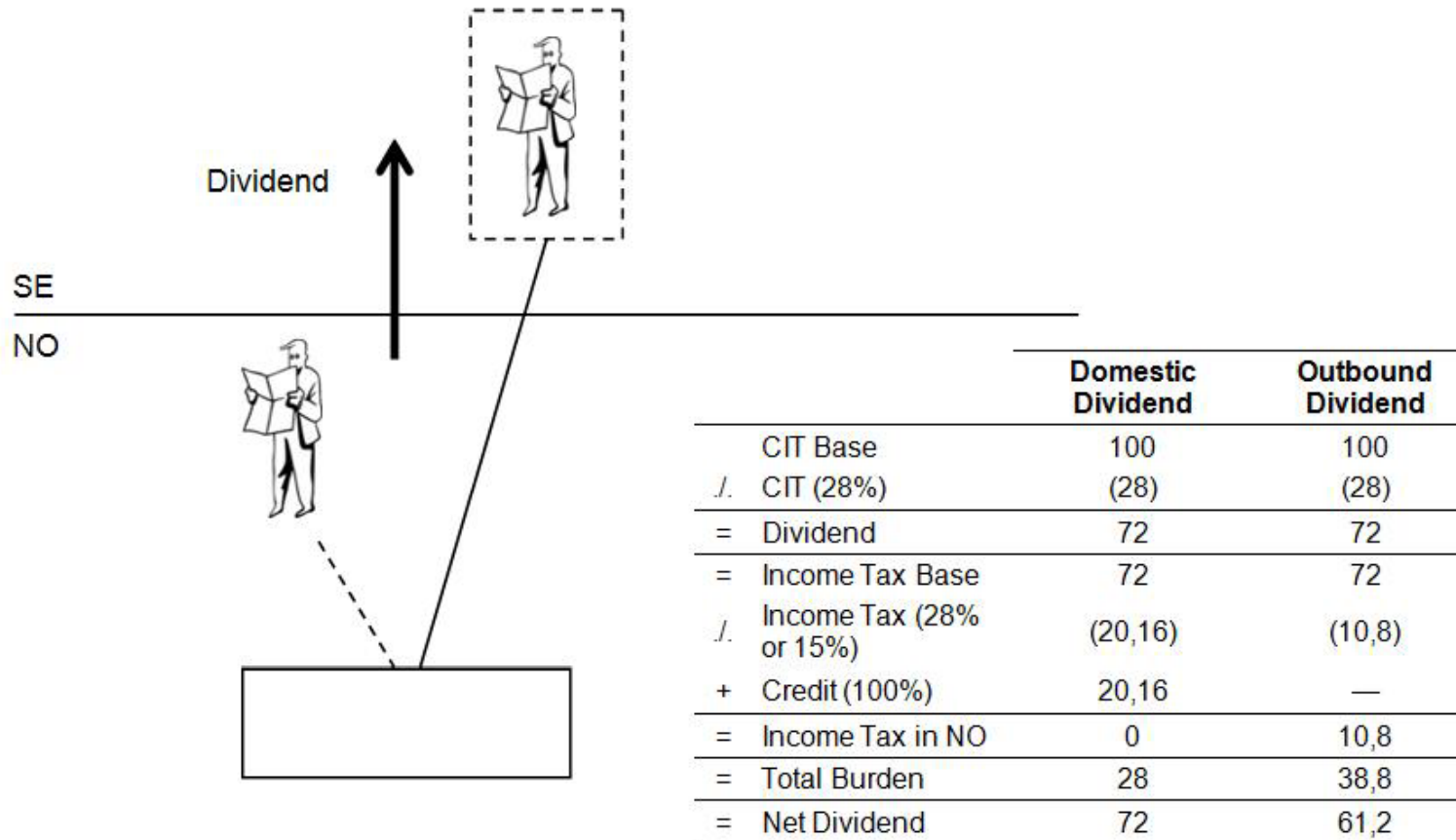
# Recent Issues: Cross-Border Compensation

- **“Single Country” versus “Overall Approach”**
  - **“Equality in a Box”?**
  - **Factual Situations, Linked Systems and Comparability**
    - *Schumacker*
    - *De Groot, Oy AA*
    - *Marks & Spencer*
    - *Manninen, Meilicke*
  - **Cross-Border Compensation**
    - **Unilateral Compensation**
    - **Tax Treaty Compensation** → *Fokus Bank, Denkavit Internationaal, Amurta*



# Recent Issues: Cross-Border Compensation

- **Strict Single Country Approach** —EFTA-Court, 23 November 2004, E-1/04, **Fokus Bank ASA** [2004] EFTA Court Report 11





# Recent Issues: Cross-Border Compensation

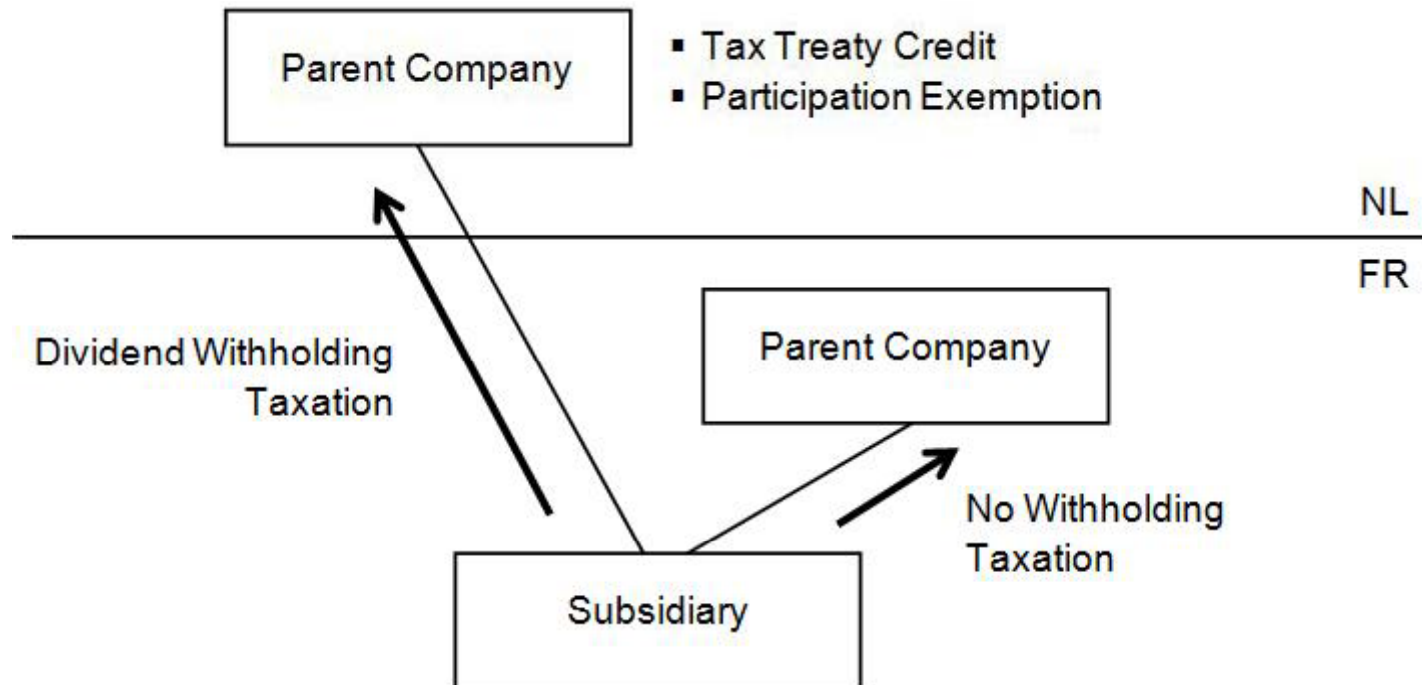
- **Strict Single Country Approach** —EFTA-Court, 23 November 2004, E-1/04, *Fokus Bank ASA* [2004] EFTA Court Report 11 – ***But: Is there a Disadvantage?***

	Domestic Distribution in Norway	Norway as the Source State – Outbound Dividend		Domestic Distribution in the Residence State
		No Credit	Credit	
CIT Base	100	100	100	100
./. CIT (28%)	(28)	(28)	(28)	(28)
= Dividend	72	72	72	72
= IT Base in Norway	72	72	72	—
./. IT (28%) or Withholding Tax (15%) in Norway	(20.16)	(10.8)	(10.8)	—
+ Tax Credit (100%)	20.16	—	10.8	—
= IT in Norway	0	10.8	0	—
= IT Base in Shareholder's Residence State	—	72	72	72
./. Tentative IT in Shareholder's Residence State (25%)	—	(18)	(18)	(18)
+ Credit for Norwegian Withholding Tax	—	10.8	0	—
= IT in Shareholder's Residence State	—	7.2	18	18
= Overall Tax Burden	28	46	46	46
= Net Dividend	<b>72</b>	<b>54</b>	<b>54</b>	<b>54</b>



# Recent Issues: Cross-Border Compensation

- “Equality in a Box”, but **DTC Obligations** → ECJ, 14 December 2006, C-170/05, *Denkavit Internationaal*, [2006] ECR I-11949, and ECJ, 8 November 2007, C-379/05, *Amurta* [2007] ECR I-9569 → **Cross-Border Compensation?**







# Recent Issues: Cross-Border Compensation

- “Equality in a Box”, but DTC Obligations → ECJ, 14 December 2006, C-170/05, *Denkavit Internationaal*, [2006] ECR I-11949

	Domestic Distribution in France	Distribution to a Dutch Corporate Shareholder	
		Situation 1: 25% CIT in the Netherlands	Situation 2: Participation Exemption in the Netherlands
Dividend	100	100	100
= CIT Base in France	100	100	100
./. French Withholding Tax	—	(5)	(5)
= CIT in France	0	5	5
CIT Base in the Netherlands	—	100	100
./. CIT in the Netherlands	—	(25)	(0)
+ Credit for French Withholding Tax	—	5	0
= Overall Tax Burden	—	25	5
Hypothetical Burden in Case of = a Domestic Distribution in the Netherlands	—	25	0



# Recent Issues: Cross-Border Compensation

- Cross-Border Compensation: Only if Elimination of Discrimination by way of a Tax Treaty → **Treaty-Based Overall Approach**
- **Dogmatic Underpinning**
  - Disadvantage to the Taxpayer
  - Inter-Nation Equity and Revenue
    - Treaty-Based Overall Approach accepts Tax Treaty Allocations
    - Treaty-Based Overall Approach serves as “Tie Breaker”
  - Criticism
    - Credit and Exemption as Equal Methods
    - Administrative Problems
- **The Way Ahead**
  - When is Discrimination Eliminated? → “Full Credit”?
  - Treaty-Based Overall Approach not Applied, e.g., in Case C-311/97, *Royal Bank of Scotland* [1999] ECR I-2651
  - Applicable to All Income? → Case C-345/04, *Centro Equestre* [2007] ECR I-1425



## **Part IV**

# **Secondary Community Direct Tax Law**



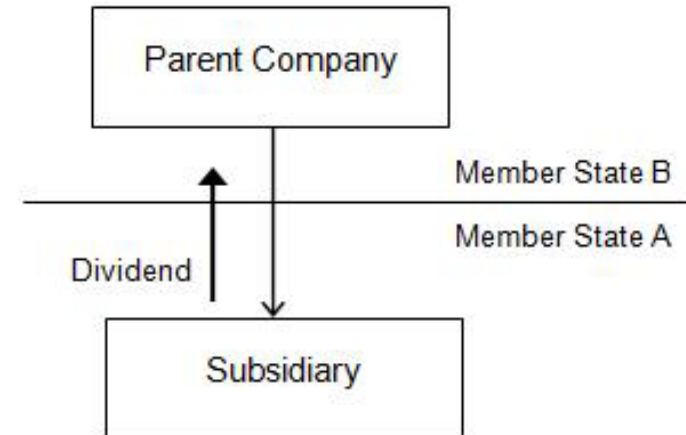
***Part IV-1***  
***The Parent-Subsidiary-Directive***



# Cross-Border Dividends

- **Economic Double Taxation**

- Corporate Level Tax in one State and Shareholder Level Tax in the other State
- Solutions
  - Usually no solution in DTCs (but: participation privileges)
  - Extension of the domestic integration system to cross border-dividends → ***Freedom of Capital Movement***
  - Prohibition of economic double taxation → ***Parent-Subsidiary-Directive***



- **Juridical Double Taxation**

- Source State (= State of residence of the distributing company) levys a withholding tax (e.g., 25%), i.e., a tax on the foreign shareholder, and the Residence State of the shareholder taxes the dividends received
- Solutions
  - Reduction of withholding taxes by the Source State and credit by the Residence State → ***DTCs (Art 10, 23 OECD-MC)***
  - Extension of the domestic system to cross border-dividends → ***Freedom of Capital Movement***
  - Prohibition of source taxation → ***Parent-Subsidiary-Directive***

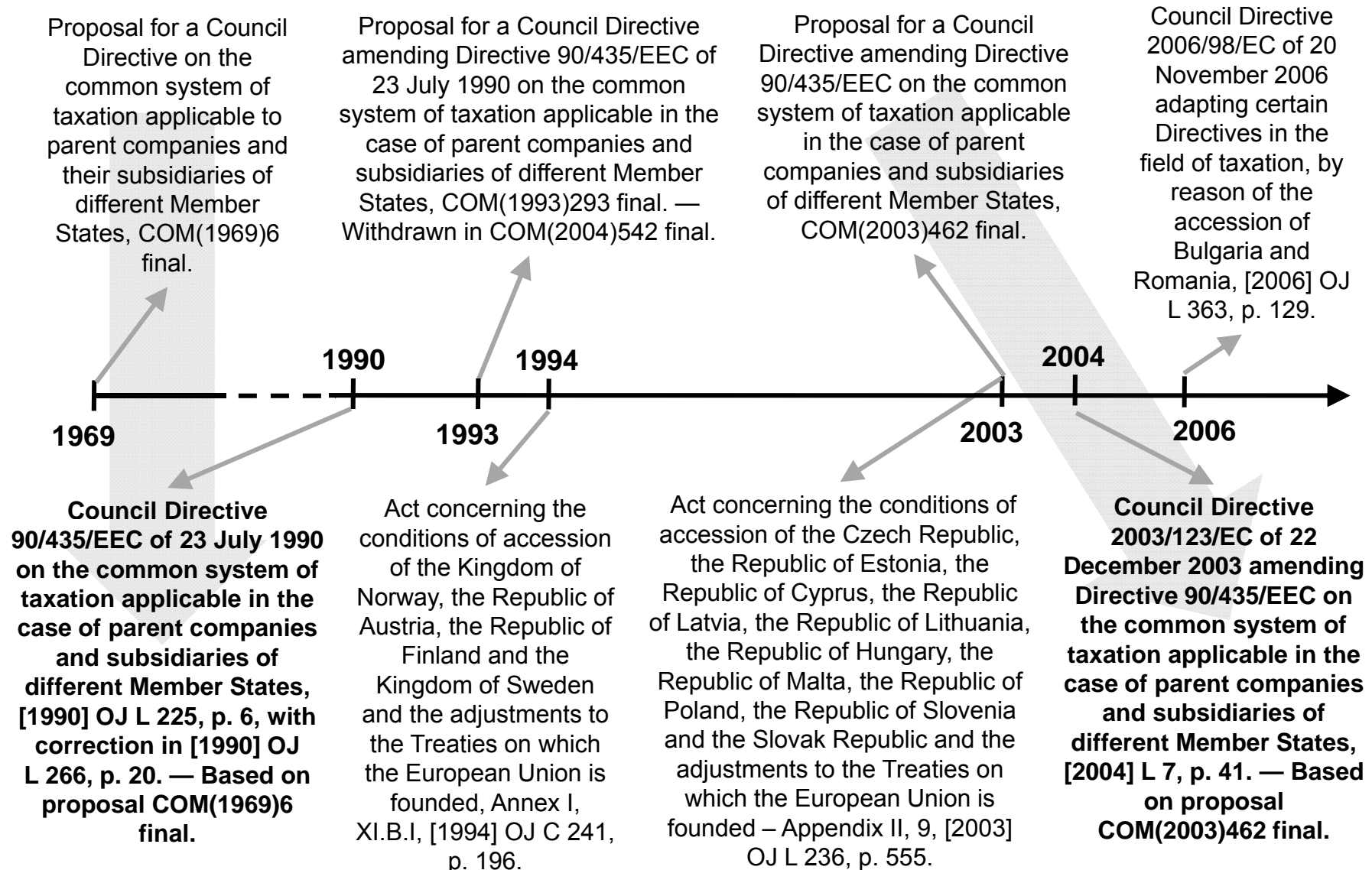


# Overview

- **Objective**
  - Removal of tax barriers concerning the distribution of profits within a group of companies
  - Twofold approach
    - Relief from ***juridical double taxation*** through exemption from withholding taxation on the subsidiary level → **Art 5**
    - Relief from ***economic double taxation*** through either exemption or indirect tax credit on the parent level → **Art 4**
- **Legal Texts**
  - Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, [1990] OJ L 225, p. 6, with correction in [1990] OJ L 266, p. 20.
  - Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, [2004] L 7, p. 41.



# Parent-Subsidiary-Directive — Timeline





# Structure of the Directive

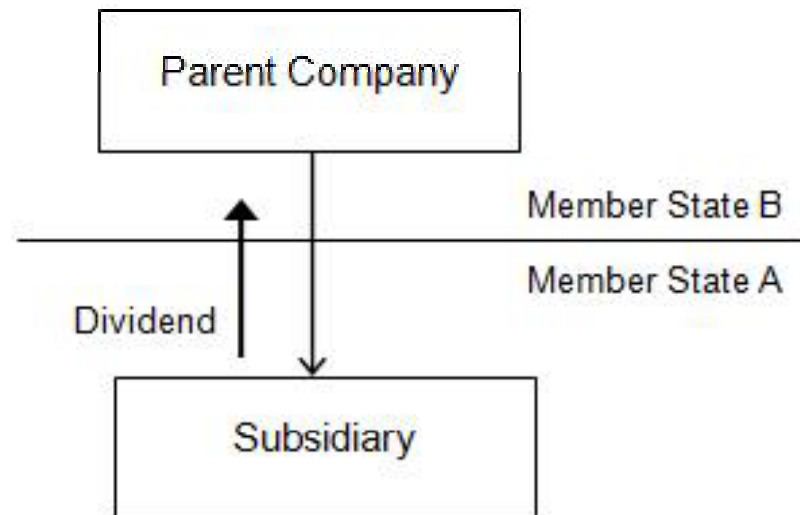
- **Art 1** – Scope of Application and Anti-Abuse
- **Art 2** – Definition of “company of a Member State” and “permanent establishment”
- **Art 3** – Definition of “parent” and “subsidiary” company
- **Art 4** – Avoidance of economic double taxation on the parent level (exemption or indirect credit) and inclusion of hybrid entities
- **Art 5** – Avoidance of juridical double taxation on the subsidiary level (prohibition of withholding taxation)
- **Art 6** – Prohibition of withholding taxation in the parent’s country
- **Art 7** – Exclusion of prepayments and certain measures for the avoidance of double taxation from the definition of taxation at source
- **Art 8** – Deadline for implementation
- **Art 9** – Directive is addressed to the Member States





# Scope of Application

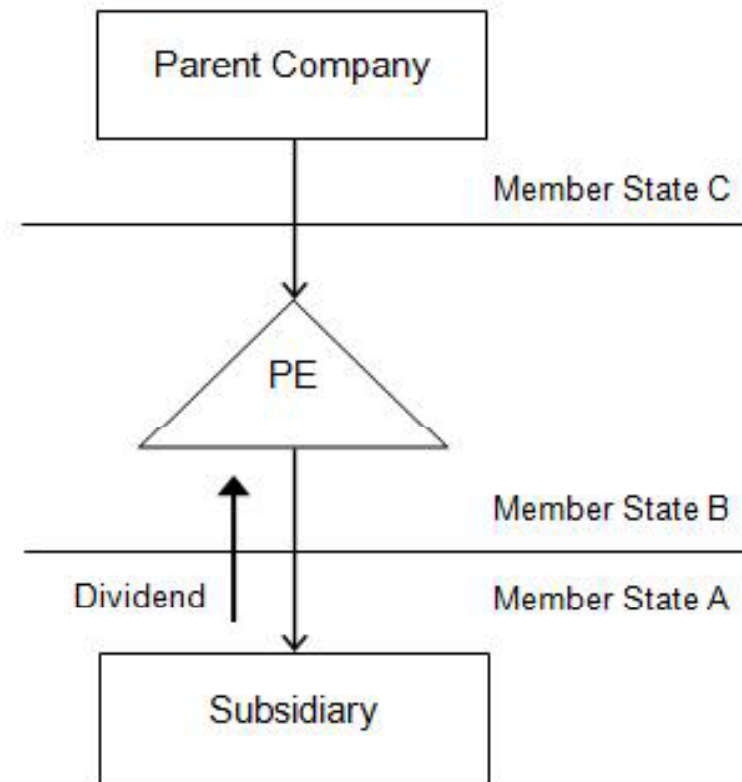
- **Art 1 — Each Member State shall apply this Directive**
  - ***to distributions of profits received by companies of that State which come from their subsidiaries of other Member States***
  - ***to distributions of profits by companies of that State to companies of other Member States of which they are subsidiaries***
  - to distributions of profits received by permanent establishments situated in that State of companies of other Member States which come from their subsidiaries of a Member State other than that where the permanent establishment is situated
  - to distributions of profits by companies of that State to permanent establishments situated in another Member State of companies of the same Member State of which they are subsidiaries





# Scope of Application

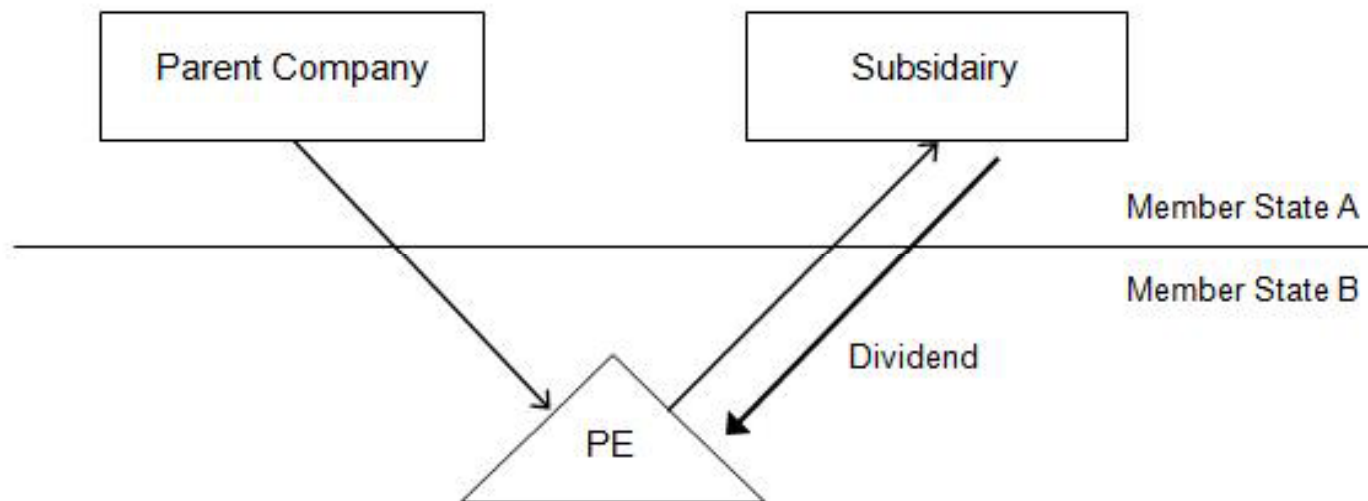
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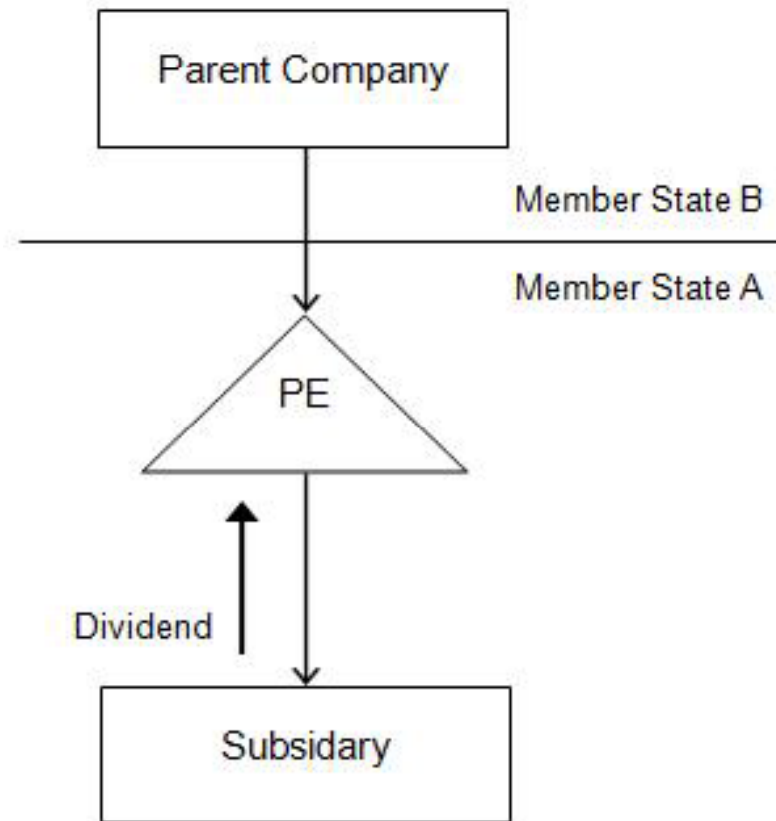
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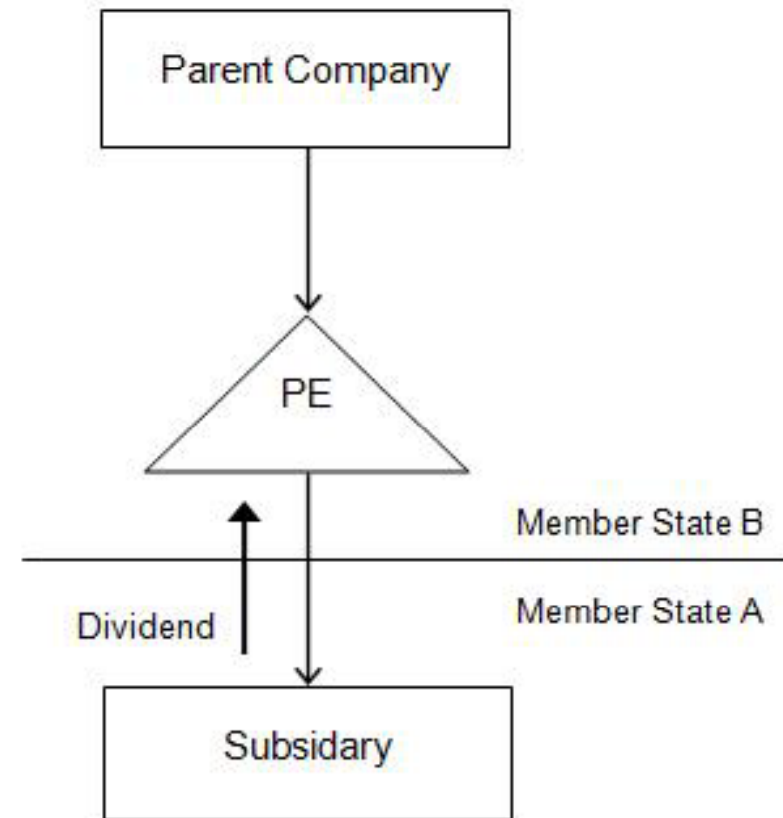
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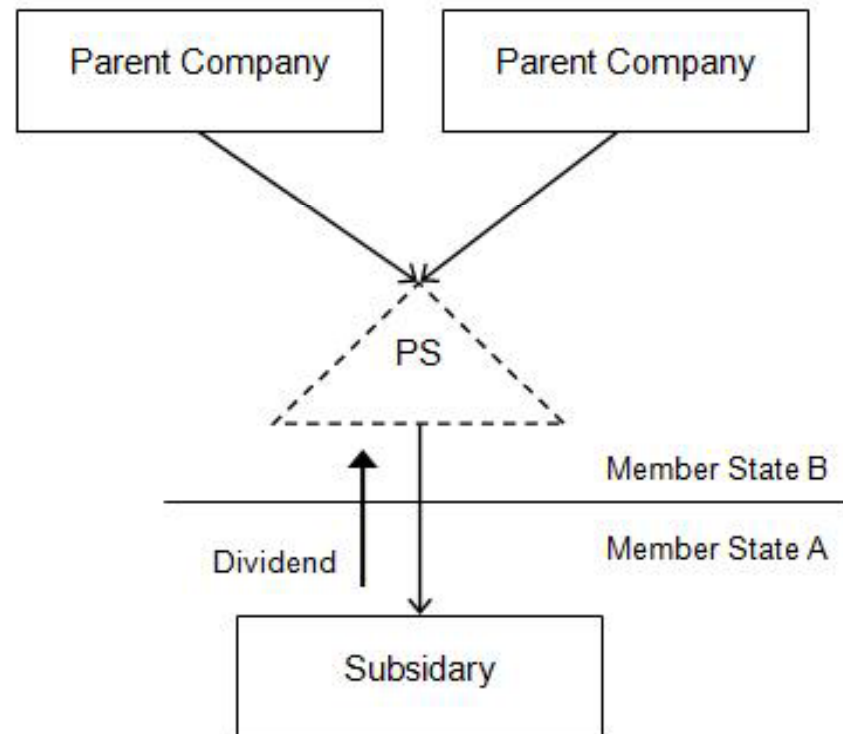
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  - to distributions of profits by companies of that State to permanent establishments situated in another Member State of companies of the same Member State of which they are subsidiaries





# Definitions

- Art 2 → For the purposes of this Directive 'company of a Member State' shall mean any company which:
  - takes one of the **legal forms** listed in the Annex to the Directive → Art 2(a)
  - according to the tax laws of a Member State is considered to be **resident in that 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 Community** → Art 2(b)
  - is **subject to one of the taxes** listed in Art 2(c), **without the possibility of an option or of being exempt**
- “Permanent establishment” means **a fixed place of business situated in a Member State** through which the business of a company of another Member State is wholly or partly carried on in so far as the **profits of that place of business are subject to tax in the Member State in which it is situated by virtue of the relevant bilateral tax treaty or, in the absence of such a treaty, by virtue of national law.**



# Parent and Subsidiary

## ▪ Minimum Holding Requirement → Art 3(1)

- Liberalization
  - 20% from 1 January 2005 to 31 December 2006;
  - 15% from 1 January 2007 to 31 December 2008;
  - 10% from 1 January 2009.
- Main Features
  - Directly in the foreign subsidiary or indirectly in a domestic subsidiary via a permanent establishment in another Member State
  - Capital or voting rights (Art 3(2))

## ▪ Minimum Holding Period → Art 3(2)

- Member States shall have the option of “not applying this Directive to companies of that Member State which **do not maintain** for an uninterrupted period of at least two years holdings qualifying them as parent companies or to those of their companies in which a company of another Member State does not maintain such a holding for an uninterrupted period of at least two years.”
- Usually 1 year, but differentiation for purposes of Art 4 and Art 5 possible
- Timing issues → Minimum Holding Period need not be fulfilled at the moment of the distribution, as long as the holding is maintained for the holding period → ECJ, 17 October 1996, C-283/94 etc, **Denkavit, VITIC und Vormeer**





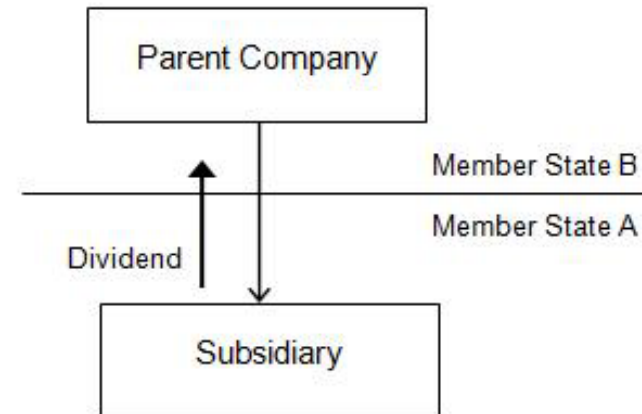
# Economic Double Taxation

- **Two Options for Member States**
  - Exemption at the Parent Level → Art 4(1) 1st intend
  - Indirect Tax Credit at the Parent Level → Art 4(1) 2nd intend
- **“Distributions of profits” in Art 1 and 4**
  - Transfer of wealth from the subsidiary to the parent that reduces the subsidiary's capital and is based on an equity investment of the parent
  - Examples:
    - Dividends
    - Constructive Distributions
    - Reclassified interest payments
    - Excluded are capital gains and liquidating distributions → Art 4(1), but questionable for Art 5



# Economic Double Taxation

- **Art 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 State of the parent company and the State of its permanent establishment shall, except when the subsidiary is liquidated, either:
  - **refrain from taxing such profits**, or
  - 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 meet the requirements provided for in Articles 2 and 3, up to the limit of the amount of the corresponding tax due.

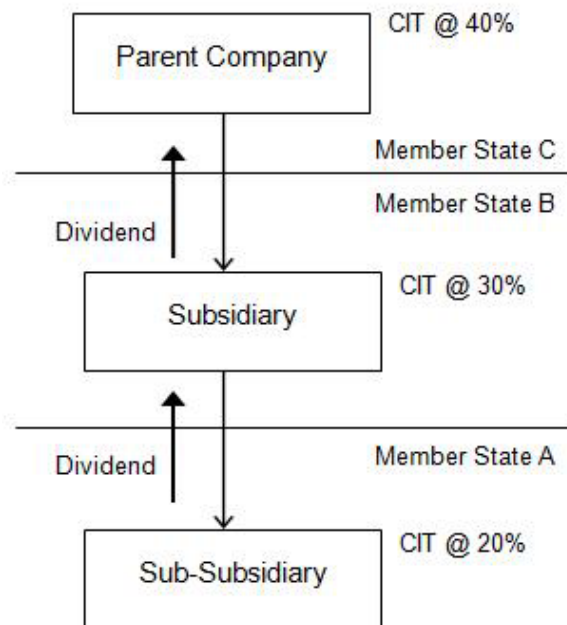


	Exemption	Credit
CIT in MS S (30%)	30	30
Income in MS P	70	100
Tentative CIT in MS P (40%)	28	40
Exemption (70 @ 40%)	28	—
Credit (Min(30;100@40%))	—	(30)
CIT in MS P	0	10
Overall CIT	30	40



# Economic Double Taxation

- **Multi-Tier Tax Credit according to Art 4(1) 2nd intend**
- **Member States** “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 meet the requirements provided for in Articles 2 and 3, up to the limit of the amount of the corresponding tax due.”



	MS S: Exemption		MS S: Credit	
	Domestic	Directive	Domestic	Directive
CIT in <b>MS SS</b> (20%)	<b>20</b>	<b>20</b>	<b>20</b>	<b>20</b>
Income in MS S	80	80	100	100
Tentative CIT in MS S (30%)	24	24	30	30
Credit (Min(20;100@30%))	—	—	(20)	(20)
Exemption	(24)	(24)	—	—
CIT in <b>MS S</b>	<b>0</b>	<b>0</b>	<b>10</b>	<b>10</b>
Income in MS P	80	100	80	100
Tentative CIT in MS P (40%)	32	40	36	40
Credit (Min(CIT;Income@40%))	<b>0</b>	<b>20</b>	<b>10</b>	<b>30</b>
CIT in <b>MS P</b>	<b>32</b>	<b>20</b>	<b>26</b>	<b>10</b>
Overall CIT	<b>52</b>	<b>40</b>	<b>56</b>	<b>40</b>



# Economic Double Taxation

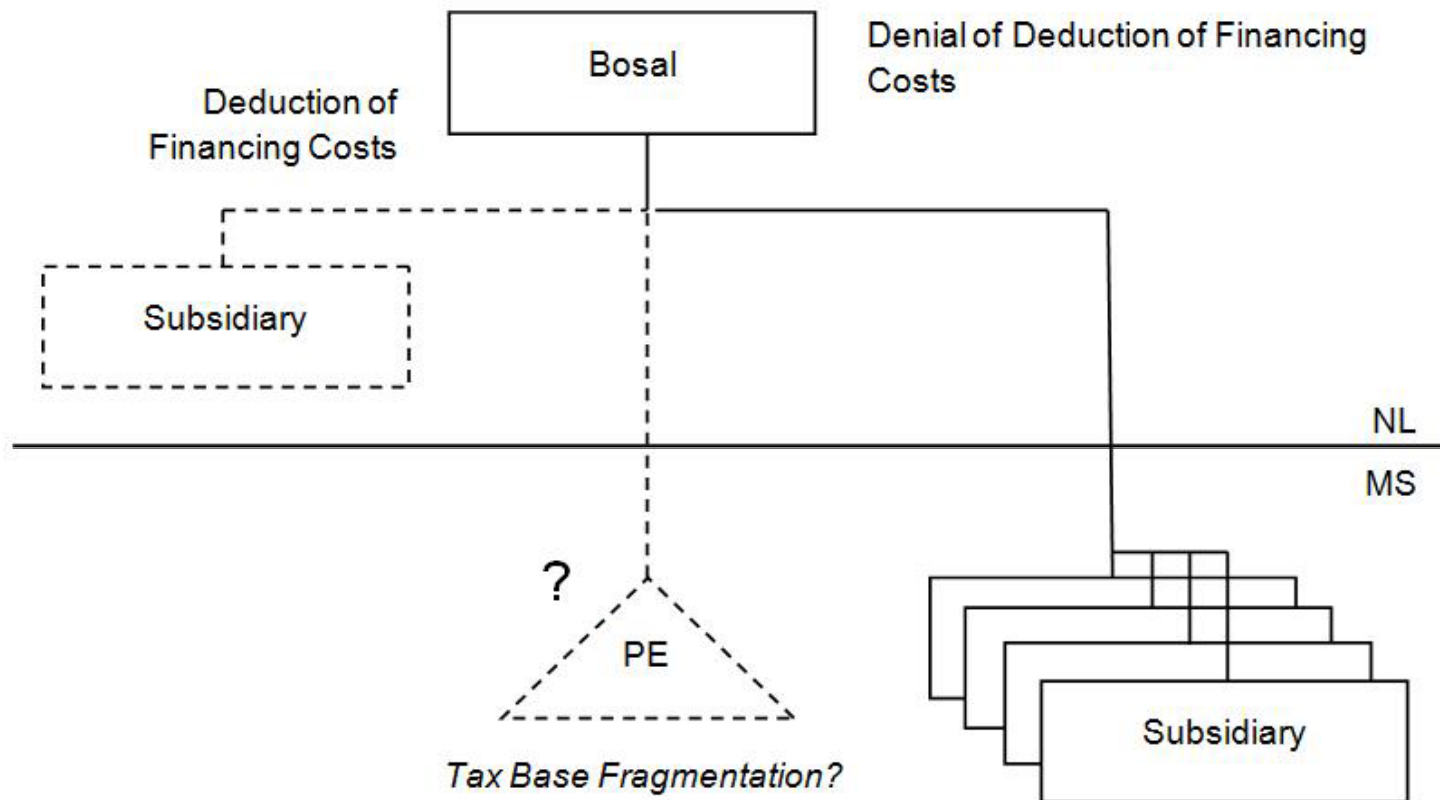
- **Costs of the Holding**

- Asymmetry of Treatment of Profits and Costs?
- **Art 4(2)** → *“However, each Member State shall retain the option of providing that any charges relating to the holding and any losses resulting from the distribution of the profits of the subsidiary may not be deducted from the taxable profits of the parent company. Where the management costs relating to the holding in such a case are fixed as a flat rate, the fixed amount may not exceed 5 % of the profits distributed by the subsidiary.”*
- Typically, only 95% of the profit distribution are exempt from taxation
- But: No justification for discriminatory taxation
  - ECJ, 18 September 2003, C-168/01, **Bosal** [2003] ECR I-9409
  - ECJ, 23 February 2006, C-471/04, **Keller Holding** [2006] ECR I-2107



# Economic Double Taxation

- **Financing Costs and Exempt Income** — ECJ, 18 September 2003, C-168/01, **Bosal** [2003] ECR I-9409, and ECJ, 23 February 2006, C-471/04, **Keller Holding** [2006] ECR I-2107





# Juridical Double Taxation

- **Prohibition of Withholding Taxation → Art 5**
  - “Profits which a subsidiary distributes to its parent company shall be exempt from withholding tax.”
  - Definition of “Withholding Tax ”
    - *The term withholding tax contained in Art 5 is not limited to certain specific types of national taxation.* The nature of a tax, duty or charge must be determined under Community law, according to objective characteristics, irrespective of its classification under national law.
    - Three characteristics:
      - The chargeable event for the tax is the payment of dividends or any other income from shares,
      - the taxable amount is the income from those shares, and
      - the taxable person is the holder of the shares (?).
    - Case Law
      - ECJ, 8 June 2000, C-375/98, *Epson* [2000] ECR I-04243
      - ECJ, 4 October 2001, C-294/99, *Athinaïki Zythopiia* [2001] ECR I-6797
      - ECJ, 25 September 2003, C-58/01, *Océ van der Grinten* [2003] ECR I-9809
      - ECJ, 26 June 2008, C-284/06, [2008] ECR I-4571, *Burda Verlagsbeteiligungen*



# Juridical Double Taxation

- **Art 7(1)**

- “*The term 'withholding tax' as used in this Directive shall not cover an advance payment or prepayment (précompte) of corporation tax to the Member State of the subsidiary which is made in connection with a distribution of profits to its parent company.*”
- „Equalization Taxes“ in imputation systems → E.g., *précompte* in Frankreich, *maggiorazione di congruaglio* in Italy, *ACT* in the UK, and *Ausschüttungsbelastung* in Germany
- Questioned by ECJ, 4 October 2001, C-294/99, *Athinaïki Zythopiia* [2001] ECR I-6797, but see ECJ, 26 June 2008, C-284/06, [2008] ECR I-4571, *Burda Verlagsbeteiligungen*

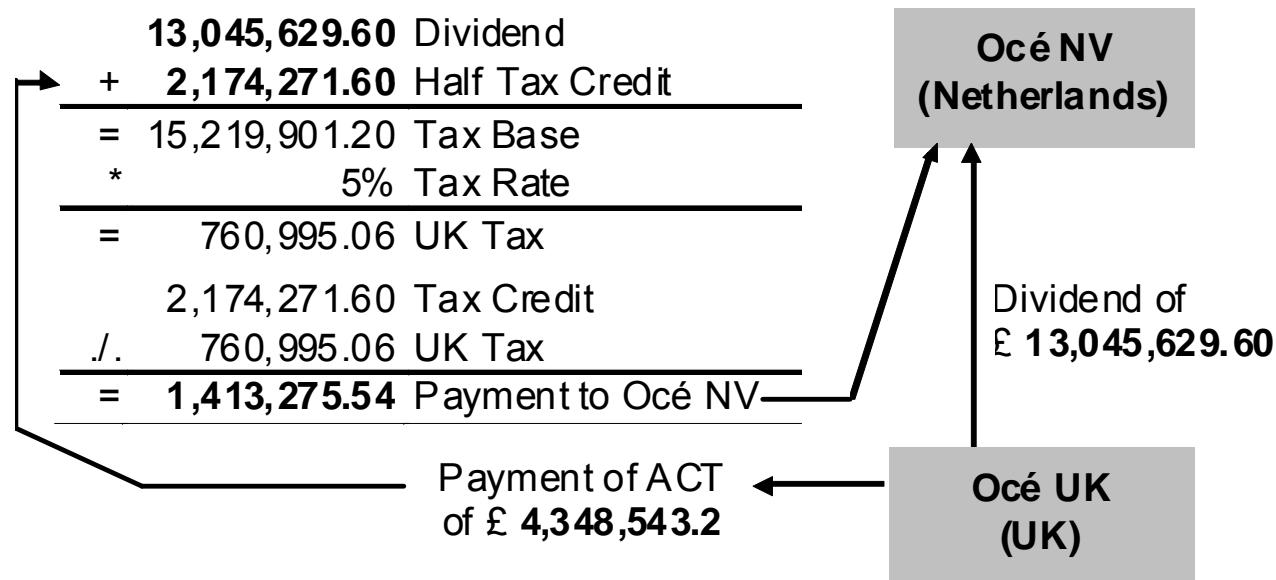
- **Art 7(2)**

- “*This Directive shall not affect the application of domestic or agreement-based provisions designed to eliminate or lessen economic double taxation of dividends, in particular provisions relating to the payment of tax credits to the recipients of dividends.*”
- Safeguard of provisions in DTCs that provide for payment of a cross-border imputation credits?
- ECJ, 25 September 2003, C-58/01, *Océ van der Grinten* [2003] ECR I-9809



# Juridical Double Taxation

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  - ECJ, 25 September 2003, C-58/01, *Océ van der Grinten* [2003] ECR I-9809







## ***Part IV-2***

### ***The Merger Directive***



# Overview

- **Objective**

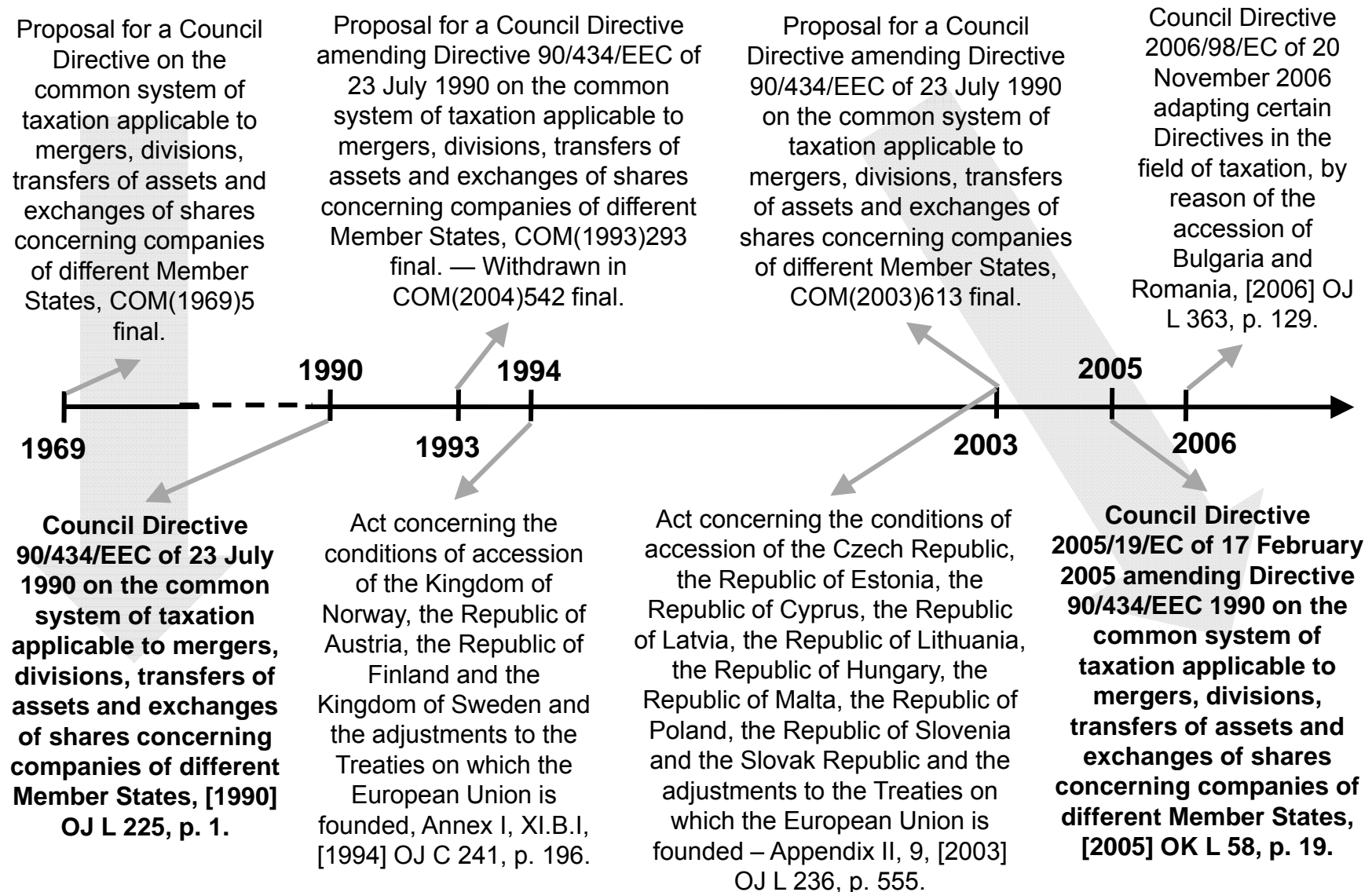
- Tax neutral treatment of mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office, of an SE or SCE, between Member States → *Deferral*
- Such operations
  - may be necessary in order to create within the Community conditions analogous to those of an internal market
  - ought not to be hampered by restrictions, disadvantages or distortions arising in particular from the tax provisions of the Member States;
  - require tax rules which are neutral from the point of view of competition, in order to allow enterprises to adapt to the requirements of the common market, to increase their productivity and to improve their competitive strength at the international level;
  - must not be treated more burdensome than those concerning companies of the same Member State.

- **Legal Texts**

- Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States, [1990] OJ L 225, p. 1.
- Council Directive 2005/19/EC of 17 February 2005 amending Directive 90/434/EEC 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States, [2005] OK L 58, p. 19.



# Merger Directive – Timeline





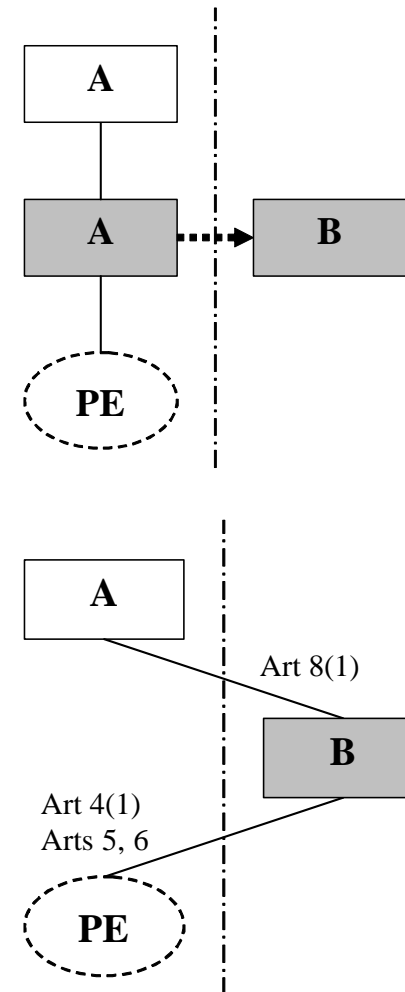
# Structure of the Directive

- **Art 1** – Scope of Application
- **Art 2** – Definitions of “merger,” “division,” “partial division,” “transfer of assets,” “exchange of shares,” “transferring company,” “receiving company,” “acquired company,” “acquiring company,” and “branch of activity”
- **Art 3** – Definition of “company from a Member State”
- **Art 4 and Art 9** – Neutrality on the level of transferred assets – „permanent establishment requirement“
- **Art 5 and Art 9** – Carry-over of provisions or reserves
- **Art 6 and Art 9** – Loss-carry forward in permanent establishments
- **Art 7** – Tax neutrality of gains accruing to the receiving company on the cancellation of its holding
- **Art 8** – Tax neutrality of the allotment of securities representing the capital of the receiving or acquiring company to a shareholder
- **Art 10** – Transfer of a permanent establishment in a third country
- **Art 10a** – Special case of transparent entities
- **Art 10b to Art 10d** – Rules applicable to the transfer of the registered office of an SE or an SCE
- **Art 11** – Anti-Abuse
- **Art 12** – Deadline for implementation
- **Art 13** – Directive is addressed to the Member States



# Scope of Application

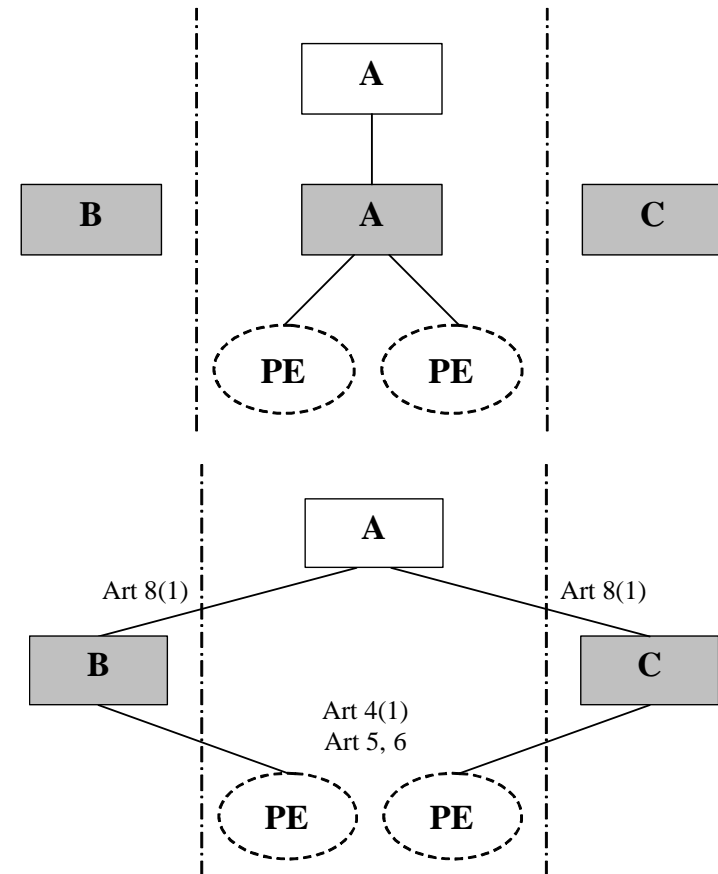
- **Merger** → Art 2(a)
  - Transfer of all assets and liabilities from the transferring company” (A) to a pre-existing “receiving company” (B) (A being dissolved without going into liquidation )
  - Transfer of all assets and liabilities from two or more transferring companies” (A) a the pre-existing “receiving company” (B)
  - Up-stream-merger of a 100% subsidiary
- **Taxation**
  - Neutrality on the Company Level
    - Permanent Establishment Requirement → Art 4, 10
    - Carry-over of provisions or reserves → Art 5, 6
  - Neutrality on the Shareholder Level
    - Tax neutrality of the allotment of securities representing the capital of the receiving company (B) to a shareholder in exchange for securities representing the capital of the “transferring company” (A) → Art 8(1)





# Scope of Application

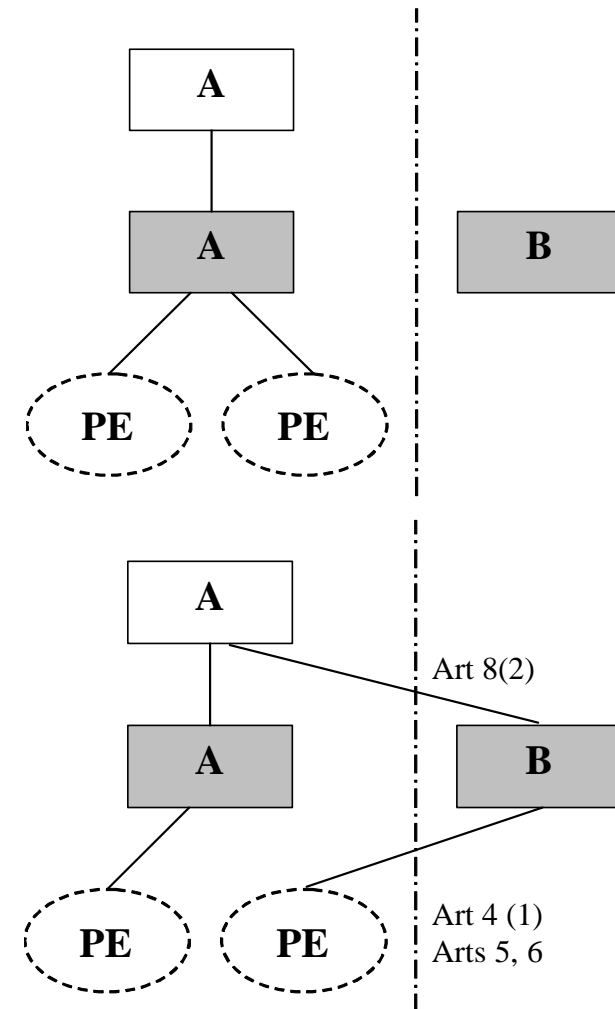
- **Division** → Art 2(b)
  - Transfer by the “transferring company” (A), on being dissolved without going into liquidation, of all its assets and liabilities to two or more existing or new “receiving companies” (B and C), in exchange for the pro rata issue to its shareholders of securities representing the capital of the “receiving companies” (B and C)
- **Taxation**
  - Neutrality on the Company Level
    - Permanent Establishment Requirement → Art 4, 10
    - Carry-over of provisions or reserves → Art 5, 6
  - Neutrality on the Shareholder Level
    - Tax neutrality of the allotment of securities representing the capital of the “receiving companies” (B and C) to a shareholder in exchange for securities representing the capital of the “transferring company” (A) → Art 8(1)





# Scope of Application

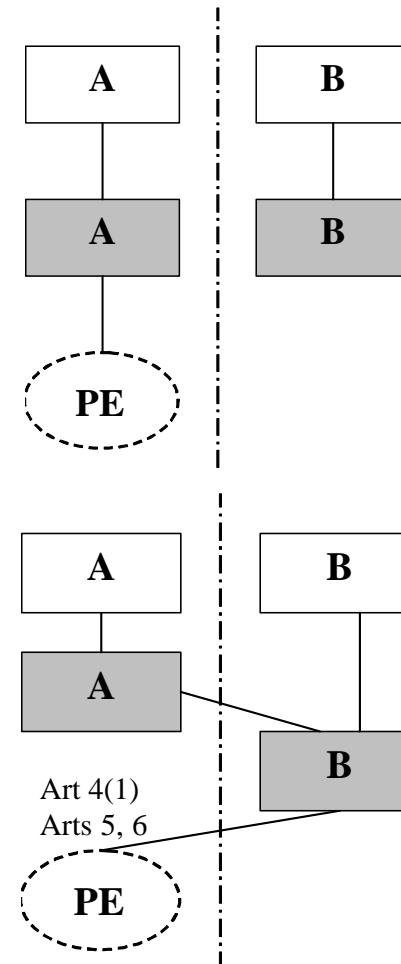
- **Partial Division** → Art 2(ba) (*new*)
  - Transfer by the “transferring company” (A), without being dissolved, of one or more branches of activity, to one or more existing or new “receiving companies” (B), leaving at least one branch of activity in the “transferring company” (A), in exchange for the pro-rata issue to its shareholders of securities representing the capital of the companies
- **Taxation**
  - Neutrality on the Company Level
    - Permanent Establishment Requirement → Art 4, 10
    - Carry-over of provisions or reserves → Art 5, 6
  - Neutrality on the Shareholder Level
    - Tax neutrality of the allotment of securities representing the capital of the “receiving company” (B) to a shareholder → Art 8(2)





# Scope of Application

- **Transfers of Assets** → Art 2(c)
  - Transfer by the “transferring company” (A), without being dissolved, of all or one or more branches of its activity to the “receiving company” in exchange for the transfer of securities representing the capital of the company receiving the transfer
- **Taxation**
  - Neutrality on the Company Level
    - Permanent Establishment Requirement → Art 4, 10
    - Carry-over of provisions or reserves → Art 5, 6
  - Neutrality on the Shareholder Level
    - No change on the shareholder level, hence no rule in the Directive

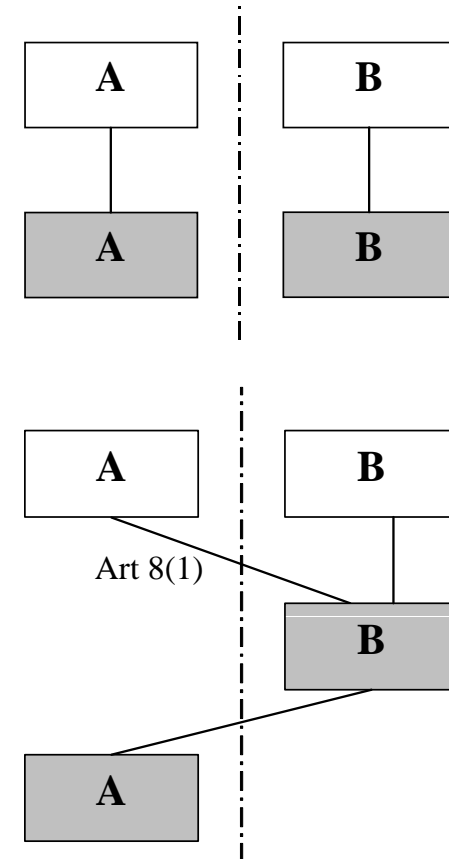






# Scope of Application

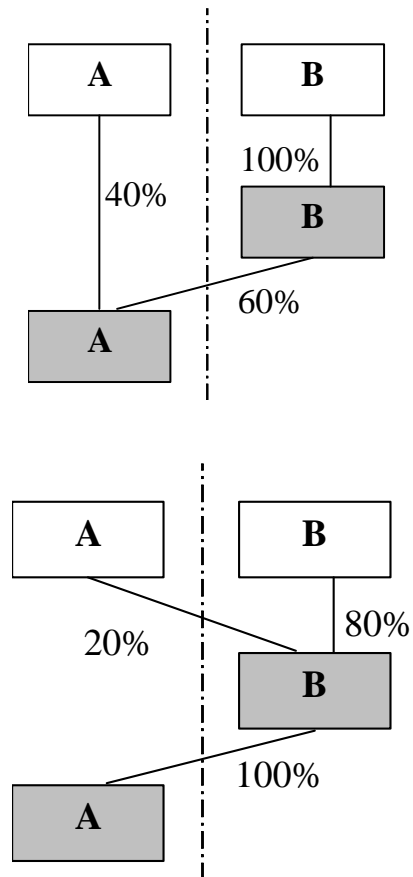
- **Exchange of Shares** → Art 2(d)
  - “Acquiring company” (B) acquires a holding in the capital of the “acquired company” (A) such that it obtains a majority of the voting rights or further extends such holding in that “acquired company” (A) from this company’s shareholders in exchange for the issue to the shareholders of the “acquired company” (A) of securities representing the capital of the “acquiring company” (B)
- **Taxation**
  - Neutrality on the Company Level
    - No change on the property level, hence no rule in the Directive
  - Neutrality on the Shareholder Level
    - Tax neutrality of the allotment of securities representing the capital of the “acquiring company” (B) to a shareholder in exchange for securities representing the capital of the “acquired company” (A) → Art 8(1)





# Scope of Application

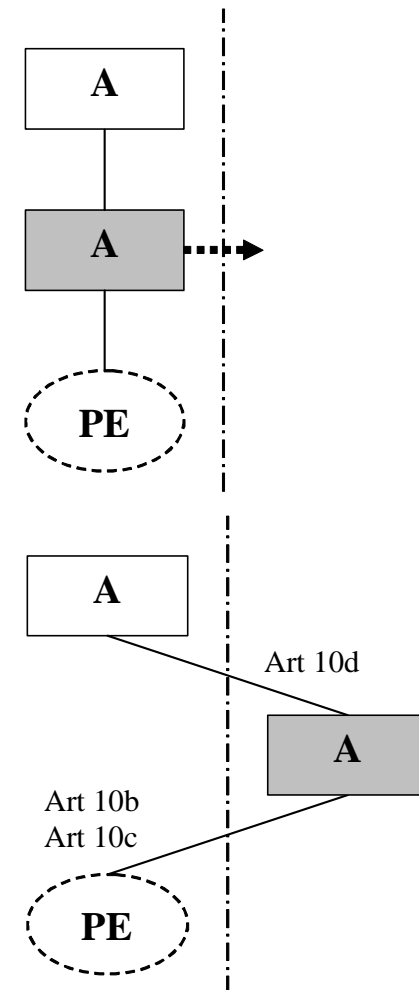
- **Exchange of Shares** → Art 2(d)
  - **Extension through Directive 2005/19/EC**
    - Until **Directive 2005/19/EC** → Acquiring company had to acquire “*a holding in the capital of another company such that it obtains a majority of the voting rights in that company*”
    - Doubts if the extension of a majority holding is also covered → **Directive 2005/19/EC**: Amendment of Art 2(d) so that acquiring company has to acquire “*a holding in the capital of another company such that it obtains a majority of the voting rights in that company, or, holding such a majority, acquires a further holding*”.





# Scope of Application

- **Transfer of the Registered Office** of an SE or an SCE → Art 2(j) (*new*)
  - A European Company (SE) or a European Cooperative Society (SCE), without winding up or creating a new legal person, transfers its registered office from one Member State to another Member State
- **Taxation**
  - Neutrality on the Company Level
    - Permanent Establishment Requirement → Art 10b
    - Carry-over of provisions or reserves → Art 10c
  - Neutrality on the Shareholder Level
    - No taxation because of the change in qualification of the shares (domestic versus foreign company) → Art 10d





## Scope of Application – Overview

	Company Level			Shareholder Level
	<i>Assets</i>	<i>Losses</i>	<i>Reserves</i>	
<b>Merger</b> Art 2(a)	Art 4(1)	Art 6	Art 5	Art 8(1)
<b>Division</b> Art 2(b)	Art 4(1)	Art 6	Art 5	Art 8(1)
<b>Partial Division</b> Art 2(ba)	Art 4(1)	Art 6	Art 5	Art 8(2)
<b>Transfer of Assets</b> Art 2(c)	Art 9 → Art 4(1)	Art 9 → Art 6	Art 9 → Art 5	—
<b>Exchange of Shares</b> Art 2(d)	—	—	—	Art 8(1)
<b>Transfer of the Registered Office</b> Art 2(j)	Art 10b	Art 10c(2)	Art 10c(1)	Art 10d



## Qualified Companies

- Art 3 → For the purposes of the Directive, “company from a Member State” shall mean any company which:
  - takes one of the **legal forms** listed in the Annex to the Directive → Art 3(a)
  - according to the tax laws of a Member State is considered to be **resident in that 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 Community** → Art 3(b)
  - is **subject to one of the taxes** listed in Art 3(c), **without the possibility of an option or of being exempt**



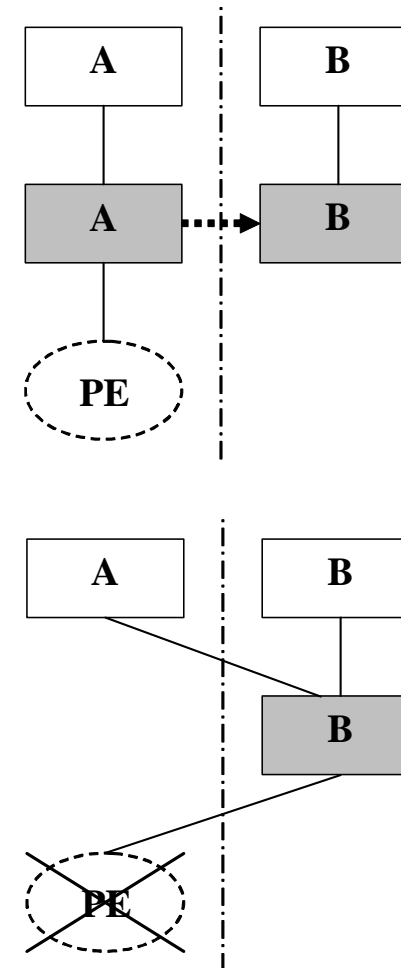
# Permanent Establishments

- **Permanent Establishment Requirement for Neutrality on the Company Level → Arts 4, 9 and 10b**
  - **Merger, Division, Partial Division or Transfer of Assets** (Art 4 and Art 9)
    - Such transactions shall not give rise to any taxation of capital gains calculated by reference to the difference between the real values of the **assets and liabilities transferred** (→ Art 4(1)(b)) and their **values for tax purposes** (→ Art 4(1)(a)).
    - The term “transferred assets and liabilities” is limited to those assets and liabilities of the transferring company which, in consequence of the transaction, are **effectively connected with a permanent establishment of the receiving company in the Member State of the transferring company** *and* **play a part in generating the profits or losses taken into account for tax purposes**
  - **Transfer of the Registered Office → Art 10b (new)**
    - Deferral under Art 10b, if assets and liabilities remain **effectively connected with a permanent establishment of the SE or of the SCE in the Member State from which the registered office has been transferred** *and* **play a part in generating the profits or losses taken into account for tax purposes**



# Permanent Establishments

- **Permanent Establishment Requirement for Neutrality on the Company Level → Arts 4, 9 and 10b**
  - No Change in Art 4 through Directive 2005/19/EC, introduction of Art 10b
  - No tax-neutrality under the Directive if the permanent establishment requirement (e.g., because of a DTC) is not met
  - Effects of the Fundamental Freedoms and ECJ case-law on Exit Taxation?
    - ECJ, 21 November 2002, C-436/00, ***X and Y*** [2002] ECR I-10829
    - ECJ, 11 March 2004, C-9/02, ***Hughes de Lasteyrie du Saillant*** [2004] ECR I-2409
    - ECJ, 7 September 2006, C-470/04, ***N*** [2006] ECR I-7409





# Permanent Establishments

- **Treatment of Permanent Establishments → Art 10**
  - Art 10 applies to mergers, divisions, partial divisions and transfers of assets, but not to transfers of the registered office of an SE or an SCE
  - **PE Member State and Residence Member State of the *Receiving* Company**
    - **Legal fiction that PE State is the residence country of the *transferring* company** (Art 10(1) 3rd sentence) → Application of Arts 4, 5 and 6 from the perspective of the PE State and the residence country of the *receiving* company
    - This applies even if the PE State is the residence country of the *receiving* company (Art 10(1) 4th sentence)
  - **Residence Member State of the Transferring Company**
    - DTC with **Exemption Method** → Art 10(1)
      - The residence Member State of the transferring company shall renounce any right to tax that permanent establishment (even if it is situated in the country of the receiving company) → Art 10(1) 1st sentence
      - However, the residence Member State of the transferring company may **recapture losses of the permanent establishment** that have been set off against the taxable profits of the company → Art 10(1) 2nd sentence
    - DTC with **Credit Method** → Art 10(2)
      - The residence Member State of the transferring company may **tax capital gains**
      - But: **Credit for fictitious tax** that would have been levied (but for Art 10(1) 3rd and 4th sentence)

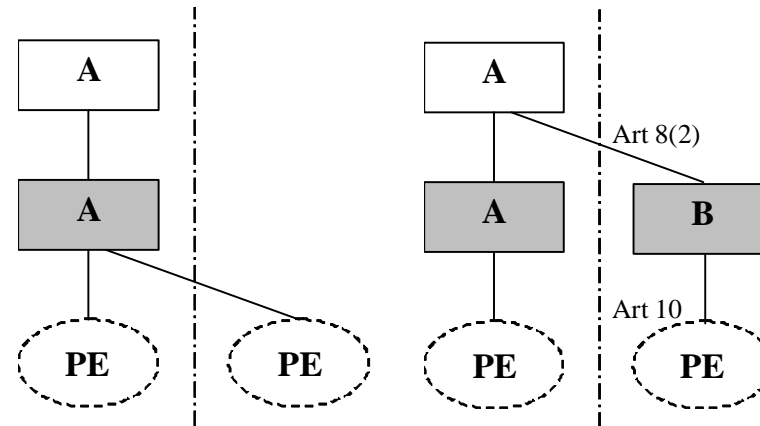




# Permanent Establishments

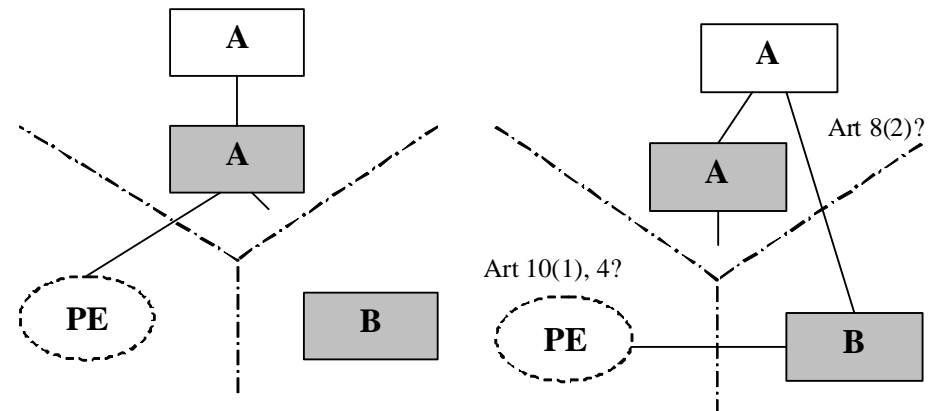
- “Incorporation” of Foreign Permanent Establishment?

- Extension of Art 10(1) through Directive 2005/19/EC to cover “split-offs”
- Art 10(1) **4th sentence** now explicitly covers situations „**where the permanent establishment is situated in the same Member State as that in which the receiving company is resident**”.
- Recapture of losses under Art 10(1) **2nd sentence**



- “Split-off” of a Permanent Establishment in a Third Member State?

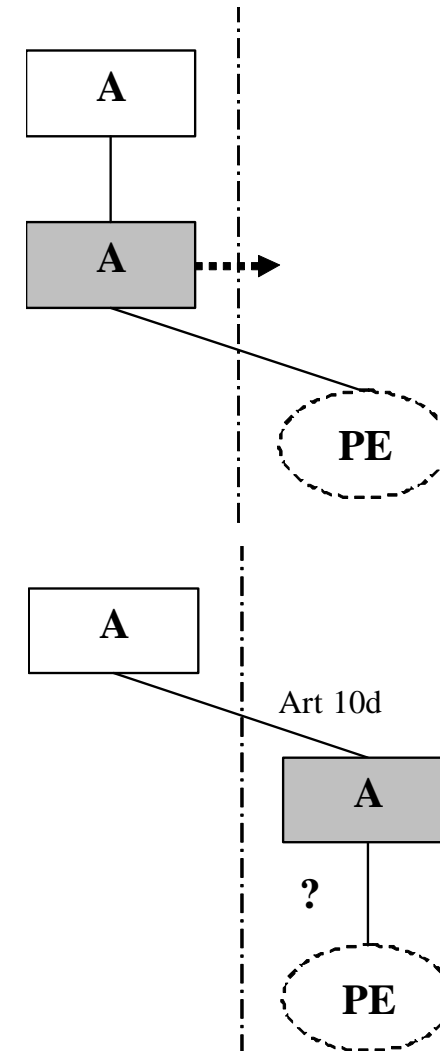
- Point 14 of the Preamble of Directive 2005/19/EC → “it should be made clear that this transaction, being the transfer of assets from a company of a Member State of a permanent establishment located in a different Member State to a company of the **latter** Member State, is covered by the Directive.”





# Permanent Establishments

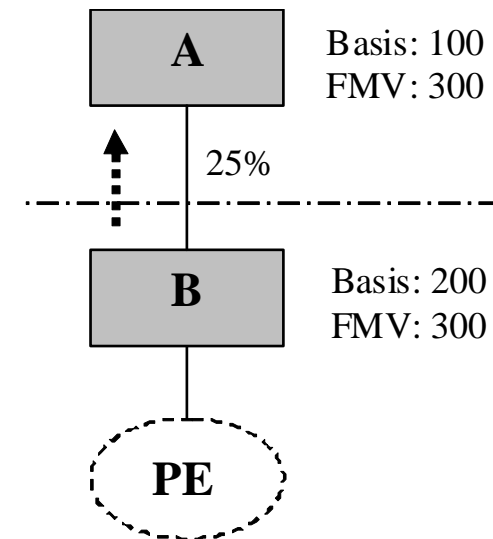
- **Transfers of the Registered Office of an SE or an SCE**
  - Art 10(1) **2nd sentence** allows a recapture of losses in the case of a DTC with the exemption method
  - But: Art 10 applies to mergers, divisions, partial divisions and transfers of assets, **but not to transfers of the registered office of an SE or an SCE** → Art 10(1) **1st sentence**
  - **No Rule for the Transfer of the Registered Office**
    - The Commission Proposal included an explicit reference to Art 10 in Art 10b(3)
    - *Point 8 of the Preamble of Directive 2005/19/EC* → “*Directive 90/434/EEC does not deal with losses of a permanent establishment in another Member State recognised in the Member State of residence of an SE or SCE. In particular, where the registered office of an SE or SCE is transferred to another Member State, such transfer does not prevent the former Member State of residence from reinstating losses of the permanent establishment in due time.*”





## “Confusio” Gains

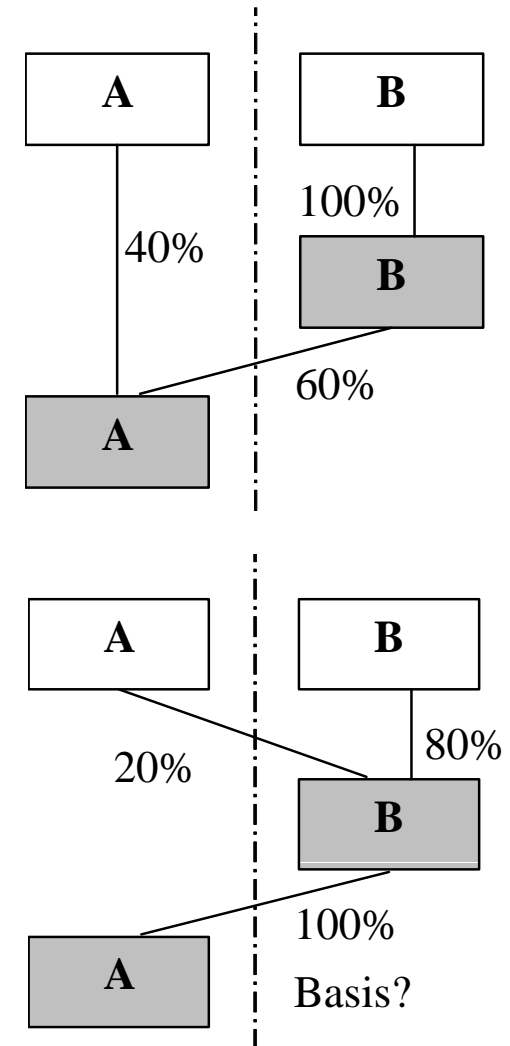
- Art 7(1) → Tax neutrality for confusio gains that result from the difference in book (?) value between the participation and the the assets → “Where the receiving company has a holding in the capital of the transferring company, **any gains accruing to the receiving company on the cancellation of its holding** shall not be liable to any taxation.”
- Prior Law: No “finetuning”
  - Art 3 of the “old” Parent-Subsidiary-Directive: „**minimum holding of 25 %**“
  - Art 7(2) of the “old” Merger Directive Directive: „The Member States may derogate from paragraph 1 where the receiving company's holding in the capital of the transferring company **does not exceed 25 %**.“
  - What happens if the holding is exactly 25%?
- New Law: “Finetuning” through Directive 2005/19/EG
  - Art 3 of the “old” Parent-Subsidiary-Directive: „**minimum holding of 20 % [15%, 10%]**“
  - Art 7(2) of the “new” Merger Directive Directive: “The Member States may derogate from paragraph 1 where the receiving company has a holding **of less than 20 % [15%, 10%]** in the capital of the transferring company“





# Double Taxation

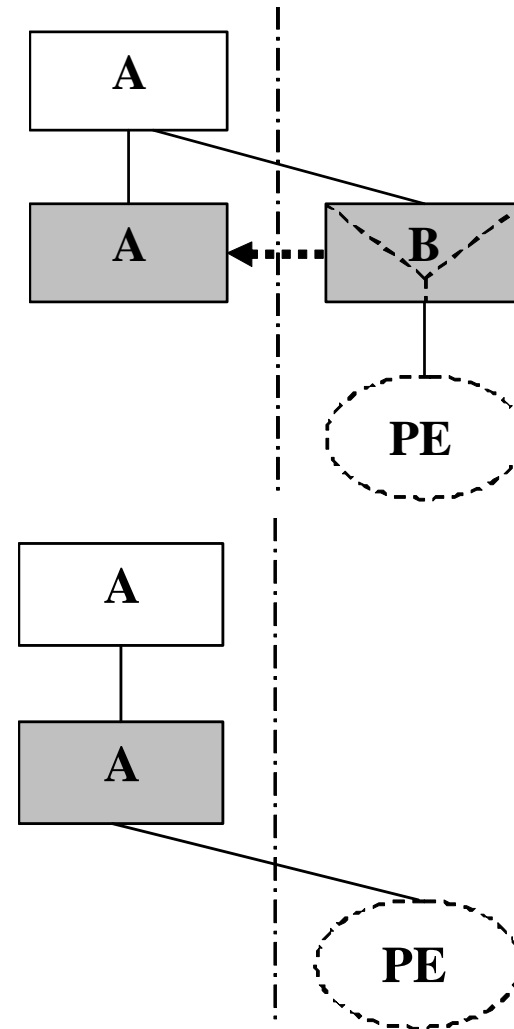
- **Duplication of Hidden Reserves, e.g., in the case of an Exchange of Shares**
  - Carry-over of book value and nonrecognition on the shareholder level upon the exchange of A shares for B shares → Art 8(1)
  - But: The Merger Directive does not contain a rule on the valuation of the A shares on the level of B → Usually, book values are carried over
  - Hidden reserves in the A shares have been duplicated by giving the B shares in the hands of the former A shareholders and the A shares in the hands of company B the same (lower) value
- **Directive 2005/19/EG**
  - Commission Proposal for an Art 8(10) → Acquiring corporation values the acquired shares with their fair market value
  - Proposal not adopted into final version of the Directive





# Hybrid Entities

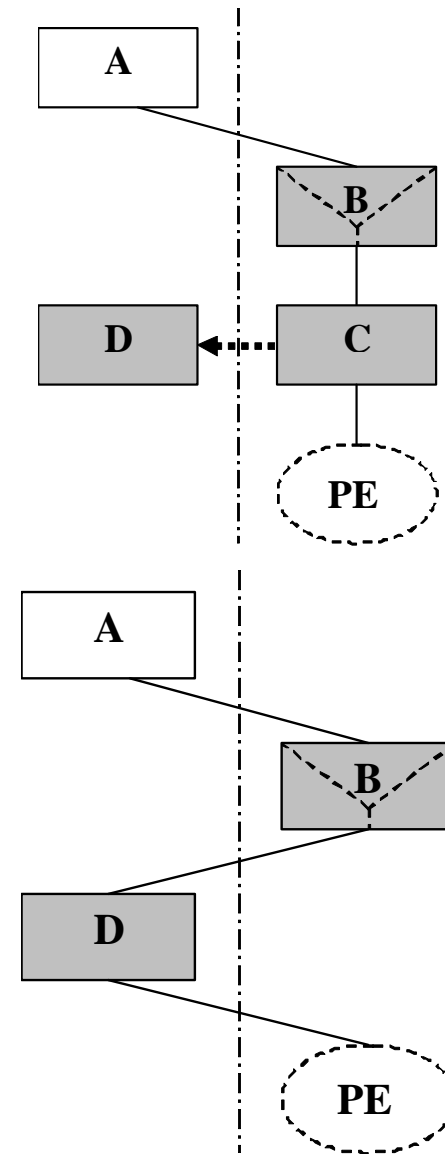
- **New Rules on Transparent (Hybrid) Entities**
  - Basic Rules → **Art 4(2)**, 8(3)
  - Opt-outs for Member States → 10a
- **Company Level → Art 4(2)**
  - Where Art 4 (1) applies and “*where a Member State considers a **non-resident transferring company as fiscally transparent** on the basis of that State’s assessment of the legal characteristics of that company arising from the law under which it is constituted and therefore taxes the shareholders on their share of the profits of the transferring company as and when those profits arise, **that State shall not tax any income, profits or capital gains calculated by reference to the difference between the real values of the assets and liabilities transferred and their values for tax purposes.***”





# Hybrid Entities

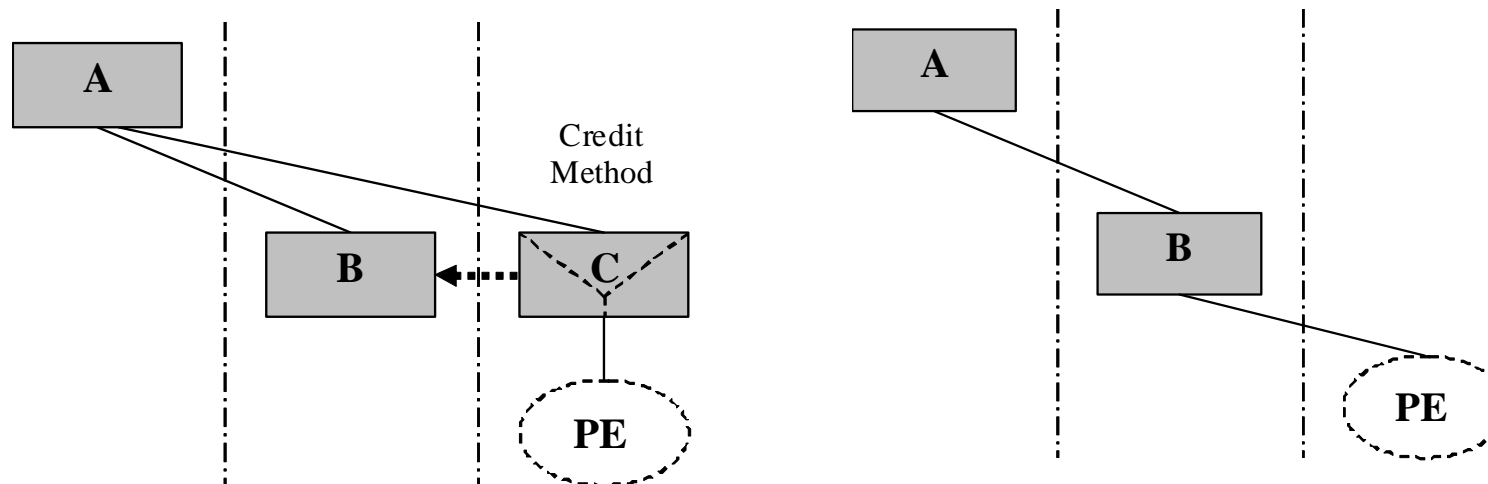
- **New Rules on Transparent (Hybrid) Entities**
  - Basic Rules → **Art 4(2), 8(3)**
  - Opt-outs for Member States → 10a
- **Shareholder Level → Art 8(3)**
  - “Where a Member State considers a **shareholder as fiscally transparent** on the basis of that State’s assessment of the legal characteristics of that shareholder arising from the law under which it is constituted and therefore taxes those persons having an interest in the shareholders on their share of the profits of the shareholder as and when those profits arise, **that State shall not tax those persons on income, profits or capital gains from the allotment of securities representing the capital of the receiving or acquiring company to the shareholder.**”





# Hybrid Entities

## Problem 1 – Merger of a hybrid leads to a permanent loss of taxing jurisdiction

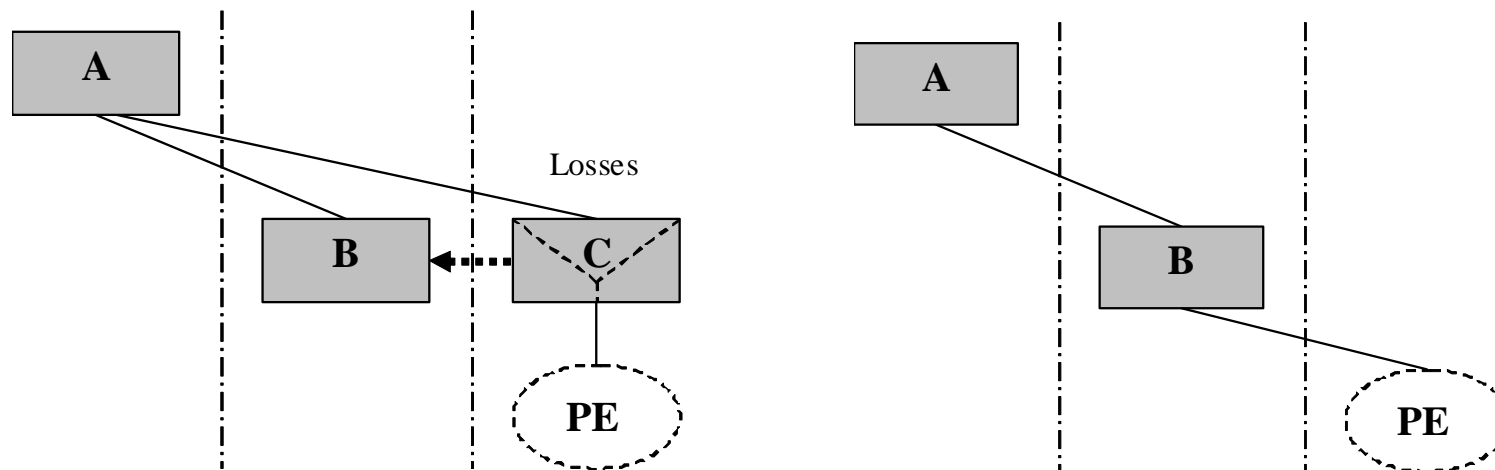


- Art 4(2) prohibits State A to tax hidden reserves in the PE's assets
- Art 8(1) prohibits State A to tax the allotment of B shares to company A
- Art 10(2) does not apply as the hybrid is a company within the meaning of the Directive (and not a permanent establishment of company A)
- But: **Art 10a(1) and (2)** → State A may tax, provided it grants relief for (fictitious) tax that would have been levied in the PE State



# Hybrid Entities

## Problem 2 – Merger of a hybrid prevents the recapture of losses



- Losses of the PE have already been utilized in Member State A, but have not yet been recaptured
- Art 10(1) does not apply as the hybrid is a company within the meaning of the Directive (and not a permanent establishment of company A)
- But: **Art 10a(1) and (2)** → State A may tax, provided it grants relief for (fictitious) tax that would have been levied in the PE State





***Part IV-3***  
***The Interest-Royalties-Directive***



# Overview

- **Objective**
  - Part of the Tax Package to Tackle Harmful Tax Competition
  - Avoidance of double taxation through removal of withholding taxes on interest and royalty payments made between associated companies of different Member States → Art 1(1)
  - Safeguard effective taxation at the level of the beneficial owner → Art 3
- **Legal Text**
  - Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, [2003] OJ L 157, p. 49.

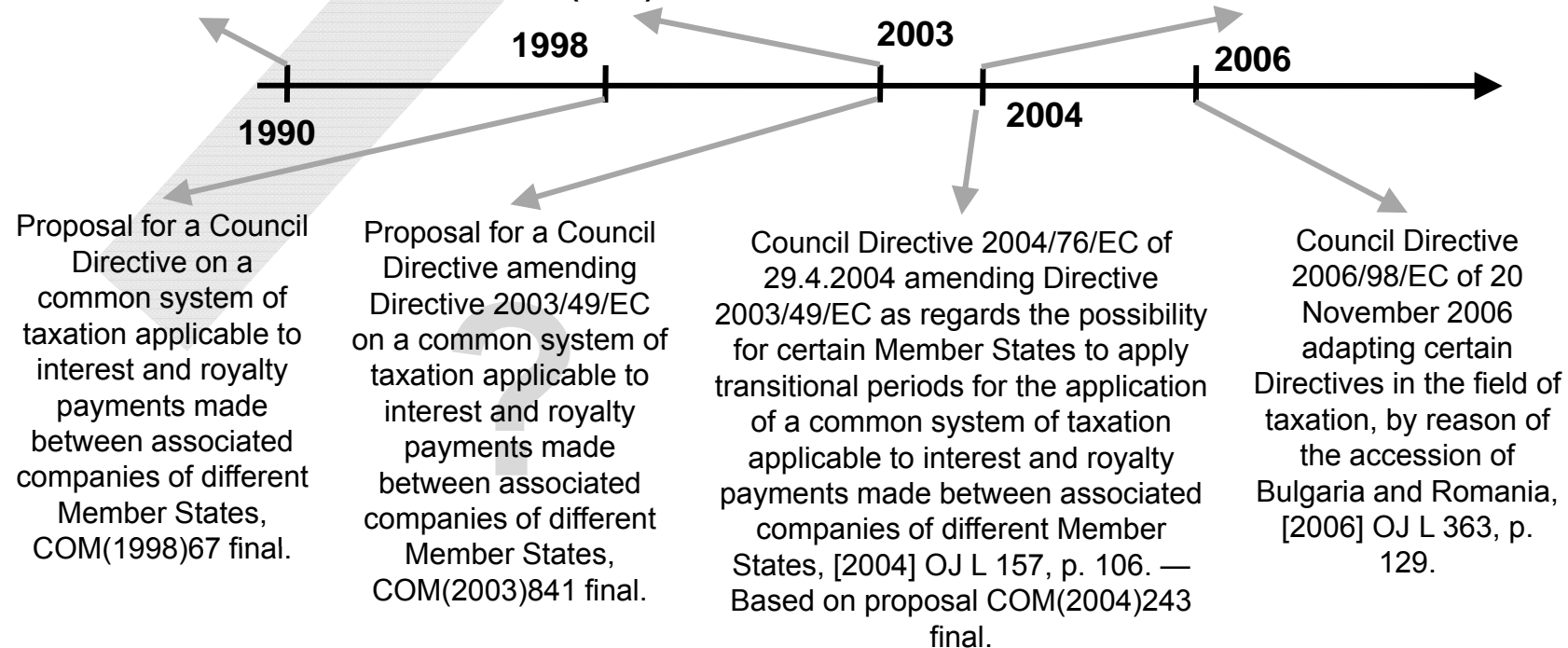


# Interest-Royalties-Directive – Timeline

Proposal for a Council Directive on a common system of taxation applicable to interest and royalty payments made between parent companies and subsidiaries in different Member States, COM(90)571 final. — Replaced by COM(93)196 final, and withdrawn on 9 December 1994.

**Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, [2003] OJ L 157, p. 49.— Based on proposal COM(1998)67 final.**

Council Directive 2004/66/EC of 26 April 2004 adapting Directives 1999/45/EC, 2002/83/EC, 2003/37/EC and 2003/59/EC of the European Parliament and of the Council and Council Directives 77/388/EEC, 91/414/EEC, 96/26/EC, 2003/48/EC and 2003/49/EC, in the fields of free movement of goods, freedom to provide services, agriculture, transport policy and taxation, by reason of the accession of the Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia and Slovakia, [2004] OJ L 168, p. 35. — Based on proposal COM(2004)148 final.





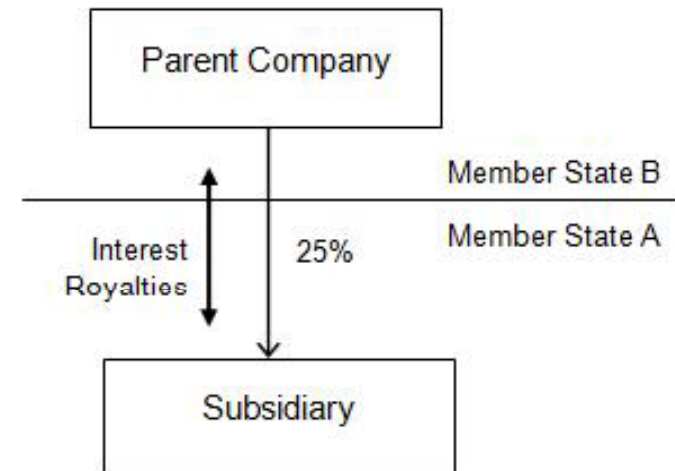
# Structure of the Directive

- **Art 1** – Scope of Application and Procedure
- **Art 2** – Definition of “interest” and “royalties”
- **Art 3** – Definition of “company,” “associated company” and “permanent establishment”
- **Art 4** – Exclusion of payments as interest or royalties
- **Art 5** – Fraud and abuse
- **Art 6** – Transitional rules for various Member States
- **Art 7** – Deadline for implementation
- **Art 8** – Review
- **Art 9** – Delimitation clause for the application of domestic or agreement-based provisions which go beyond the provisions of this Directive and are designed to eliminate or mitigate the double taxation of interest and royalties
- **Art 10** – Entry into force
- **Art 11** – Addressees



# Scope of Application

- **Exemption from source-taxation of**
  - **interest payments** → Art 2(a)
  - **royalty payments** → Art 2(b)
- Interest or royalty payments “arising” in a Member State shall be exempt from any taxes imposed on those payments in that State (“source State” → Art 1(2)), whether by deduction at source or by assessment, provided that the **beneficial owner** of the interest or royalties (→ Art 1(4) and (5)) is
  - **a company of another Member State** (→ Art 1(4) → Art 3(a))
  - or a **permanent establishment situated in another Member State of a company of a Member State** (→ Art 1(5) and (8) → Art 3(c)).
- A payment **made by a company of a Member State or by a permanent establishment situated in another Member State shall be deemed to arise in that Member State** (i.e., the “source State” → Art 1(2) and (3))





## Scope of Application

- **Precedence of the PE** → Art 1(6) → “Where a **permanent establishment** of a company of a Member State is treated as the payer, or as the beneficial owner, of interest or royalties, **no other part of the company shall be treated as the payer, or as the beneficial owner**, of that interest or those royalties for the purposes of this Article.”
- **Exemption at source** → Refund procedure only if certain procedural requirements set forth in Art 1(11) to (13) are not fulfilled
- The exemption requires that “the company which is the payer, or the company whose permanent establishment is treated as the payer, of interest or royalties **is an associated company** of the company which is the beneficial owner, or whose permanent establishment is treated as the beneficial owner, of that interest or those royalties”. → Art 1 Abs 7 → Art 3(b)



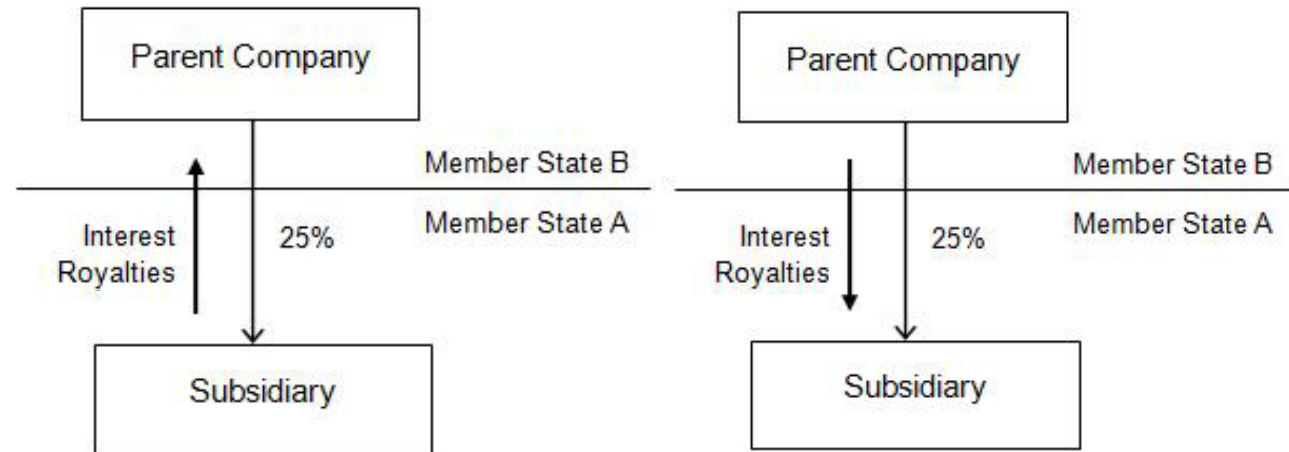
## Scope of Application

- The exemption under Art 1(1) requires that “*the company which is the payer, or the company whose permanent establishment is treated as the payer, of interest or royalties **is an associated company** of the company which is the beneficial owner, or whose permanent establishment is treated as the beneficial owner, of that interest or those royalties*”. → Art 1 Abs 7 → Art 3(b)
- Art 3(b) → A company is an “**associated company**” of a second company if, at least:
  - the **first** company has a direct minimum holding of 25% in the capital (or voting rights) of the **second** company, or
  - the **second** company has a direct minimum holding of 25% in the capital (or voting rights) of the **first** company, or
  - a **third** company has a direct minimum holding of 25% both in the capital (or voting rights) of the **first** company and in the capital of the **second** company.
- Art 1(10) → “A Member State shall have the option of not applying this Directive to a company of another Member State or to a permanent establishment of a company of another Member State in circumstances where the conditions set out in Article 3(b) **have not been maintained** for an uninterrupted period of at least two years.”

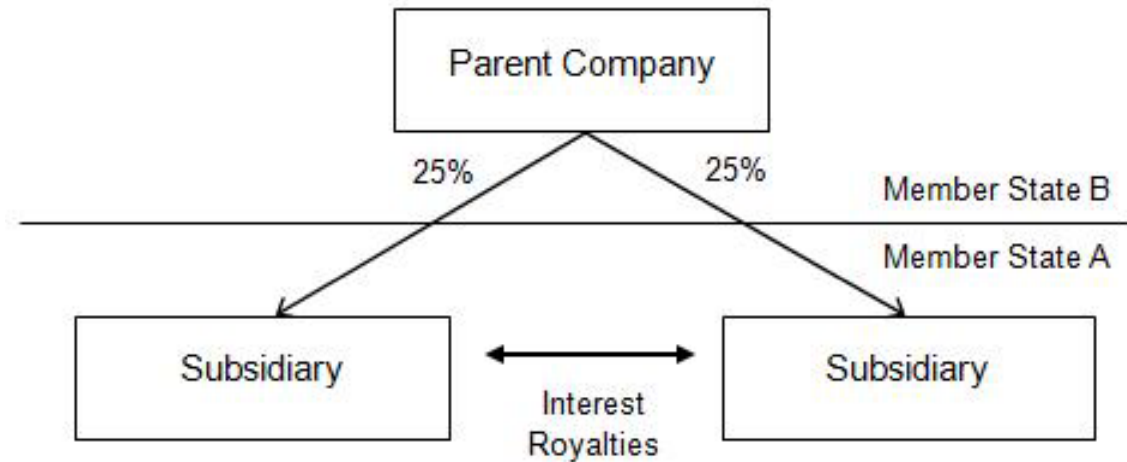


# Scope of Application – Companies

## Payment Between Parent and Subsidiary



## Payments Between Sister Companies

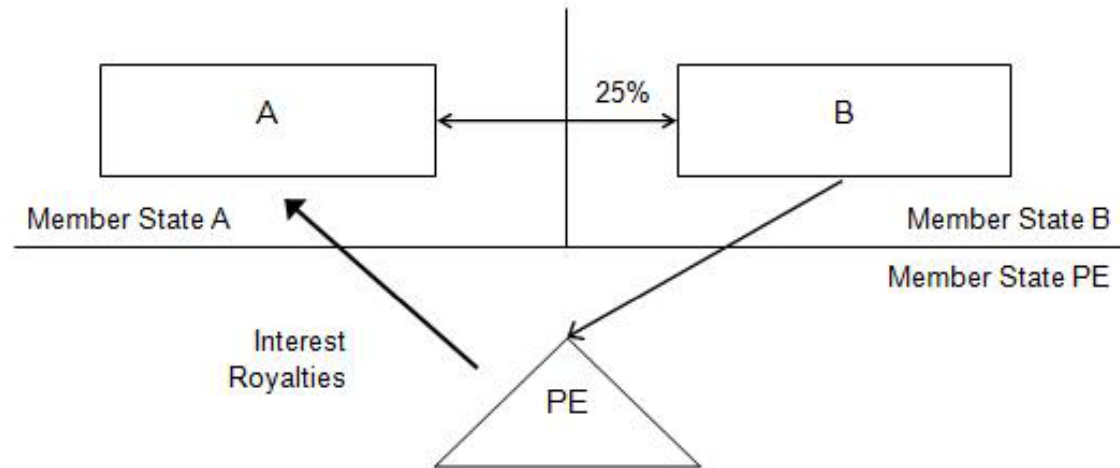




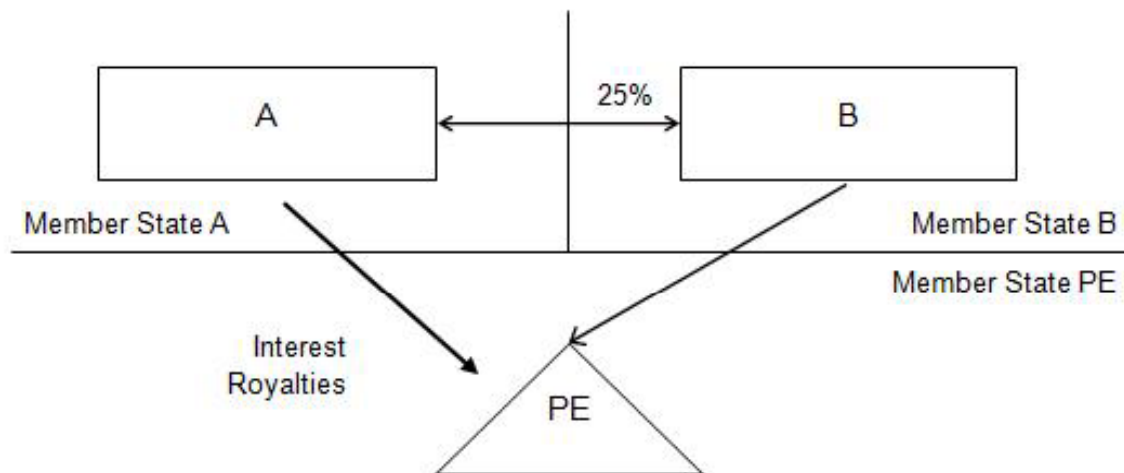


# Scope of Application – PE

Permanent  
Establishment as  
Payor



Permanent  
Establishment as  
Beneficial Owner





## Definition of “Interest” and “Royalties”

- **Interest** → Art 2(a)
  - “Interest” means *“income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures; penalty charges for late payment shall not be regarded as interest,”*
  - See also Art 11(3) OECE-MC
- **Royalties** → Art 2(b)
  - “Royalties” means *“payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work, including cinematograph films and software, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience; payments for the use of, or the right to use, industrial, commercial or scientific equipment shall be regarded as royalties.”*
  - See also Art 12(2) OECE-MC



# Definitions

- Art 3(a) → “**Company of a Member State**” shall mean any company which:
  - takes one of the **legal forms** listed in the Annex to the Directive → Art 3(a)(i)
  - 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** → Art 3(a)(ii)
  - is **subject to one of the taxes** listed in Art 3(a)(iii), 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
- Art 3(c) → “**Permanent establishment**” means “*a fixed place of business situated in a Member State through which the business of a company of another Member State is wholly or partly carried on.*”



# Exclusions and Transitional Rules

- **Option to exclude certain Interest Payments from the Benefits of the Directive → Art 4(1)**
  - payments which are treated as a distribution of profits or as a repayment of capital under the law of the source State → Art 4(1)(a)
  - payments from debt-claims which carry a right to participate in the debtor's profits → Art 4(1)(b)
  - payments from debt-claims which entitle the creditor to exchange his right to interest for a right to participate in the debtor's profits → Art 4(1)(c)
  - payments from debt-claims which contain no provision for repayment of the principal amount or where the repayment is due more than 50 years after the date of issue → Art 4(1)(d)
- **Arm's Length Standard → Art 4(2)**
  - “Where, by reason of a special relationship between the payer and the beneficial owner of interest or royalties, or between one of them and some other person, the amount of the interest or royalties exceeds the amount which would have been agreed by the payer and the beneficial owner in the absence of such a relationship, the provisions of this Directive shall apply only to the latter amount, if any.”
  - See also Art 11(6) and Art 12(4) OECD-MC
  - Application of Parent-Subsidiary-Directive?
- **Transitional rules for certain Member States → Art 6**
  - Certain Member States may temporarily apply (limited) withholding taxes → Art 6(1)
  - Obligation to credit such tax imposed on the country of the beneficial owner (company or permanent establishment) → Art 6(2)



***Part IV-4***  
***The Arbitration Convention***



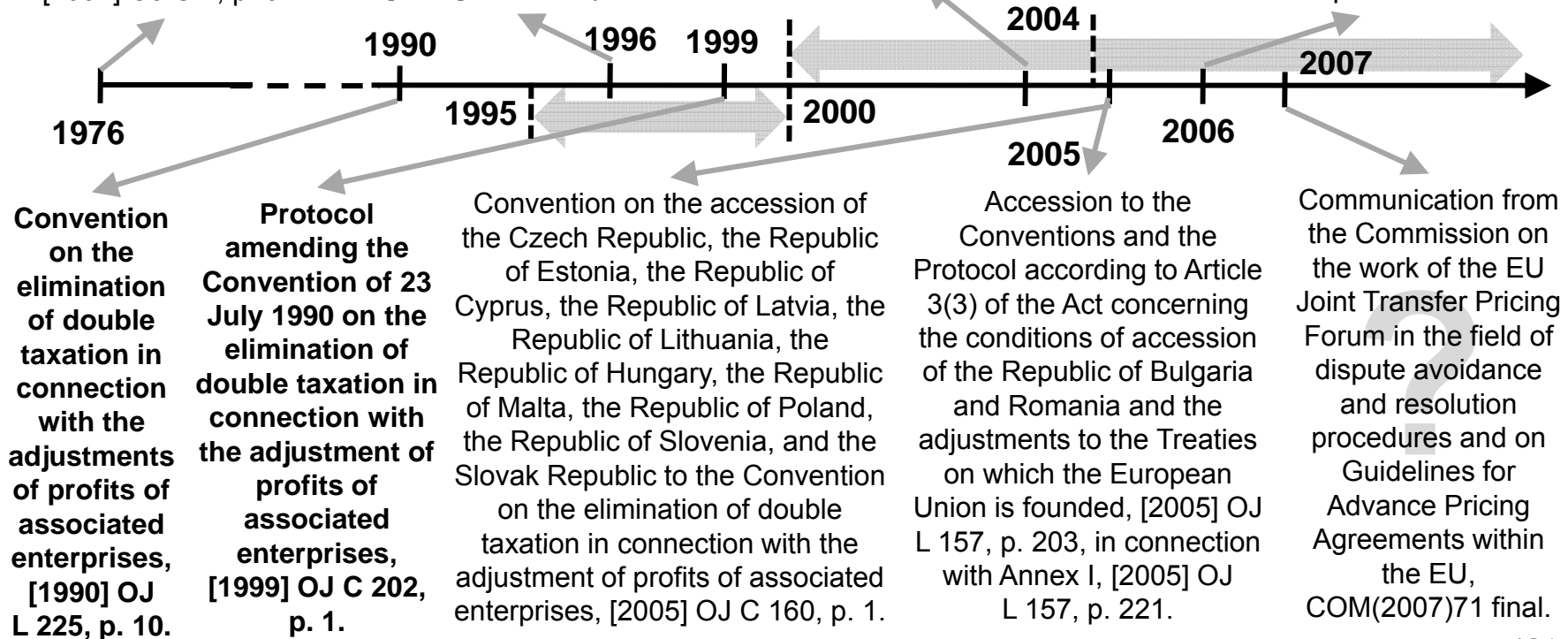
# Arbitration Convention – Timeline

Proposal for a Council Directive on the Elimination of Double Taxation in Connection with the Adjustment of Transfers of Profits between Associated Enterprises (Arbitration Procedure), COM(76)611 final. — Withdrawn by [1997] OJ C 2, p. 6.

Convention on the accession of the Republic of Austria, the Republic of Finland and the Kingdom of Sweden to the Convention on the elimination of double taxation in connection with the adjustments of profits of associated enterprises, [1996] OJ C 26, p. 1.

Communication from the Commission on the work of the EU Joint Transfer Pricing Forum and on a proposal for a Code of Conduct for the effective implementation of the Arbitration Convention (90/436/EEC of 23 July 1990), COM(2004)297 final. — Accepted by the Council in late-2004 (IP/04/1447).

Communication from the Commission on the work of the EU Joint Transfer Pricing Forum and Proposal for a Code of Conduct on transfer pricing documentation for associated enterprises in the EU, COM(2005)543 final. — Accepted by the Council in June 2006, [2006] OJ C 176, p. 1.

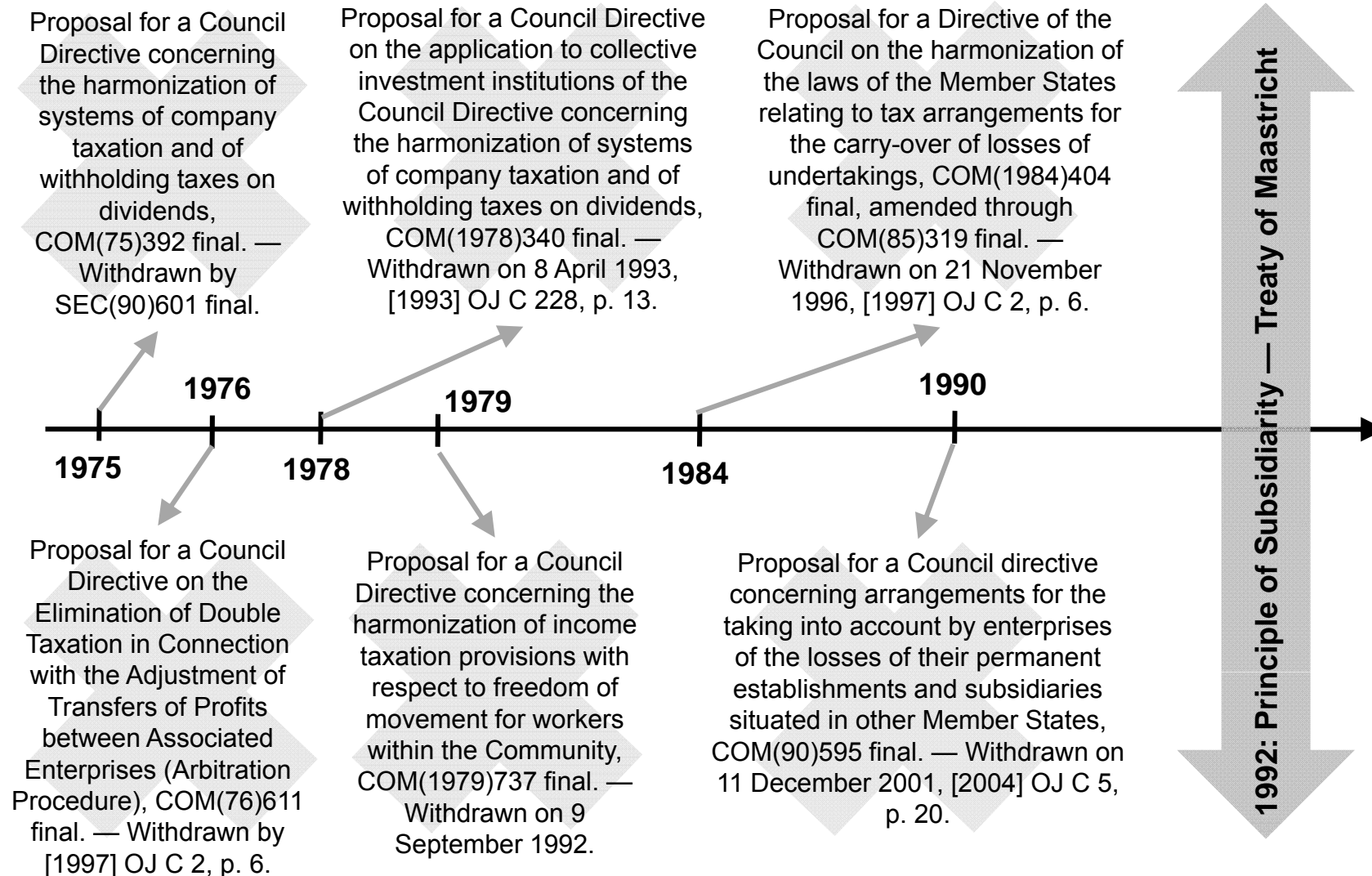




***Part IV-5***  
***Overview: Withdrawn Commission Proposals***



# Withdrawn Proposals – Timeline







# **Part V**

## **Corporate Tax Harmonization**



***Part V-1***  
***Home State Taxation (HST)***



# Core Documents

- Developed by *Malcolm Gammie* and *Sven-Olof Lodin*
- Principle of Mutual Recognition → Every Member State (branch or subsidiary) shall recognize the tax system of the headquarters State, i.e., the Home State of the group
- Home State Taxation for SMEs
  - Towards an Internal Market without tax obstacles – A strategy for providing companies with a consolidated corporate tax base for their EU-wide activities, COM(2001)582 final.
  - An Internal Market without company tax obstacles achievements, ongoing initiatives and remaining challenges, COM(2003)726 final.
  - Commission Non-Paper to informal Ecofin Council, 10 and 11 September 2004: Home State Taxation for Small and Medium-Sized Enterprises (7 July 2004).
  - Tackling the corporation tax obstacles of small and medium-sized enterprises in the Internal Market – outline of a possible Home State Taxation pilot scheme, COM(2005)702 final.
  - Tackling the corporation tax obstacles of small and medium-sized enterprises in the Internal Market – outline of a possible Home State Taxation pilot scheme – Impact Assessment, SEC(2005) 1785.



# Outline

- Principle of Mutual Recognition → Every Member State shall recognize the tax system of the headquarters State, i.e., the Home State of the group
- Group of companies is taxed as a unity and only once on its consolidated profits, irrespective of the number and legal form of its operations (branches or subsidiaries) and regardless of their location in the EU
- Income is calculated under the laws of the Home State and is subsequently divided among the jurisdictions where the group operates
- Allocation
  - Turnover, asset value and payroll
  - Fraction of the total VAT base per Member State
  - Gross Domestic Product
- Every Member State applies its own corporate tax rate to the allocated tax base



# Outline

Pros	Cons
<ul style="list-style-type: none"><li>▪ No harmonization (EU common tax base) necessary</li><li>▪ Administration and compliance for companies</li></ul>	<ul style="list-style-type: none"><li>▪ Administration for tax authorities</li><li>▪ “Capital Import Neutrality” and location of headquarters</li><li>▪ Tax measures taken by the Home State would affect all jurisdictions where the group operates</li><li>▪ Sale of shares and “switch” in Home State → Corporate emigration and “Exit Tax”?</li><li>▪ Need for similarity of tax systems → “Europe of two speeds”</li><li>▪ Member States only get a “slice” of EU average → Profits vs losses</li><li>▪ Treatment of income from third countries?</li><li>▪ Tax treaty application?</li></ul>



***Part V-2***  
***Common Consolidated Corporate Tax Base***  
***(CCCTB)***



# Core Documents

- **Positive Integration → Common Tax Base and Common Fiscal Profit Determination System**
- **Common Consolidated Corporate Tax Base**
  - Towards an Internal Market without tax obstacles - A strategy for providing companies with a consolidated corporate tax base for their EU-wide activities, COM(2001)582 final.
  - An Internal Market without company tax obstacles achievements, ongoing initiatives and remaining challenges, COM(2003)726 final.
  - Commission Non-Paper to informal Ecofin Council, 10 and 11 September 2004: A Common Consolidated EU Corporate Tax Base (7 July 2004).
  - Implementing the Community Lisbon Programme: Progress to date and next steps towards a Common Consolidated Corporate Tax Base (CCCTB), COM(2006)157 final.
  - Common Consolidated Corporate Tax Base Working Group (CCCTB WG) – *Progress to date and future plans for the CCCTB*, CCCTB/WP/046.
  - Implementing the Community Programme for improved growth and employment and the enhanced competitiveness of EU business: Further Progress during 2006 and next steps towards a proposal on the Common Consolidated Corporate Tax Base (CCCTB), COM(2007)223 final.
  - CCCTB: possible elements of a technical outline, CCCTB/WP/057.
- **Proposal announced for 2009!**



# Outline

- Positive Integration → Common Tax Base
- Group of companies is taxed as a unit and only once on its consolidated profits, irrespective of the number and legal form of its operations (branches or subsidiaries) and regardless of their location in the EU
- Income is calculated based on the *Common Tax Base*, not on a domestic tax base as in HST
- Allocation/Appportionment → Turnover, asset value and payroll
- Every Member State applies its own corporate tax rate to the allocated tax base





# Outline

Pros	Cons
<ul style="list-style-type: none"><li>▪ Only one system → Administration and compliance for companies and tax authorities</li><li>▪ Removal of many Transfer Pricing Issues</li></ul>	<ul style="list-style-type: none"><li>▪ Harmonization necessary → Unanimous decision required or “core group” of Member States → <i>Tax Base and Allocation</i></li><li>▪ Member States only get a “slice” of EU average → Profits vs losses</li><li>▪ Apportionment and double taxation</li><li>▪ Treatment of income from third countries?</li><li>▪ Tax treaty application?</li></ul>



## **Part VI**

# **Harmful Tax Competition**



# Overview

- Capital mobility puts **downward pressure on corporate income taxes**, but little consensus on whether this is **beneficial, harmful or irrelevant to economic welfare**
- “Tax Competition” →
  - **Corporate Taxation and Location Decisions** → Countries lower their corporate income taxes in order to attract the real activities of firms → Sensitive to tax-rate and allowances
  - **“Taxing Rights” and “Income Shifting”** → Competition for taxing rights, i.e. competition for having profits reported in a particular country, without an associated movement of production (e.g., by transfer pricing) → Sensitive only to tax-rate
- Consensus: Address ***harmful tax practices*** and **promote *fair tax competition***
  - Both OECD and EU are concerned at the proliferation of certain tax regimes which, together with the new opportunities opened up by globalization,
    - increase the potential for distorting economic behavior and
    - widen the avenues for non-compliance with the tax laws of a taxpayer’s home country.
  - Law-abiding businesses are concerned that such opportunities can skew the competitive environment unfairly in favour of the tax abuser and against the company that plays by the rules.



# Tax Competition

## Tax Competition

**“First-best result”** → Classical jurisdictional theory → Universal preference satisfaction

*Samuelson*-condition of public sector economics → A person's willingness to pay for another unit of a public good = cost of producing that additional unit

But: Distortions and fiscal externalities

Financial services and mobile investments → *Harmful Tax Competition*

**Establishing fiscal discipline** → Government efficiency and reduction of political distortions → Monopoly versus “lean state”, restriction of unbridled growth of the public sector and promotion of efficiency in the use of government finances → Taxes as price for benefits

Spontaneous approximation of laws

But: Marginal costs versus average costs → decrease of public investments?

“Cartelization” through tax harmonization



# Tax Harmonization

## Tax Harmonization

**Economic Distortions** → Removal of economic distortions, but restriction of sovereignty of states → CIN *and* CEN

**Lack of efficiency of allocation** → Tax Competition might lead to a “Race to the Bottom” and massive limitation of the scope of state action (e.g., redistribution)

But: No empirical evidence, but rather modest corporate tax rates and broad tax base

**International Equity** → Transfer of tax bases to source countries (e.g., because of “ring fenced” tax preferences with low marginal costs) and “free riders” of the domestic welfare state

**Individual Equity** → Mobile versus less mobile taxpayers and shift of tax burden to less mobile taxpayers

But: Tax relief for business profits will eventually benefit employees



# Overview – OECD and EU

OECD	EU
<ul style="list-style-type: none"><li>▪ “Harmful Tax Competition: An Emerging Global Issue” (1998)</li><li>▪ “Towards Global Cooperation: Progress in Identifying and Eliminating Harmful Tax Practices” (2000) (“2000 Report”) [47 potentially harmful regimes and 35 potential tax havens]</li><li>▪ “Guidance in Applying the 1998 Report to Preferential Tax Regimes (Consolidated Application Note)” (2004)</li></ul> <p><b>Also:</b></p> <ul style="list-style-type: none"><li>▪ “The OECD’s Project on Harmful Tax Practices: The 2001 Progress Report” (2001)</li><li>▪ “The OECD’s Project on Harmful Tax Practices: The 2004 Progress Report” (2004)</li><li>▪ “The OECD’s Project on Harmful Tax Practices: 2006 Update on Progress in Member Countries” (2006)</li></ul>	<ul style="list-style-type: none"><li>▪ Communication “Towards tax co-ordination in the European Union – A package to tackle harmful tax competition”, COM(97)495 final and COM(97)564 final</li><li>▪ Conclusions of the ECOFIN Council Meeting on 1 December 1997 concerning taxation policy, 1998 O.J. C 2/1 (Jan. 6, 1998)</li><li>▪ <b>Package:</b><ul style="list-style-type: none"><li>▪ Code of Conduct [1998 O.J. C 2/1 (Jan. 6, 1998)] and <i>Primarolo</i> Report, 4901/99.</li><li>▪ <i>Savings Directive</i></li><li>▪ <i>Interest and Royalty Directive</i></li></ul></li></ul> <p><b>Also:</b></p> <ul style="list-style-type: none"><li>▪ Communication on “Community Action to Combat International Tax Evasion and Avoidance”, COM(84)603 final</li><li>▪ Commission Notice on the application of the State aid rules to measures relating to direct business taxation, 1998 O.J. C 384/, 3 (Dec. 10, 1998)</li></ul>



# Overview – OECD and EU

OECD	EU
<ul style="list-style-type: none"><li>▪ <b>Scope</b><ul style="list-style-type: none"><li>▪ Criteria to identify harmful preferential regimes</li><li>▪ Limited to financial and other service activities</li><li>▪ Broad geographical grouping</li><li>▪ Focus on exchange of information</li><li>▪ OECD Guidelines are accompanied by 19 Recommendations</li></ul></li></ul>	<ul style="list-style-type: none"><li>▪ <b>Scope</b><ul style="list-style-type: none"><li>▪ Criteria to identify harmful preferential regimes</li><li>▪ Business activities in general (emphasis on mobile activities)</li><li>▪ Code of Conduct is part of a “package” of measures</li></ul></li></ul>



# Overview – OECD and EU

OECD	EU
<ul style="list-style-type: none"><li>▪ <b>Policy Considerations</b><ul style="list-style-type: none"><li>▪ Positive impact of globalization on taxation (less distortions, government spending, “fiscal climate”, reduction of tax barriers)</li><li>▪ But: Preferential regimes may cause harm by<ul style="list-style-type: none"><li>- distorting financial and, indirectly, real investment flows;</li><li>- undermining the integrity and fairness of tax structures;</li><li>- discouraging compliance by all taxpayers;</li><li>- re-shaping the desired level and mix of taxes and public spending;</li><li>- causing undesired shifts of part of the tax burden to less mobile tax bases, such as labour, property and consumption; and</li><li>- increasing the administrative costs and compliance burdens on tax authorities and taxpayers.</li></ul></li></ul></li></ul>	<ul style="list-style-type: none"><li>▪ <b>Policy Considerations</b><ul style="list-style-type: none"><li>▪ Welcomes tax competition “as a means of benefiting citizens and of imposing downward pressure on government spending”</li><li>▪ But: Unrestrained competition for mobile factors<ul style="list-style-type: none"><li>- can bias tax systems against employment;</li><li>- can make an orderly and structured reduction in the overall tax burden more difficult;</li><li>- reduces the room for manouvre to meet Community objectives (e.g., protection of the environment);</li><li>- can hamper efforts to reduce budget deficits (necessary to comply with the Maastricht criteria and the Stability and Growth Pact);</li><li>- can, in an integrated market without co-ordination, put increasing constraints on Member States’ freedom to choose the appropriate tax structure</li></ul></li></ul></li></ul>





# Overview – OECD and EU

OECD	EU
<ul style="list-style-type: none"><li>▪ <b>Harmful Tax Competition</b> – Preferential Tax Regimes<ul style="list-style-type: none"><li>▪ Low or no taxes on the relevant income (from geographically mobile financial and other service activities);</li><li>▪ regime lacks transparency;</li><li>▪ no effective exchange of information with respect to the regime;</li><li>▪ regime is ring-fenced from the domestic economy, especially</li><li>▪ regimes that restrict benefits to non-residents;</li><li>▪ regimes that deny access to domestic markets.</li><li>▪ Additionally:<ul style="list-style-type: none"><li>- Artificial definition of the tax base;</li><li>- failure to adhere to international transfer pricing principles;</li><li>- foreign source income is exempt from tax;</li><li>- negotiable tax rate or tax base;</li><li>- existence of secrecy provisions;</li><li>- access to a wide network of tax treaties</li><li>- regimes are promoted as tax minimization vehicles;</li><li>- regime encourages purely tax-driven operations or arrangements</li></ul></li></ul></li></ul>	<ul style="list-style-type: none"><li>▪ <b>Harmful Tax Competition</b> - Tax measures that provide for a significantly lower effective level of taxation than those levels which generally apply in the Member State in question are regarded as potentially harmful.</li><li>▪ Other factors:<ul style="list-style-type: none"><li>▪ Advantages are accorded only to non-residents or in respect of transactions carried out with non-residents;</li><li>▪ advantages are ring-fenced from the domestic market; advantages are granted even without any real economic activity and substantial economic presence;</li><li>▪ profit determination departs from internationally accepted standards;</li><li>▪ tax measure lacks transparency.</li></ul></li></ul>



# Overview – OECD and EU

OECD	EU
<ul style="list-style-type: none"><li>▪ <b>Measures and Outlook</b><ul style="list-style-type: none"><li>▪ 19 Recommendations<ul style="list-style-type: none"><li>▪ concerning domestic legislation (CFC rules, foreign investment funds, restriction of participation exemptions, reporting rules, ruling practice, transfer pricing standards, access to banking information)</li><li>▪ concerning tax treaties (exchange of information, entitlement to benefits, status of domestic anti-abuse rules, “exclusion” list, no treaties with tax havens, co-ordinated enforcement, recovery of tax claims)</li><li>▪ for intensification of international cooperation (Forum, standstill and rollback, list of tax havens, links with tax havens, “Principles of Good Tax Administration”, associating non-member countries)</li></ul></li><li>▪ “Model Agreement on Information Exchange on Tax Matters”</li><li>▪ Global level playing field in the areas of transparency and effective exchange of information in tax matters</li></ul></li></ul>	<ul style="list-style-type: none"><li>▪ <b>Measures and Outlook</b><ul style="list-style-type: none"><li>▪ Code of Conduct is part of the “Tax Package”</li><li>▪ Standstill and Rollback</li><li>▪ Review Process - Primarolo Report, 4901/99</li><li>▪ State Aid - Commission Notice on the application of the State aid rules to measures relating to direct business taxation, 1998 O.J. C 384/, 3 (Dec. 10, 1998)</li></ul></li></ul>



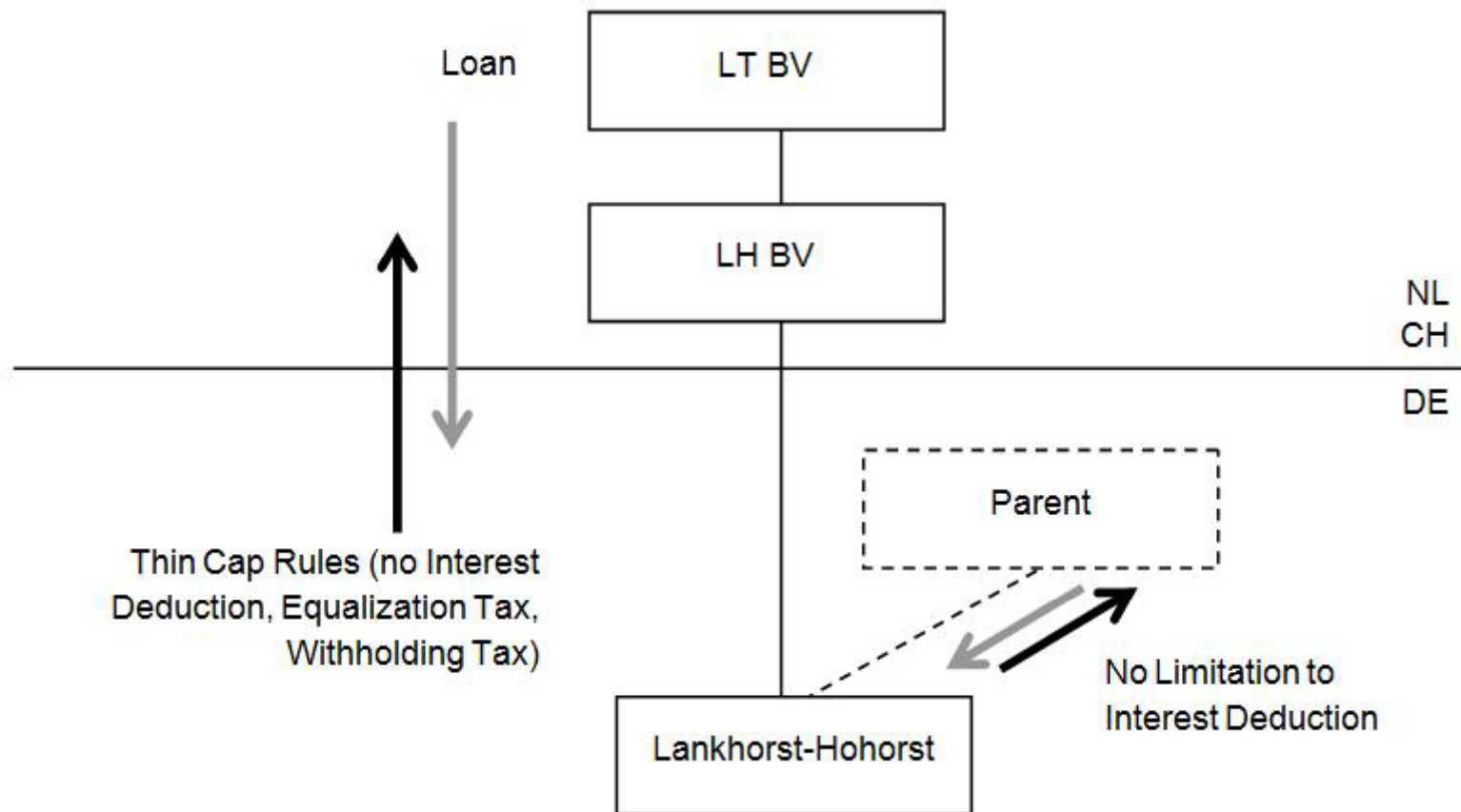
# “Abuse” and Countermeasures

- **Domestic Measures and ECJ Case Law**
  - **Thin Capitalization** → ECJ, 12 December 2002, C-324/00, *Lankhorst-Hohorst* [2002] ECR I-11779, and ECJ, 13 March 2007, C-524/04, *Thin Cap Group Litigation* [2007] ECR I-2107
  - **CFC-Legislation** → ECJ, 12 September 2006, C-196/04, *Cadbury Schweppes* [2006] ECR I-7995
  - **Switch Over** → ECJ, 6 December 2007, C-298/05, *Columbus Container Services* [2007] ECR I-10451
  - **Treaty Shopping**
    - **GAARs**
    - **Limitation on Benefits** → ECJ, 12 December 2006, C-374/04, *ACT Group Litigation* [2006] ECR I-11673
- **Commission**
  - Communication from the Commission on the **application of anti-abuse measures in the area of direct taxation – within the EU and in relation to third countries**, KOM(2007)785 final



# Thin Capitalization

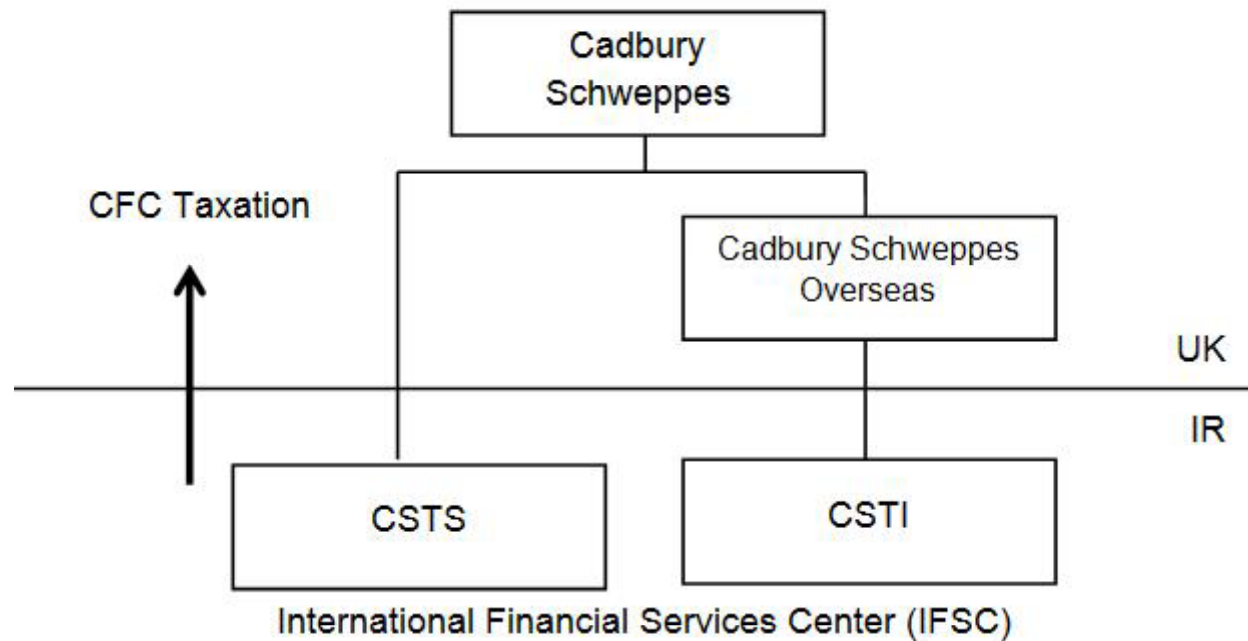
- **Anti-Avoidance: Thin Cap Rules** — ECJ, 12 December 2002, C-324/00, *Lankhorst-Hohorst* [2002] ECR I-11779, and ECJ, 13 March 2007, C-524/04, *Thin Cap Group Litigation* [2007] ECR I-2107





# CFC Rules

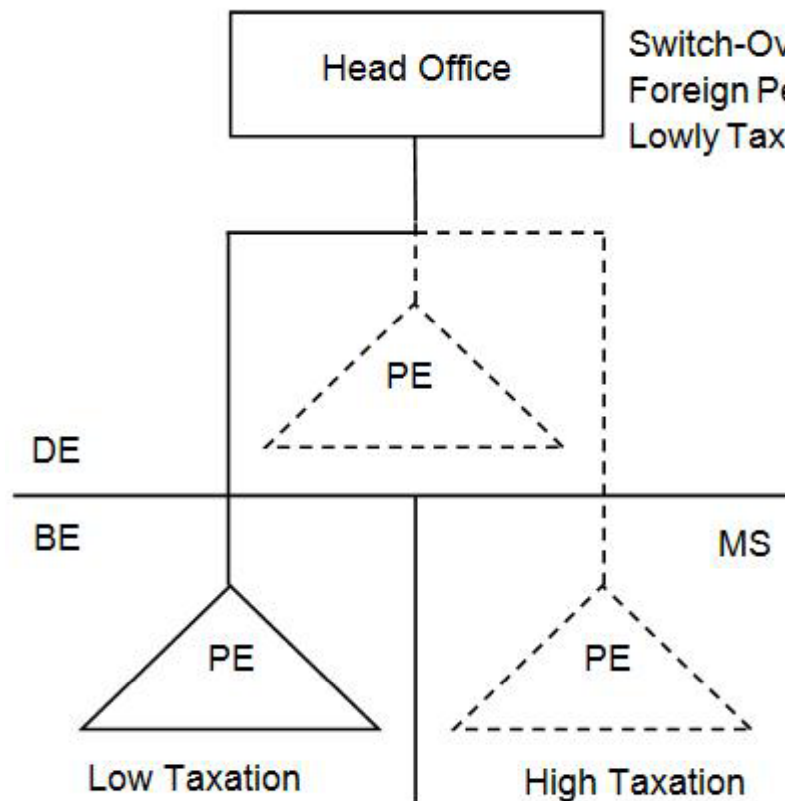
- **Anti-Avoidance: CFC Rules** — ECJ, 12 September 2006, C-196/04, **Cadbury Schweppes** [2006] ECR I-7995





# Switch-Over

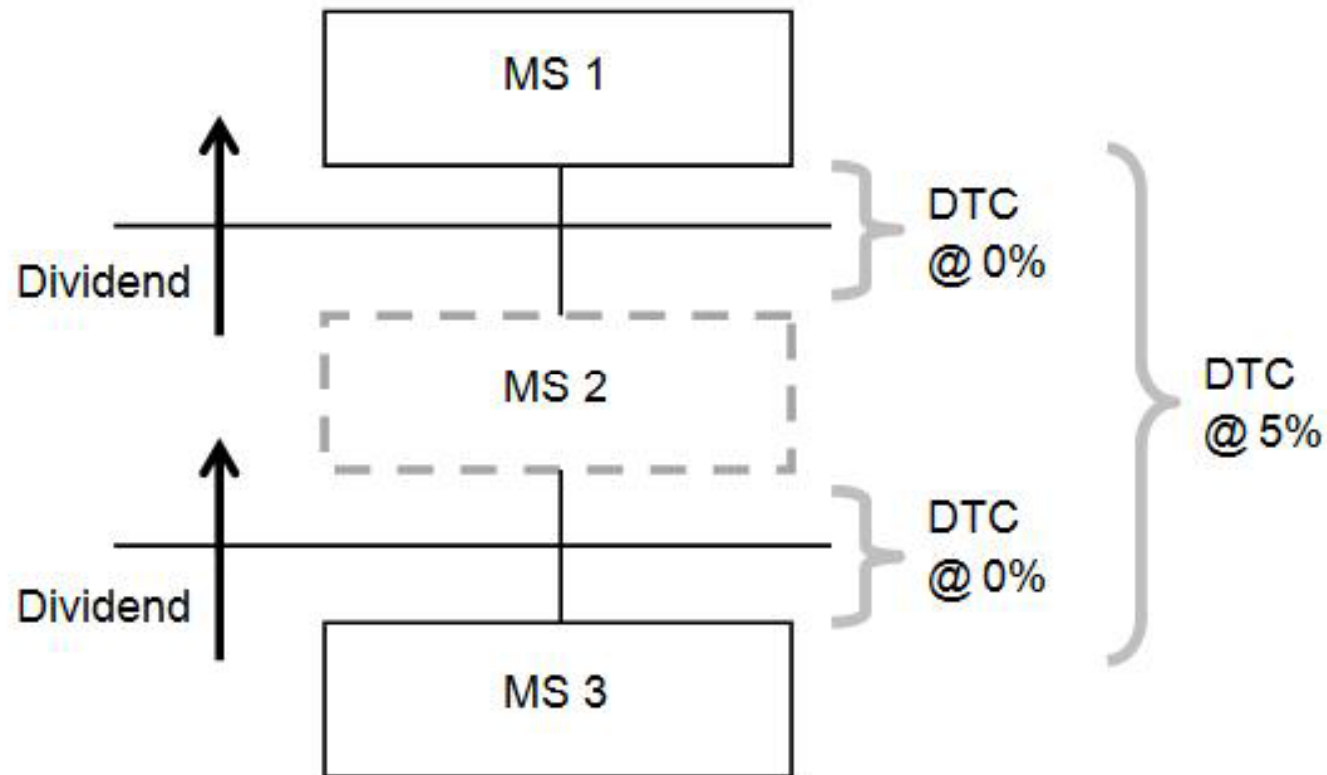
- **Anti-Avoidance: Switch-Over** — ECJ, 6 December 2007, C-298/05, **Columbus Container Services** [2007] ECR I-10451



	German PE	Belgian PE	
		DTC Exemption	Switch-Over to Credit
Belgian Tax Base	—	100	100
CIT in BE (e.g., 10%)	—	(10)	(10)
German Tax Base	100	0	100
./. Tax in DE (25%)	(25)	(0)	(25)
+ Credit for Belgian Tax	—	—	10
= Tax Burden in DE	25	0	15
= Overall Tax Burden	25	10	25



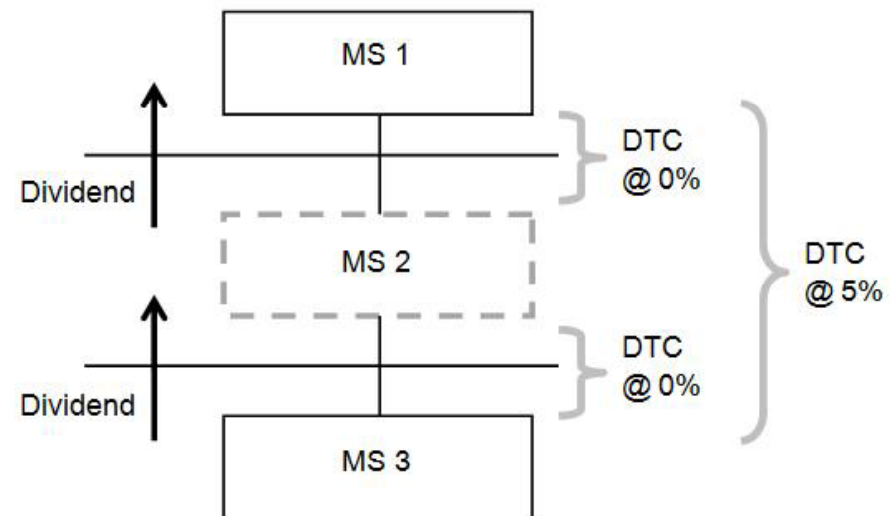
# Treaty Shopping and Treaty Entitlement





# Treaty Shopping and Limitation on Benefits

- Personal Scope of a DTC → Residence under Art 4 OECD-MC and Art 4 US-MC
- Residents of third states could establish legal entities in a contracting state with a principal purpose to obtain the benefits of a tax treaty between the contracting states → **Treaty Shopping**
- **But:** Exclude situations in which the third country resident had substantial reasons for establishing the structure that are unrelated to obtaining treaty benefits
- → US Treaty Policy of including **Limitation on Benefits Clauses** since the early 1980s, which basically limit the personal scope of the respective DTC



- **Open Skies-Judgments** — “Nationality clauses” in the bilateral air services agreements between the US and several EU Member States, the so-called “open skies” agreements, infringe the freedom of establishment (e.g., C-466/98, *Commission v UK*).
- EC Law issues of the **Ownership and Base Erosion Test** in LoB-Clauses in US Tax Treaties with Member States






# Treaty Shopping and Limitation on Benefits

- **No Prohibition of *Limitation on Benefits*-Clauses** → ECJ, 12 December 2006, C-374/04, **ACT Group Litigation** [2006] ECR I-11673 → What happened to *Open Skies*?

	Dutch Company	German Company
Dividend	100	100
+ Credit	5,5	—
= DTC-Refund	0,27	—
= Net	100,27	100

Limitation on Benefits-Clause ↑ Dividend			
	NL	DE	DE
	UK	NL	NL
		UK	UK



## **Important Weblinks**



## Important Weblinks

- **Gateway to the European Union** — <http://europa.eu/>
- **European Court of Justice** — <http://curia.europa.eu/en/>
- **European Commission – Taxes and Customs** — [http://ec.europa.eu/taxation\\_customs/taxation/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/index_en.htm)
- **Eur-LEX** — <http://europa.eu.int/eur-lex/lex/en/index.htm>
- **Documentation on EC Direct Tax Law** — <http://www.steuerrrecht.jku.at/gwk> → *EU-Doku*