

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

# **EC Tax Law**

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**Fundamental Freedoms and Secondary EC Tax Law**

Thursday, 27 May 2010, HS 1  
Friday, 28 May 2010, HS 3  
Monday, 31 May 2010, BA 9911

# Overview

- **Introduction**
- **Milestones in European Tax Policy**
- **The Fundamental Freedoms**
  - Dogmatic Foundations
  - Third Country Situations
  - Double Taxation Agreements and EC Tax Law
  - Excursus
    - Cross-Border Dividends
    - Anti-Avoidance Provisions
- **Secondary EC Tax Law**
  - Parent Subsidiary Directive
  - Interest and Royalties Directive
  - Merger Directive

*Part I*  
**Introduction**



**European Commission**



**Council**

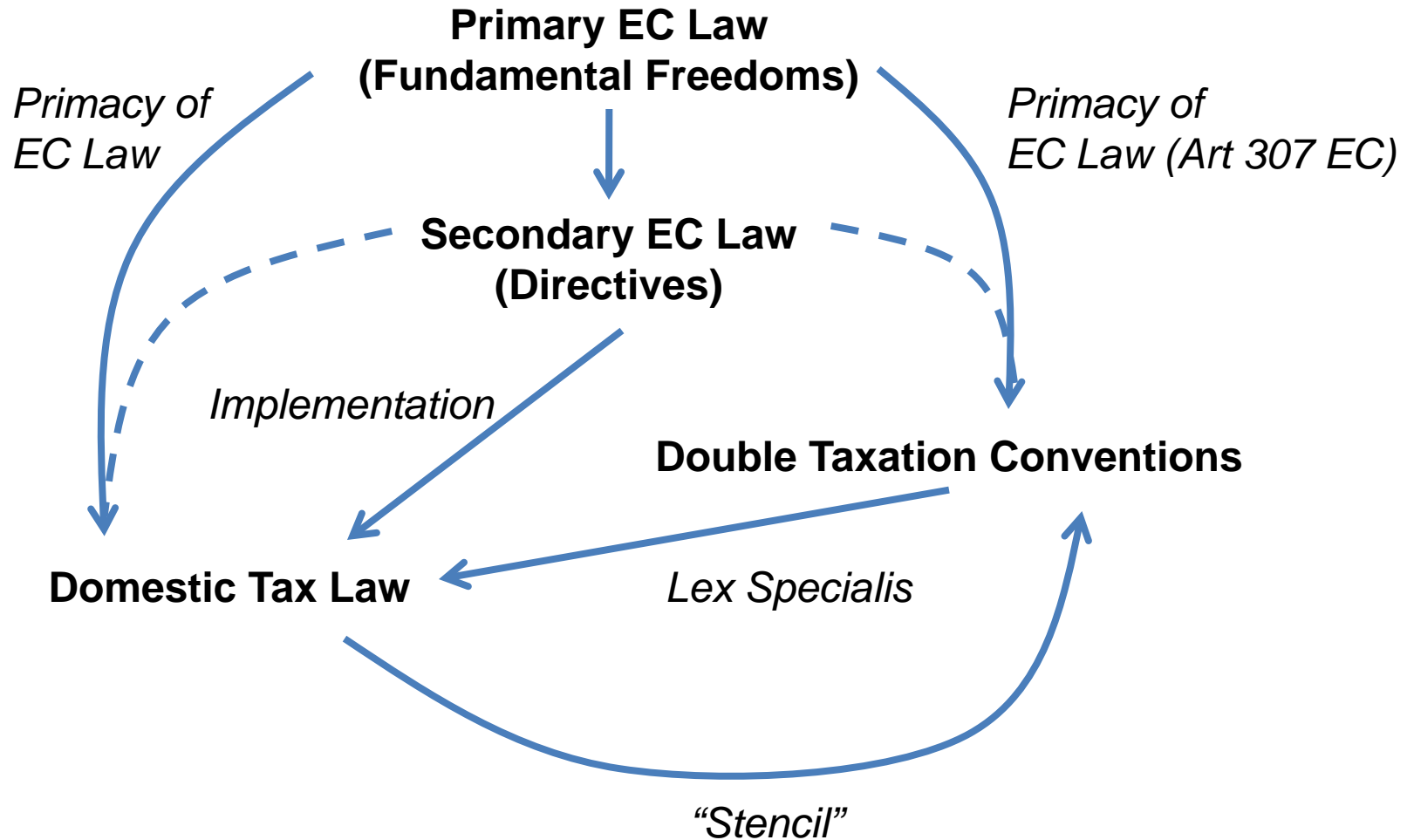


**European Parliament**



**Court of Justice**

# Overview



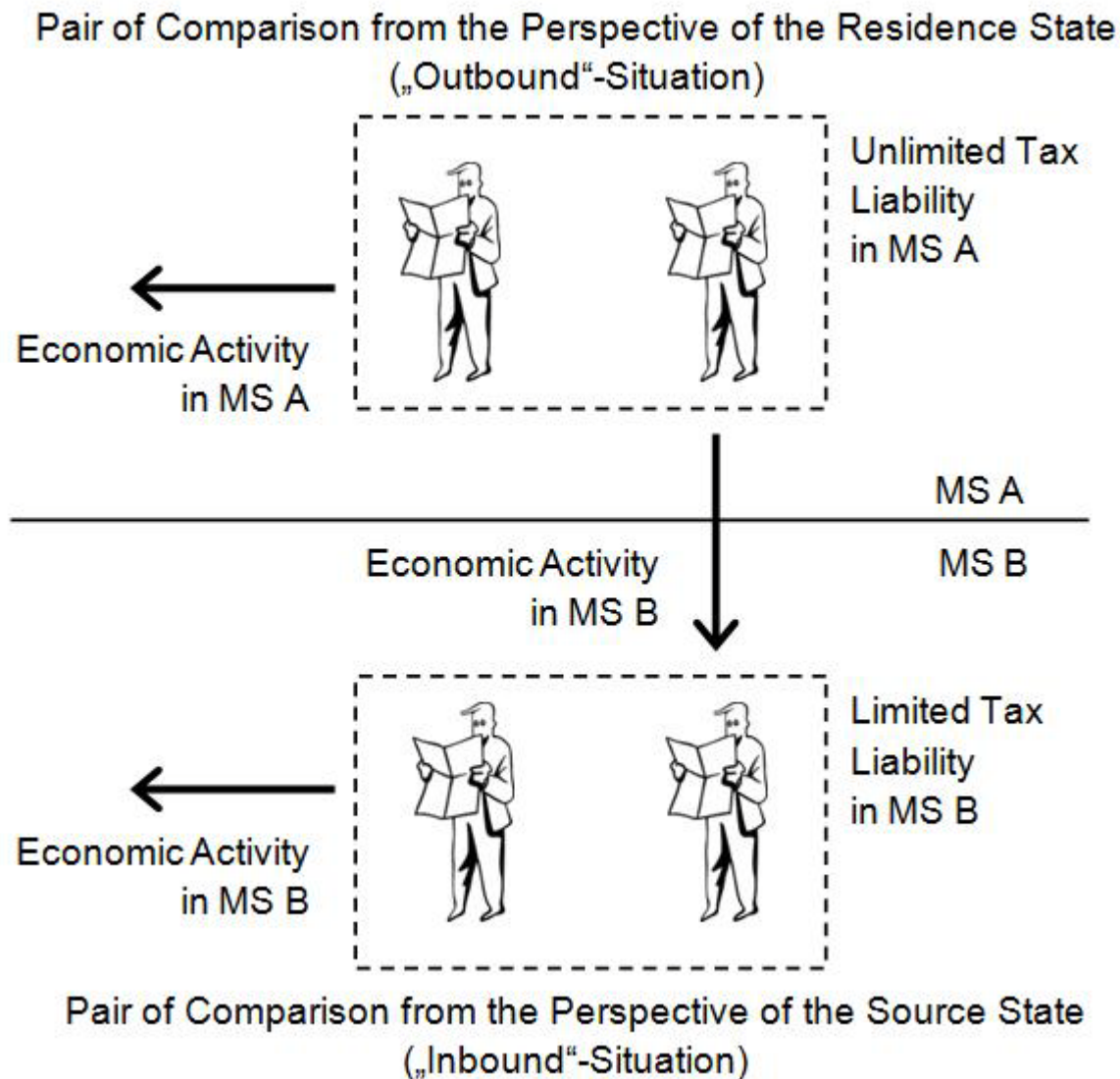
# Overview

- **Direct and Indirect Taxation**
  - **Indirect Taxation** → Customs Union (Art 23 et seq EC – now Art 28 TFEU), prohibition of custom duties (Art 25 EC – now Art 30 TFEU), and prohibition of direct and indirect discrimination against foreign products (Art 90 EC – now Art 110 TFEU); harmonization under **Art 93 EC** (now Art 113 TFEU)
  - **Direct Taxation** → No harmonization program, but **Art 94 EC** (now Art 115 TFEU )
- **EC Law and Direct Taxation**
  - **Fundamental Freedoms**
    - Free Movement of Workers (Art 39 EC, now Art 45 TFEU — *Art 28 EEA*)
    - Freedom of Establishment (Art 43 EC, now Art 49 TFEU — *Art 31 EEA*)
    - Freedom to Provide Services (Art 49 EC, now Art 56 TFEU — *Art 36 EEA*)
    - Free Movement of Capital (Art 56 EC, now Art 63 TFEU — *Art 40 EEA*) — Under EC Law: 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





# Basics – Inbound Situations

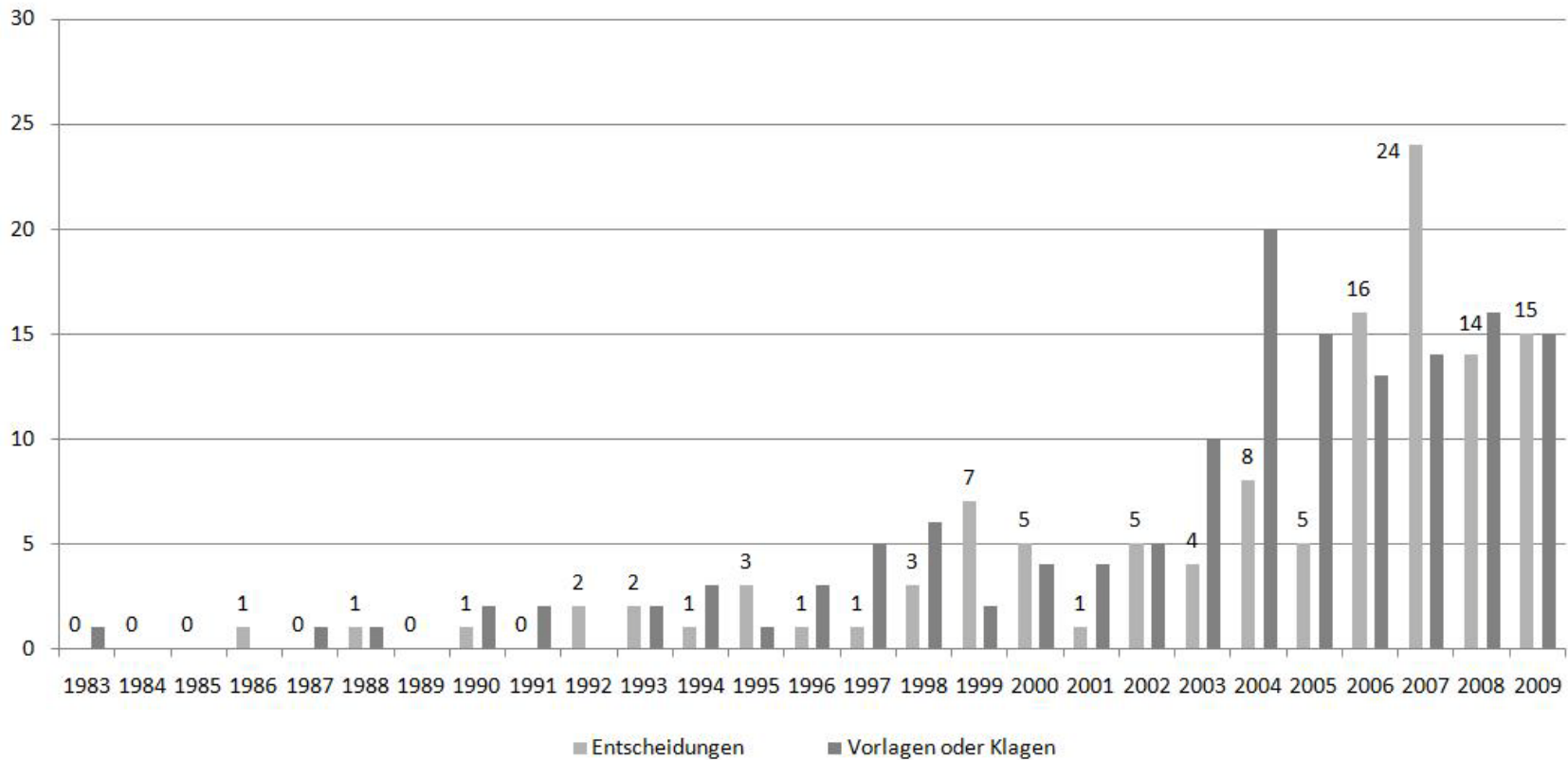
- **Disadvantageous Treatment of Non-Residents by the Source State**
  - Identification of a Pair of Comparison and the Criterion of Comparison (*tertium comparationis*) = “Equality in a Box” (“Kästchengleichheit”)
  - *Ad personam*-Comparison (→ Competition!)
- **Vertical Issues**
  - Obligation of 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*)

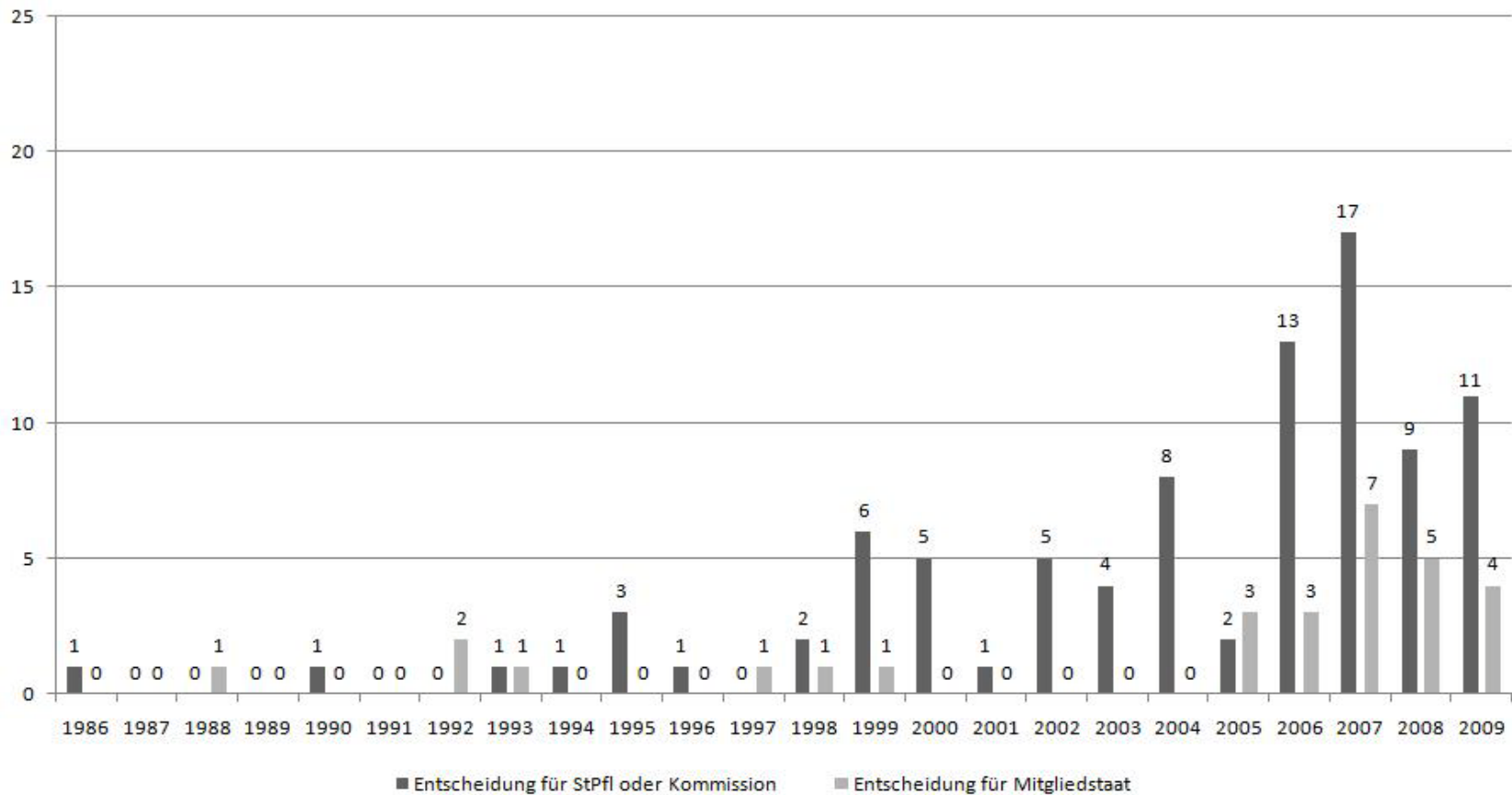
# Relevance

**Graph 1:** Number of (pending) direct tax cases before the ECJ as of 1 January 2010



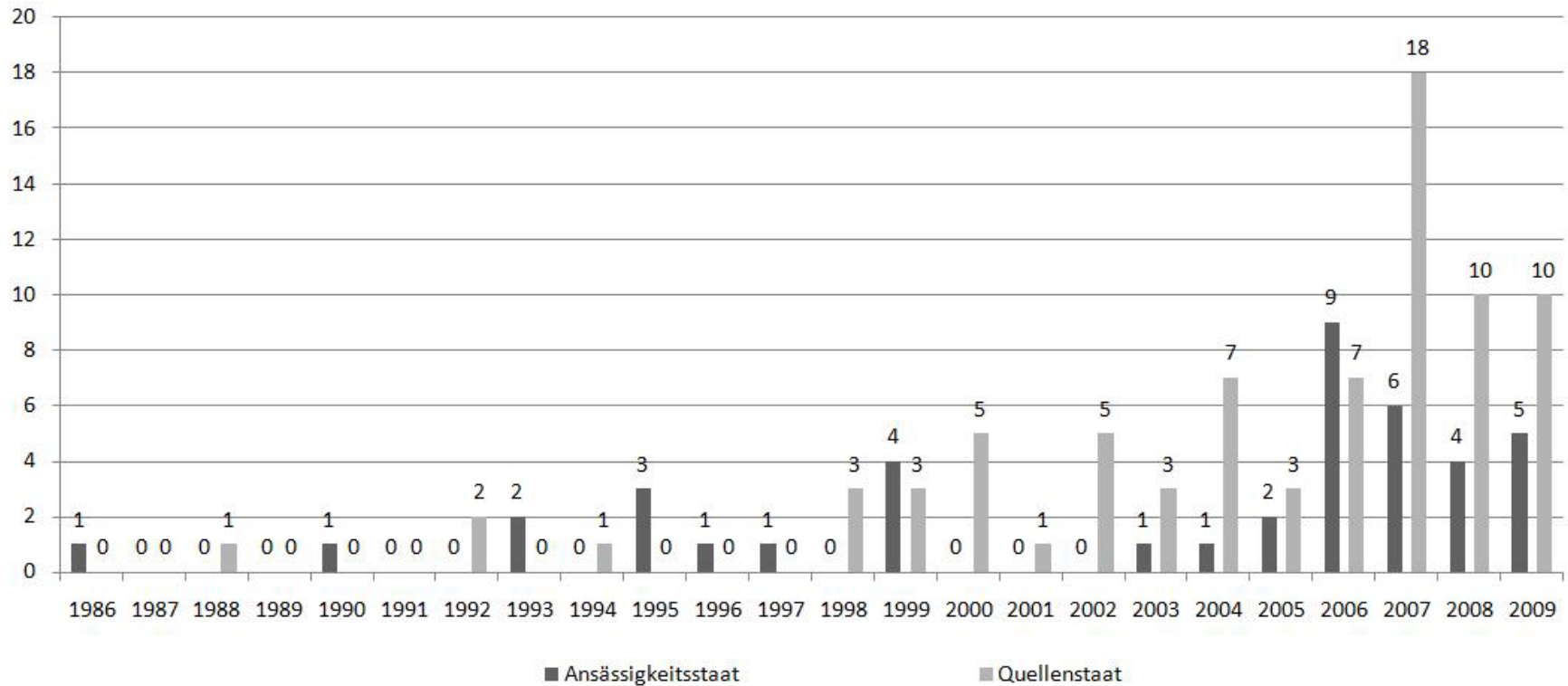
# Relevance

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



# Relevance

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



*Part II*  
**Milestones in European Tax Policy**

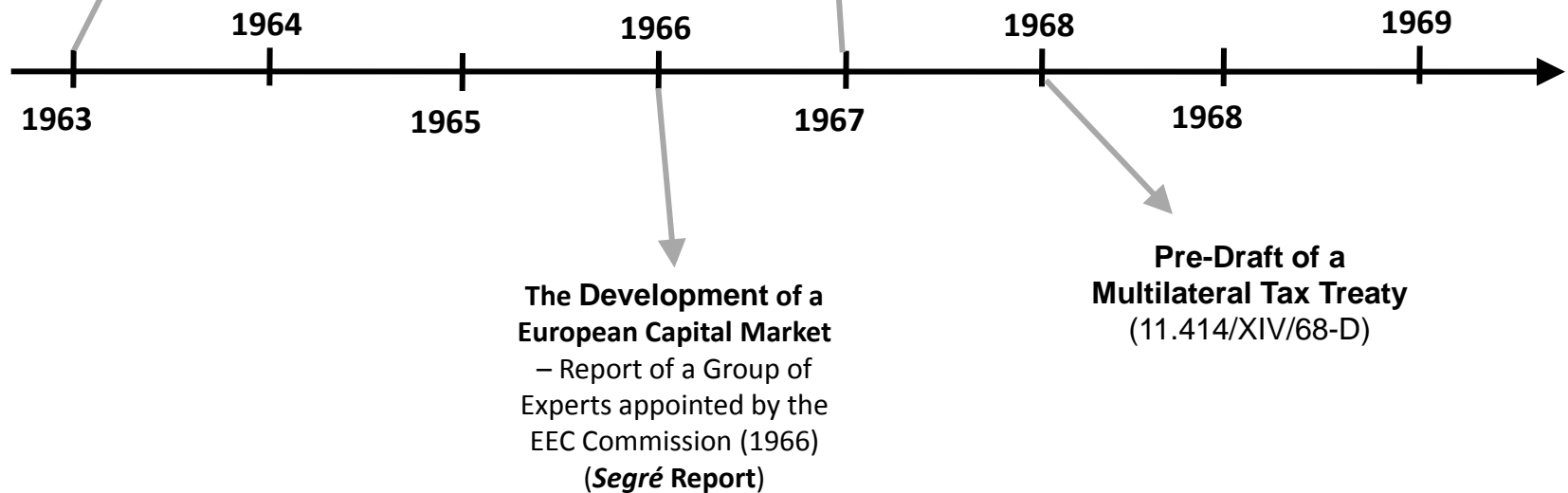
# European Tax Policy

- **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**? Treaty of Lisbon!

# Milestones – 1963 to 1969

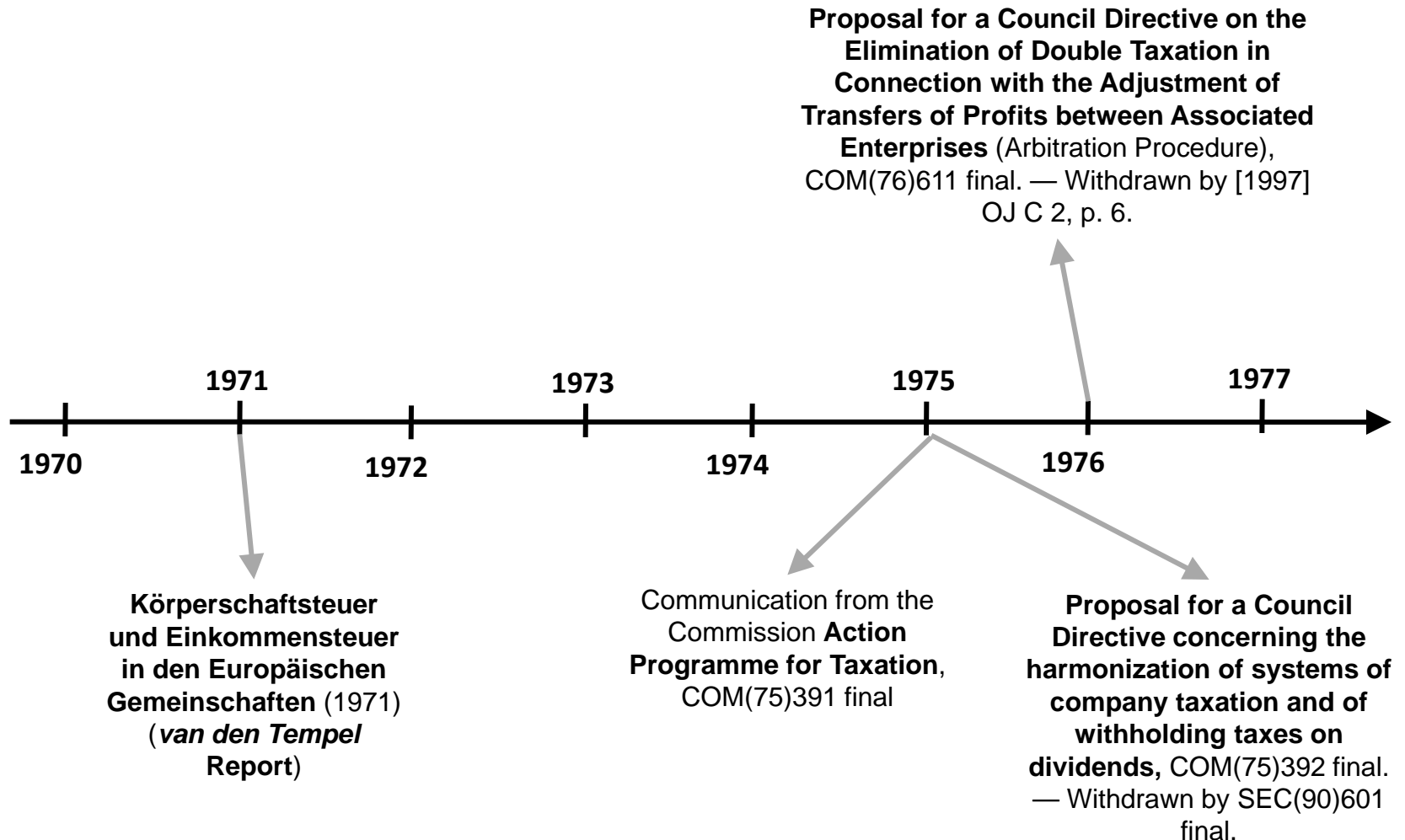
**The EEC Reports on Tax Harmonization.** The Report of the Fiscal and Financial Committee and the Reports of the Sub-Groups A,B and C (1963) (*Neumark Report*)

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





# Milestones – 1970 to 1977

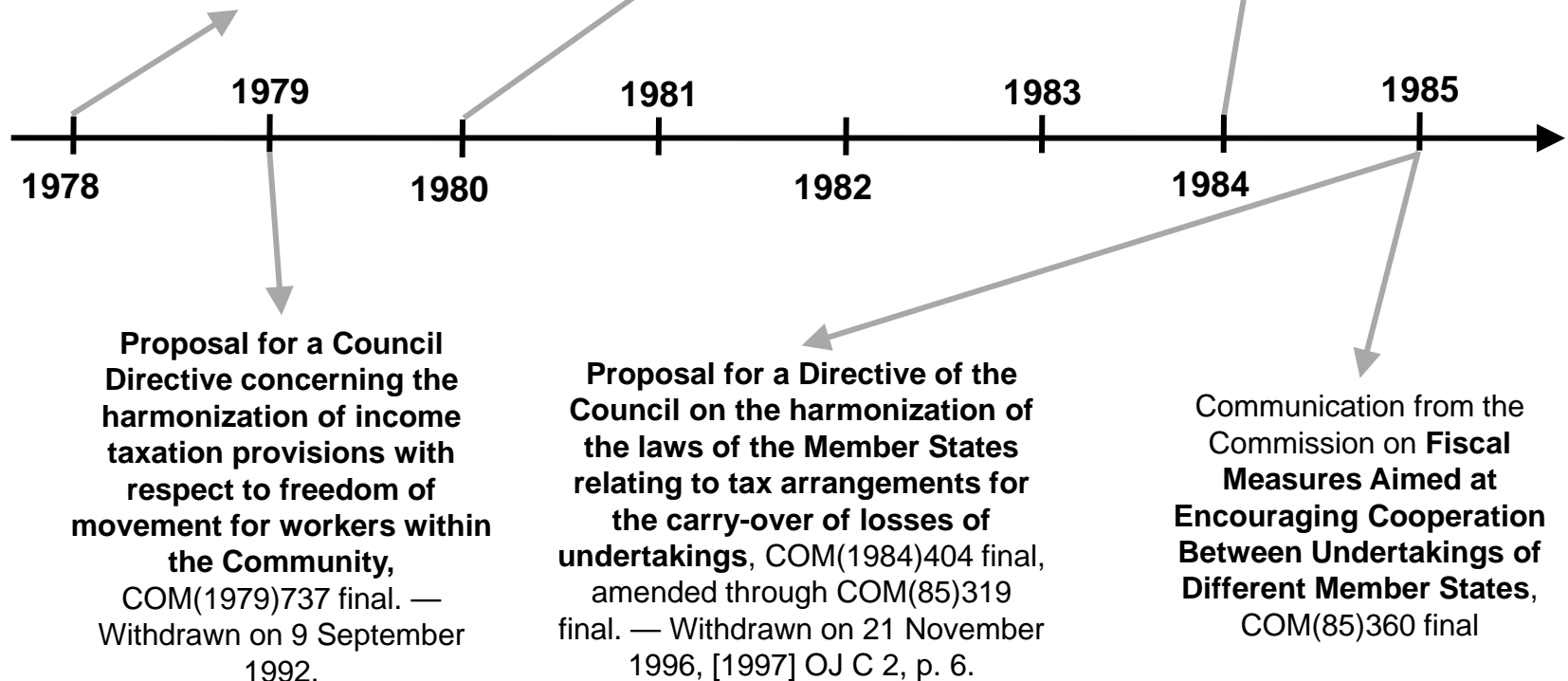


# Milestones – 1978 to 1985

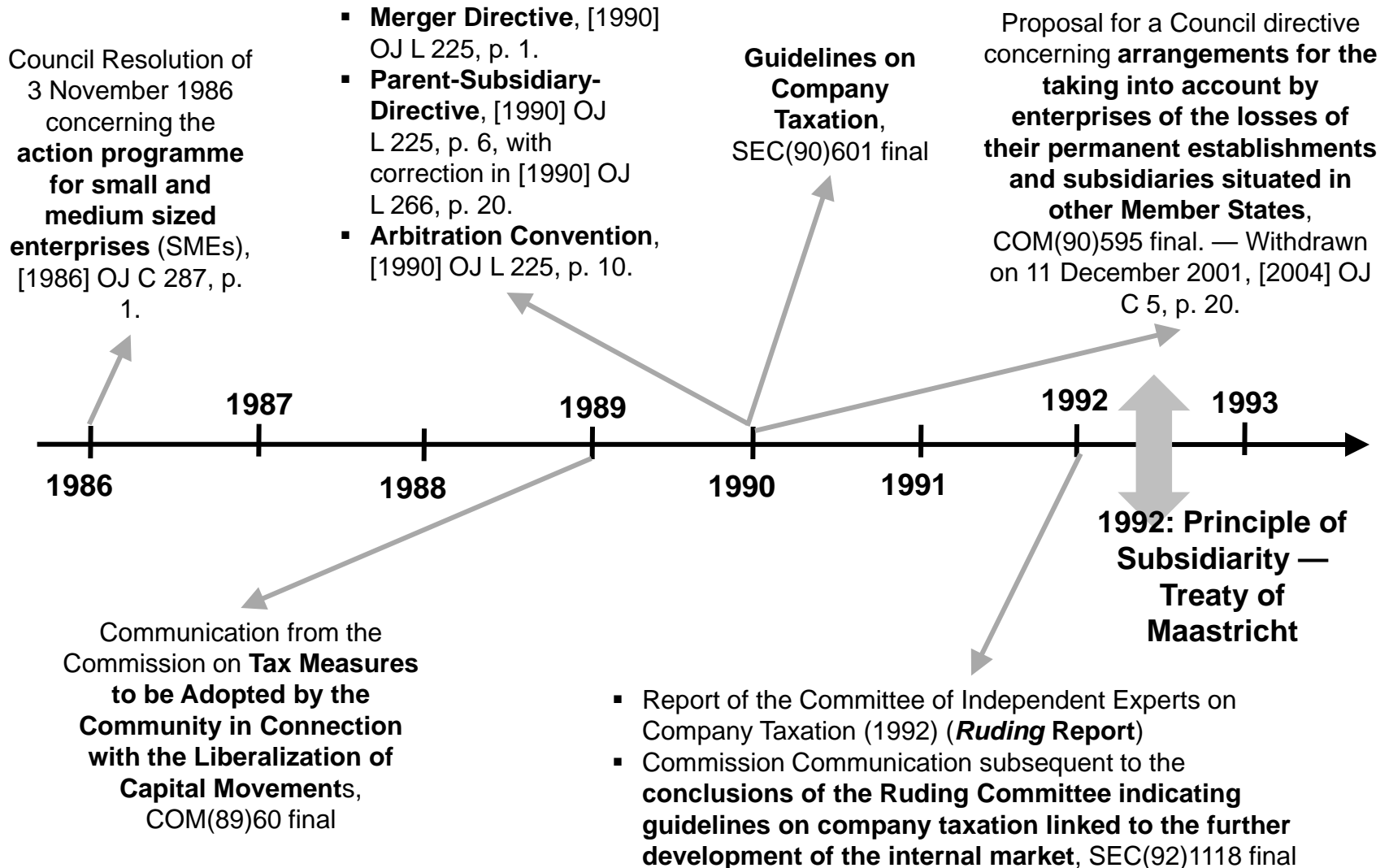
**Proposal for a Council Directive on the application to collective investment institutions of the Council Directive concerning the harmonization of systems of company taxation and of withholding taxes on dividends, COM(1978)340 final. — Withdrawn on 8 April 1993, [1993] OJ C 228, p. 13.**

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

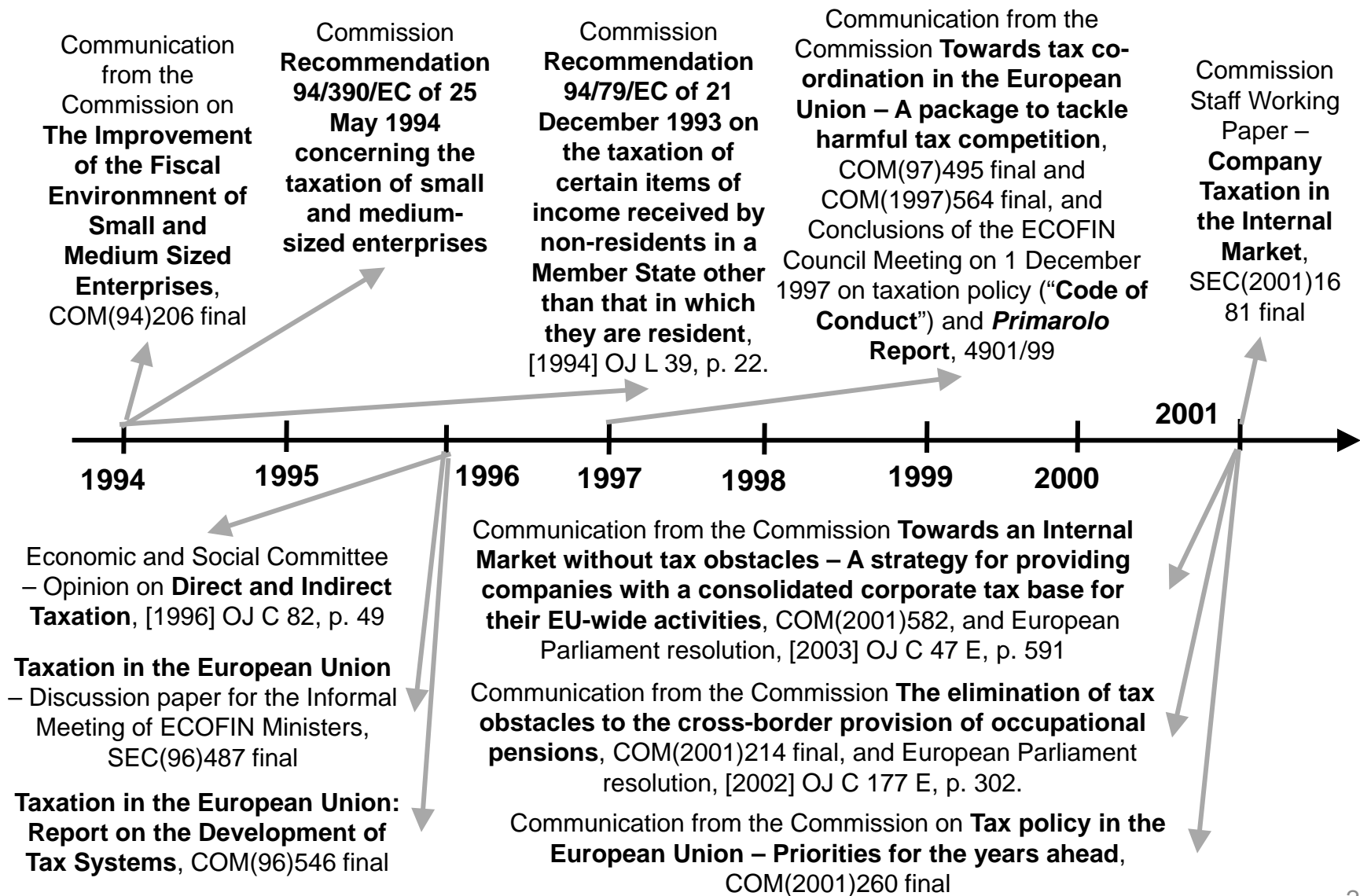
**Communication from the Commission on Community Action to Combat International Tax Evasion and Avoidance, COM(84)603 final**



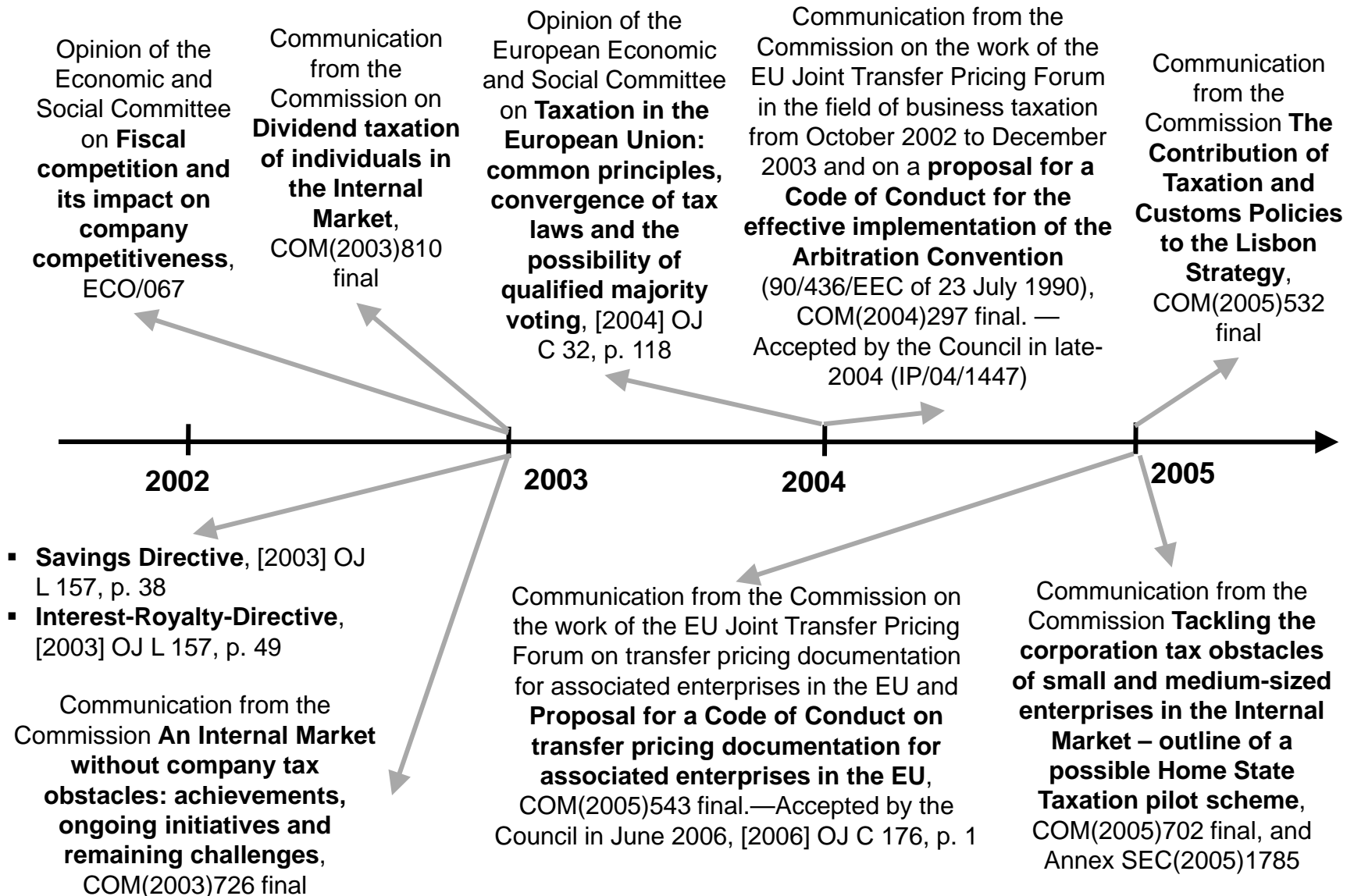
# Milestones – 1986 to 1993



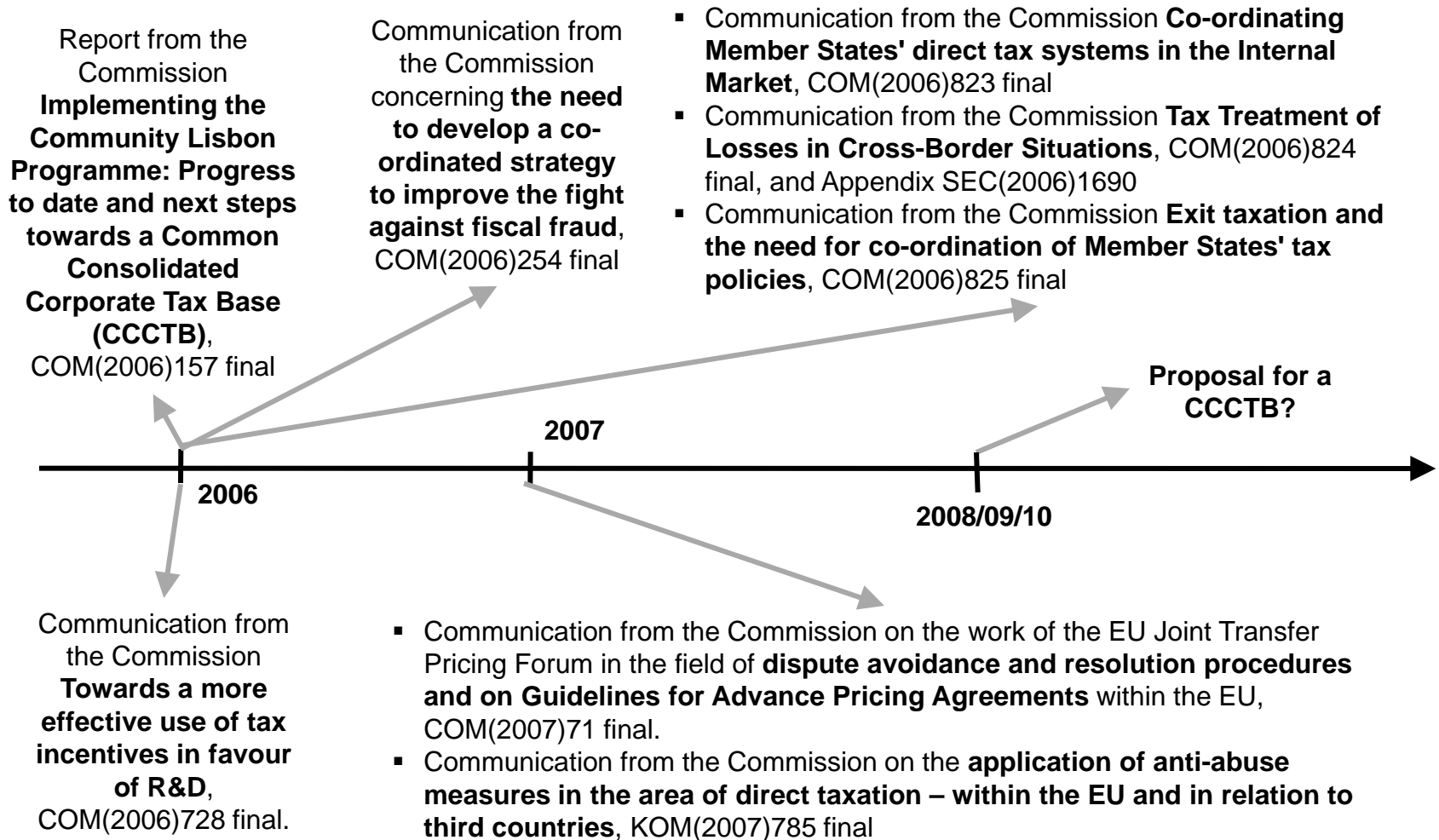
# Milestones – 1994 to 2001



# Milestones – 2002 to 2005



# Milestones – 2006 to 2009



*Part III*  
**The Fundamental Freedoms**

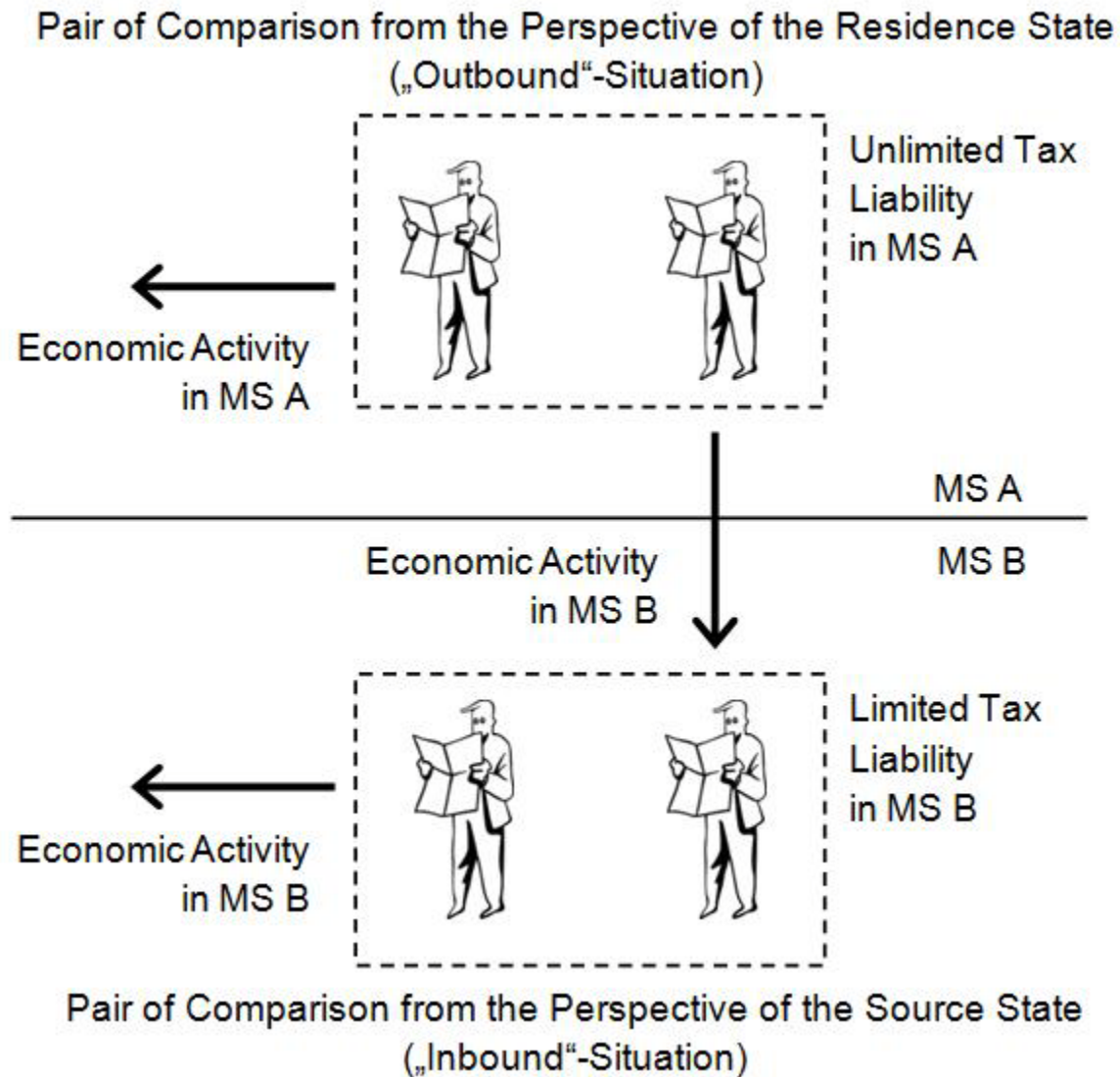
# Overview

- **The Fundamental Freedoms**
  - Dogmatic Foundations
  - Third Country Situations
  - Double Taxation Agreements and EC Tax Law
  - Selected Issues
    - *Objective and Subjective Ability to Pay*
    - *Cross-Border Dividends*
    - *Cross-Border Losses*
    - *Taxation of Permanent Establishments*
    - *Exit Taxation*
    - *Anti-Avoidance Provisions*

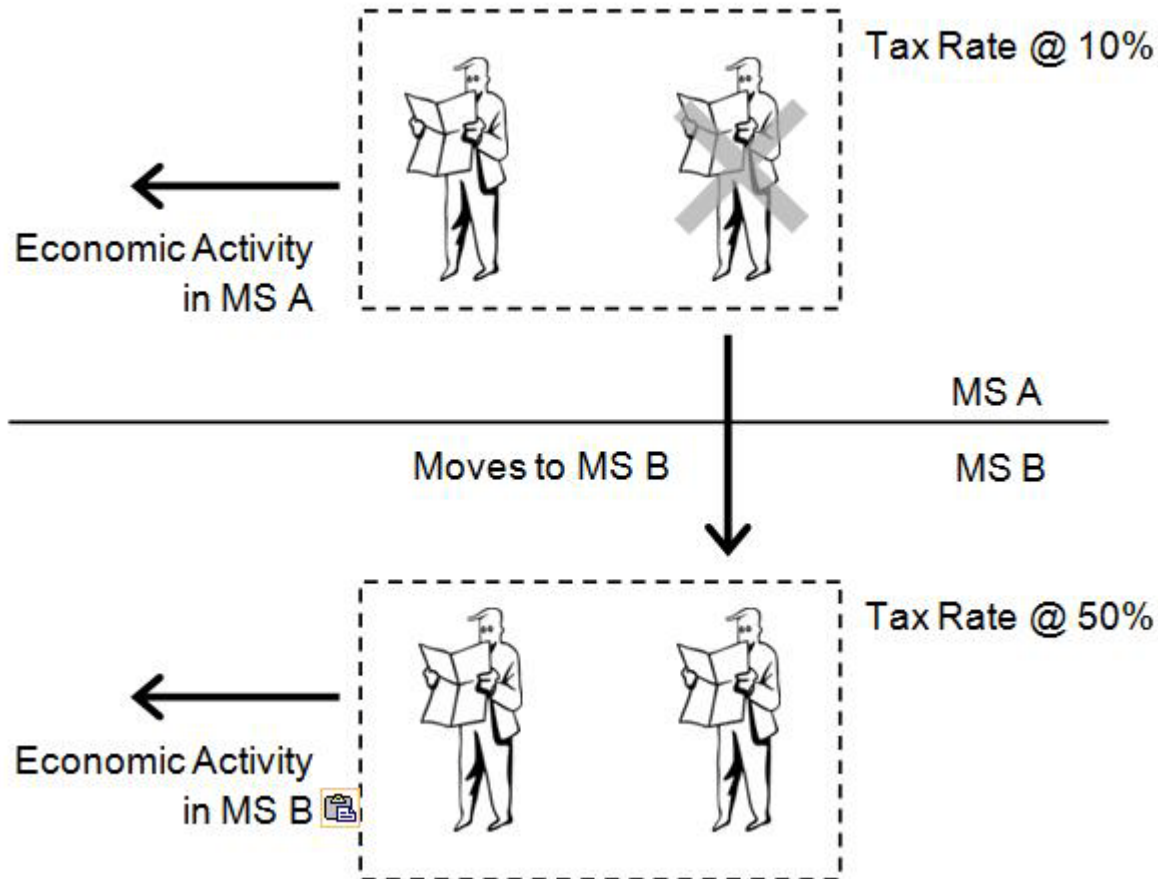


*Part III-1*  
**Dogmatic Foundations**

# Discrimination



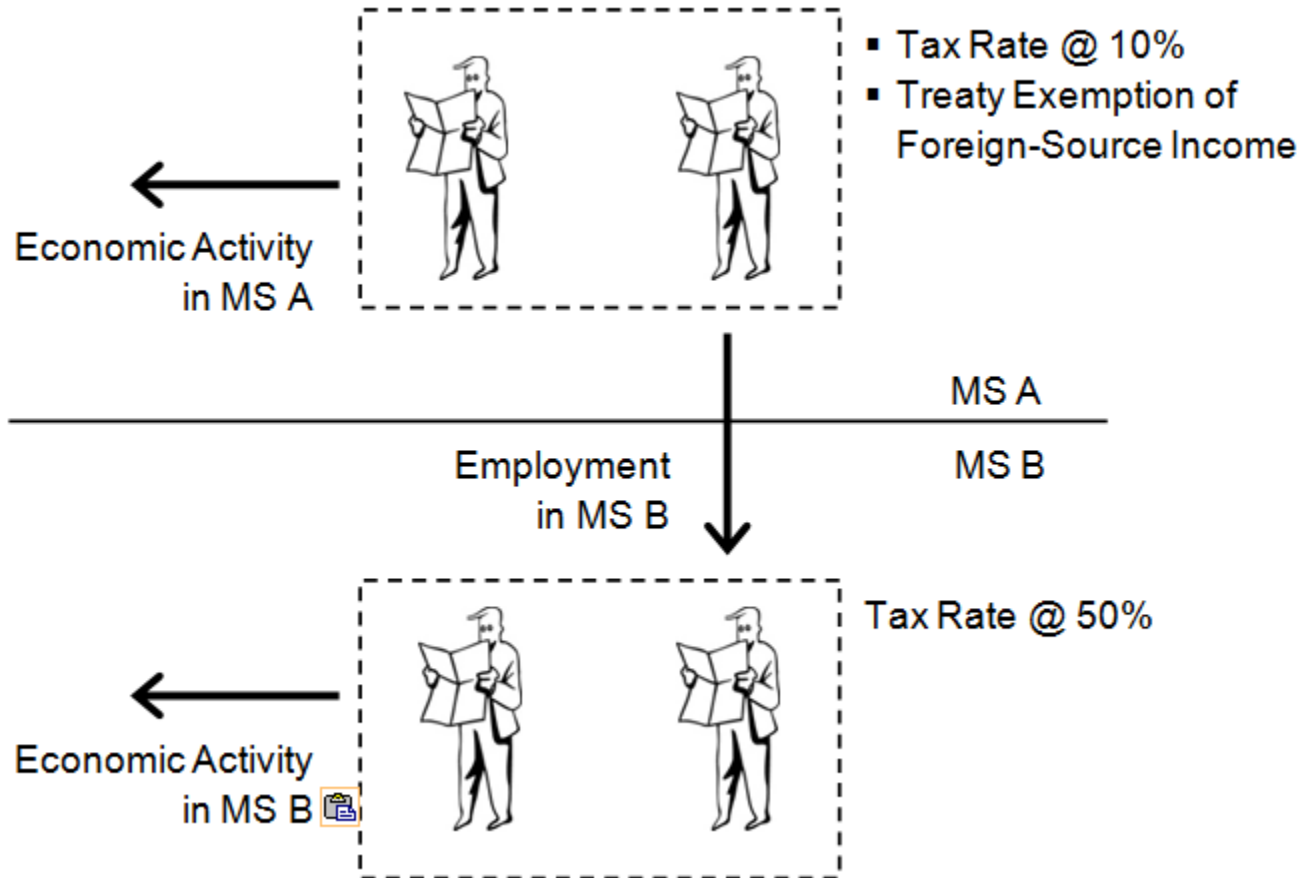
# Disparities



- 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”?

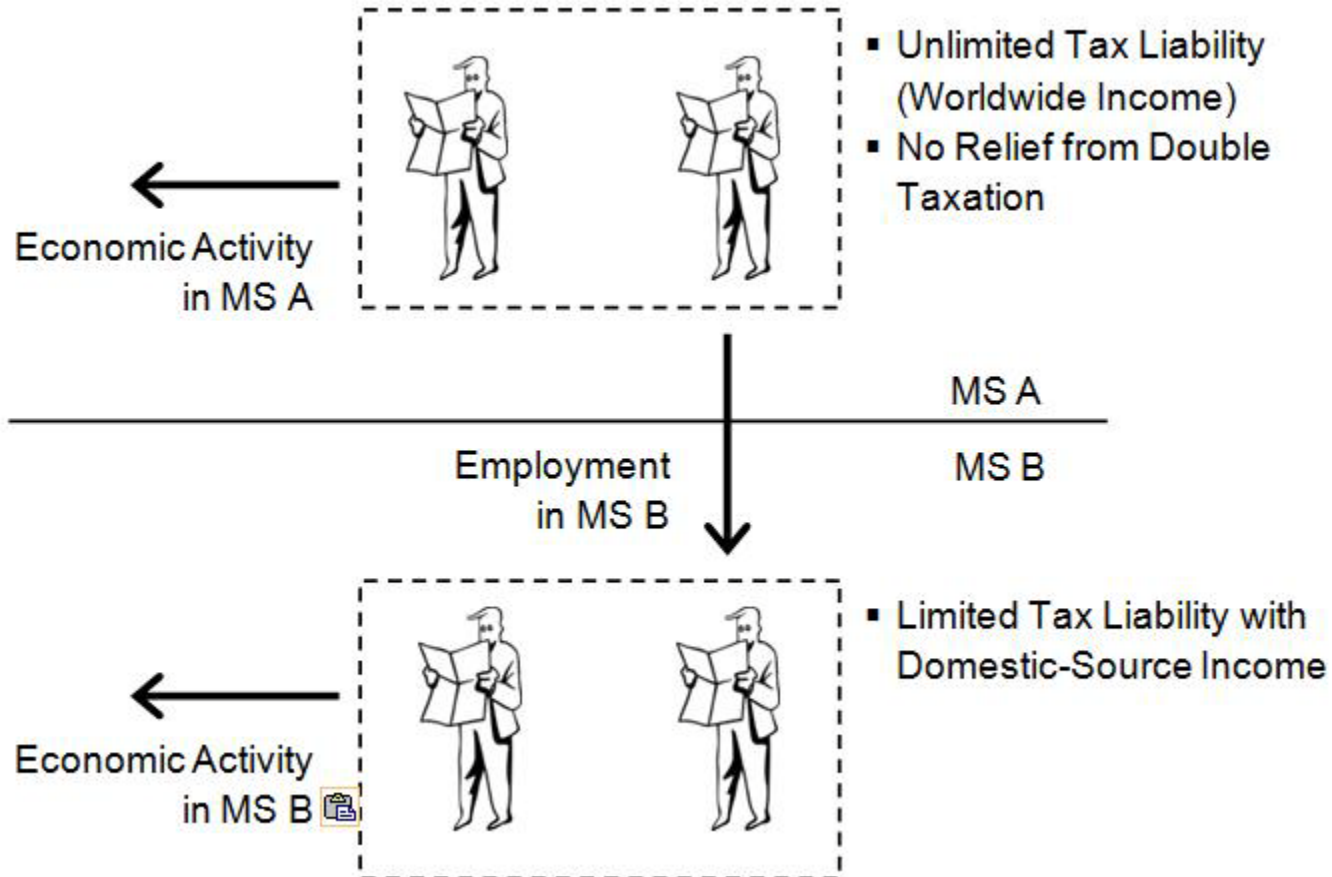
# Disparities

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



# “Double Burdens”

- Double Taxation as “Double Burden” or as “Quasi-Restriction”?



# Juridical Double Taxation

- **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***, [...]”
  - Striken by the Treaty of Lisbon!
- **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*

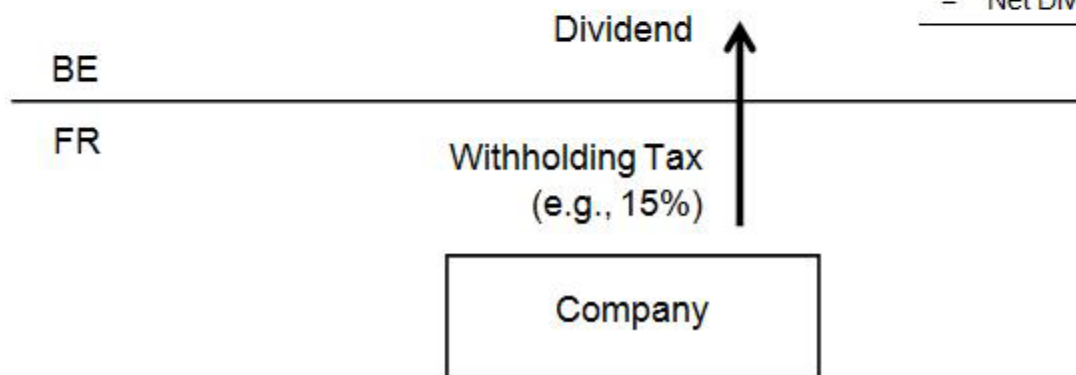
# Juridical Double Taxation

- **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**
  - Withdraw: 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 (formerly) Art 293 EC
  - Procedural Issues

# Juridical Double Taxation

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

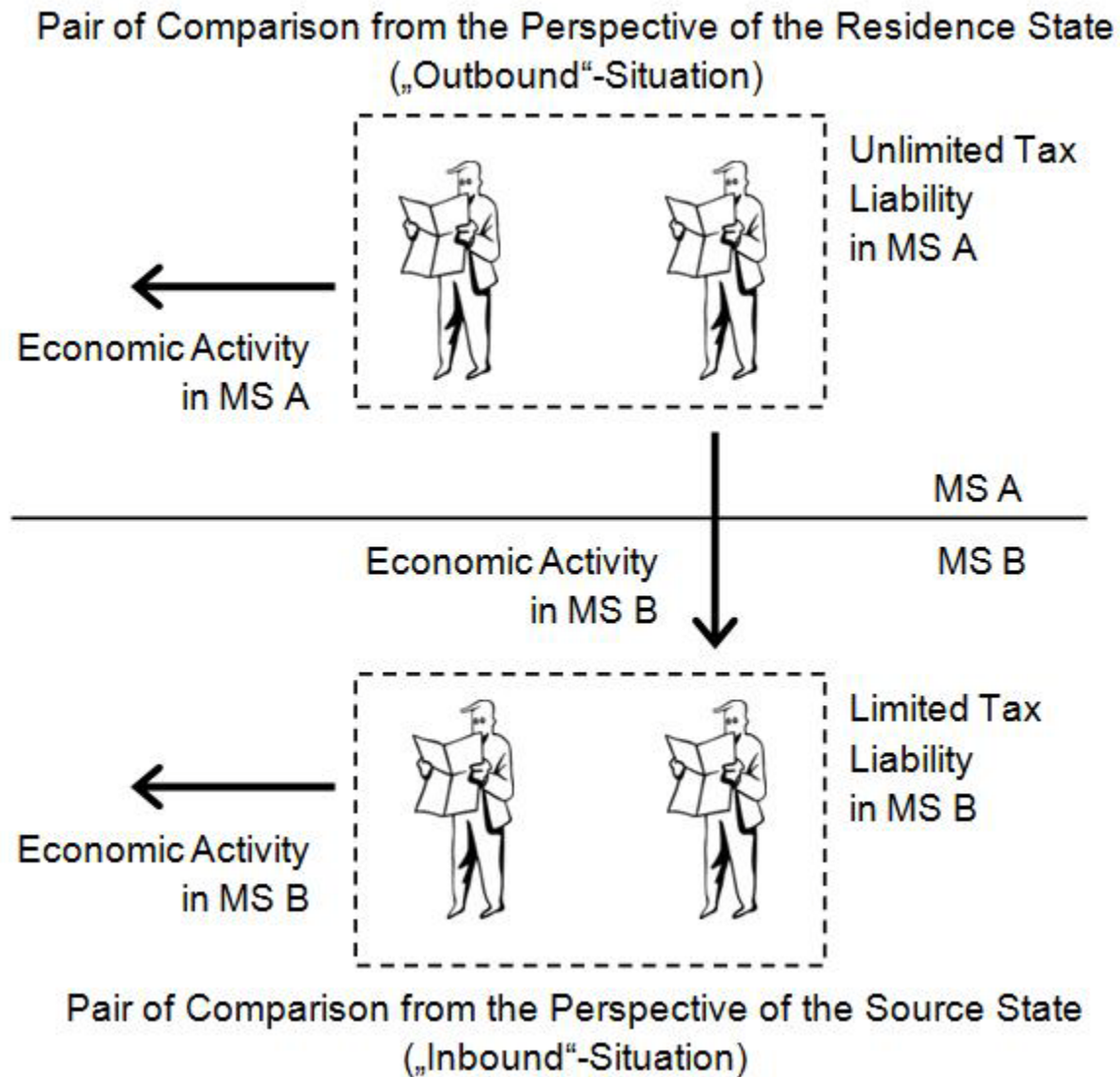
- Taxation of Foreign and Domestic Dividends @ 25%
- Deduction for Foreign Withholding Tax (no Credit)



	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

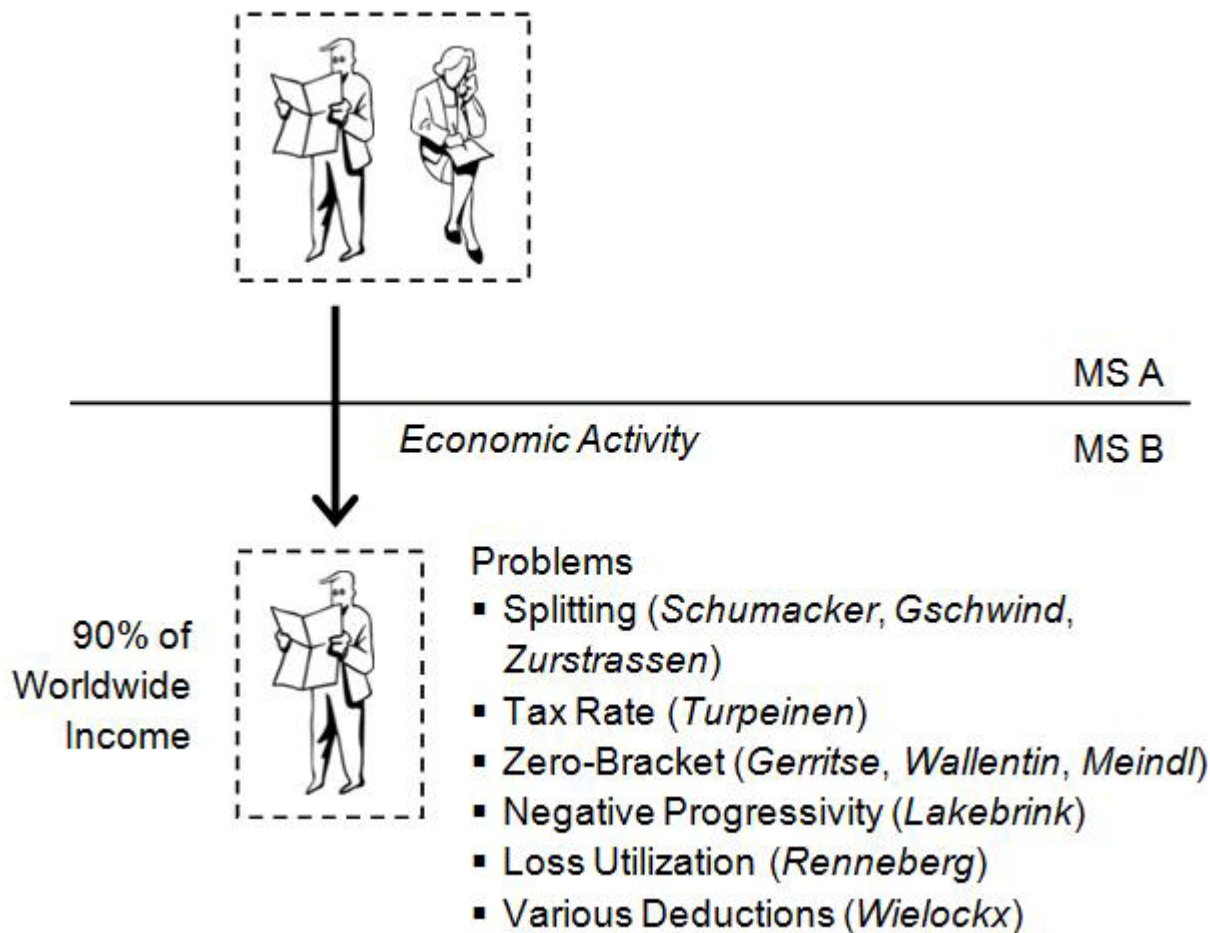


# Inbound Situations



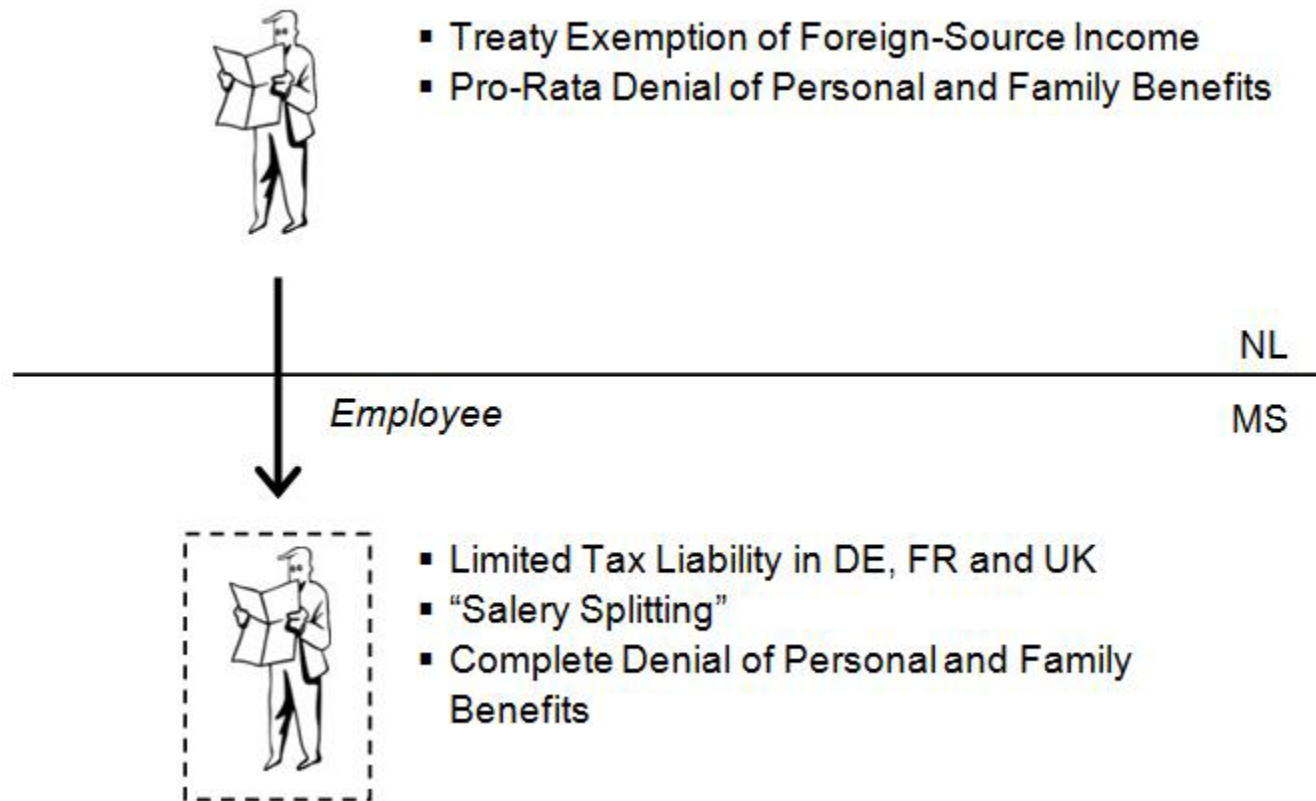
# Inbound Situations – Subjective Ability to Pay

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



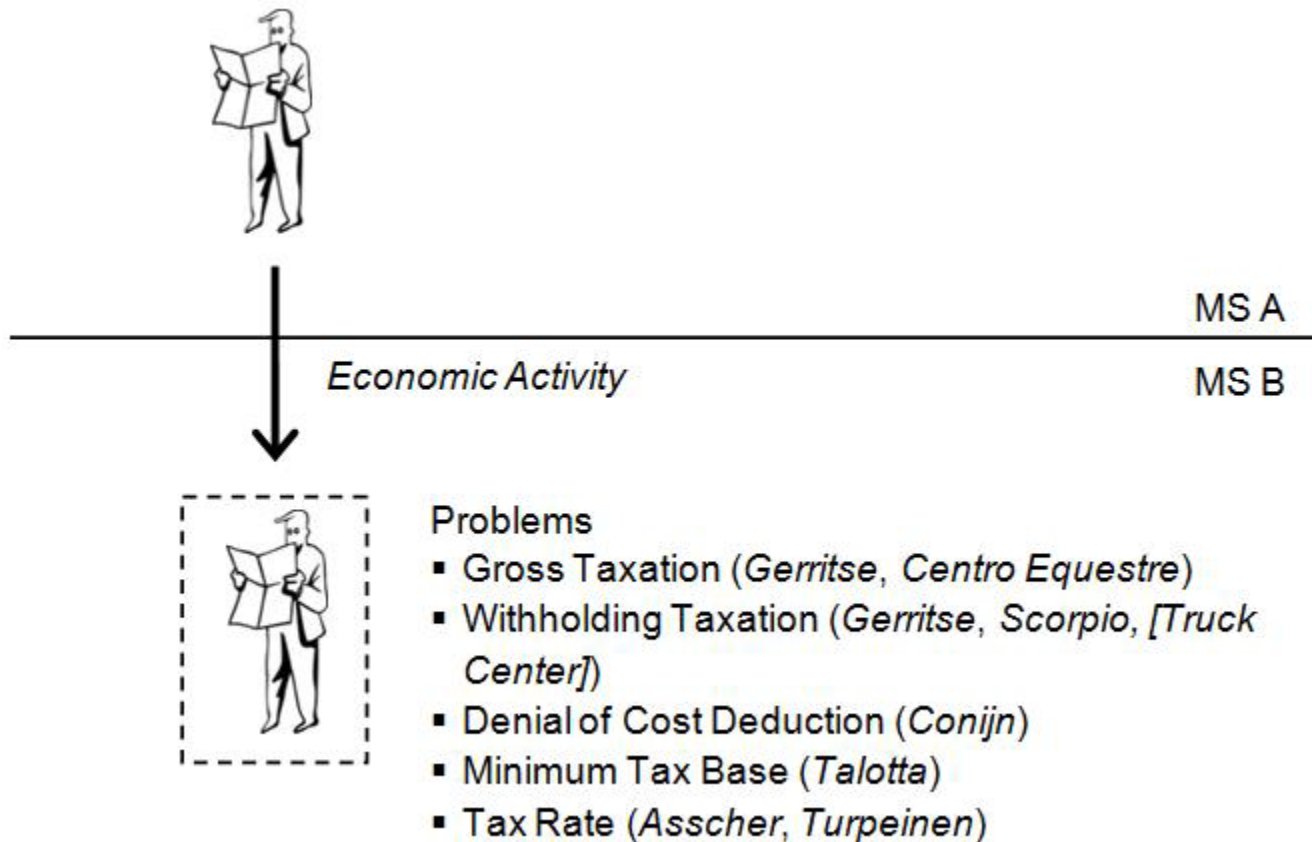
# Inbound Situations – Subjective Ability to Pay

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



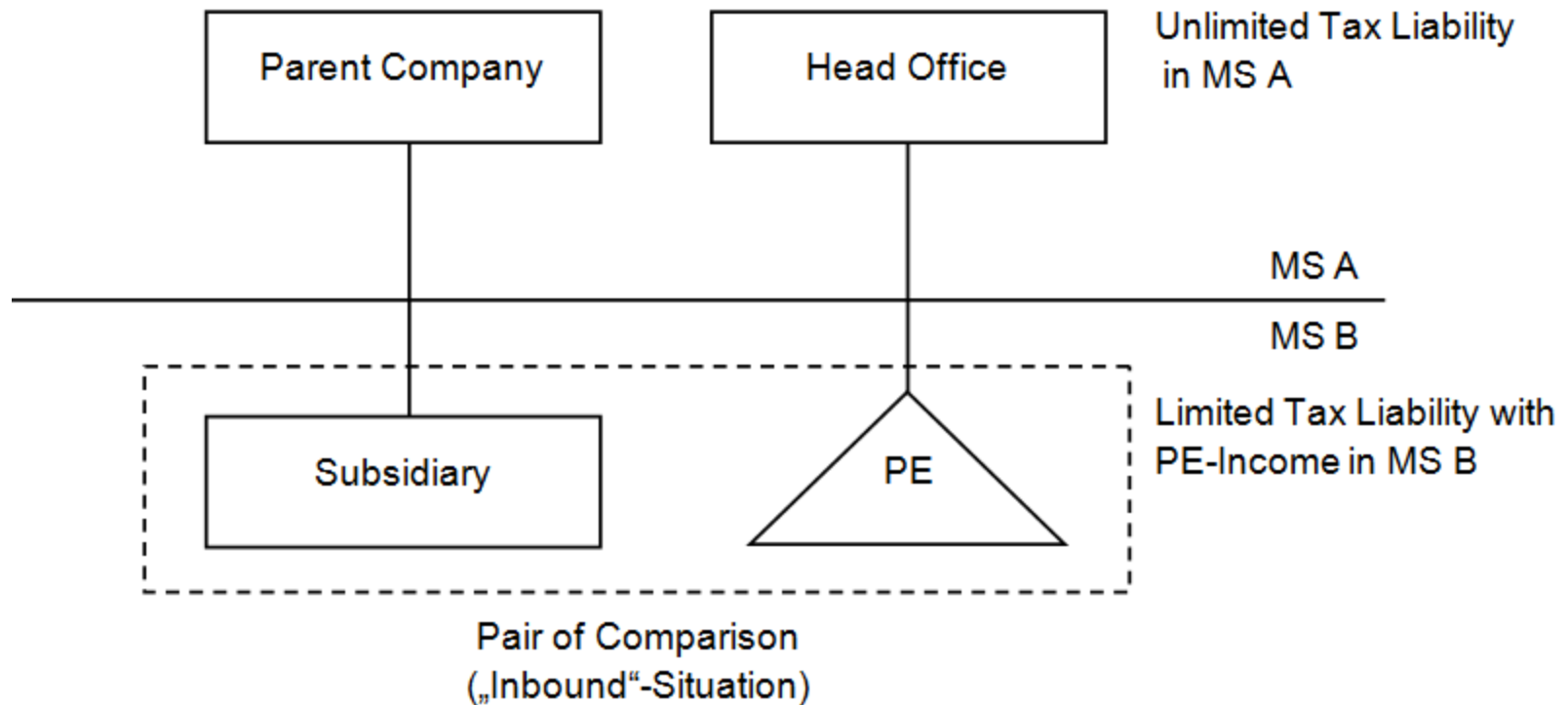
# Inbound Situations – Objective Ability to Pay

- **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



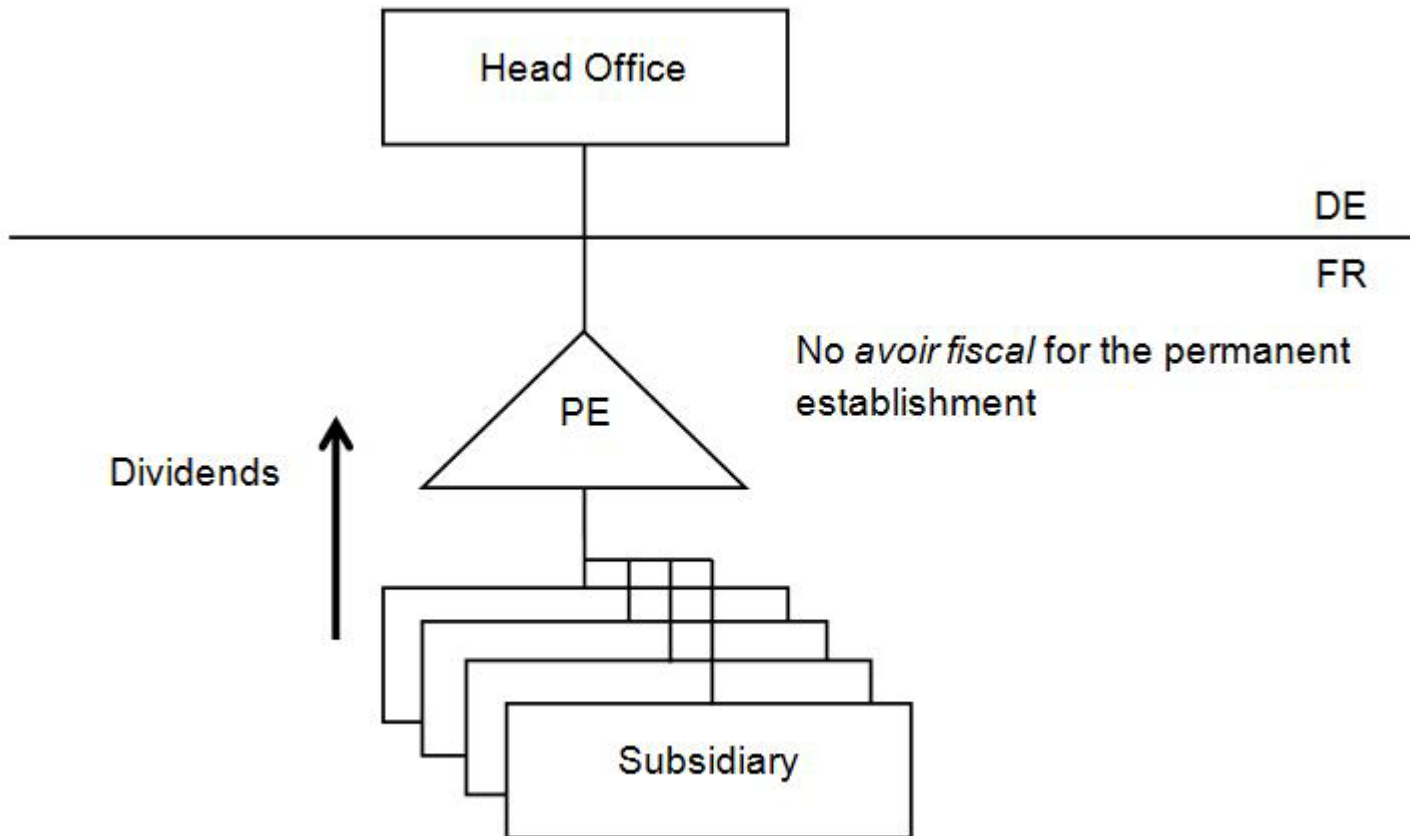
# Inbound Situations – Objective Ability to Pay

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



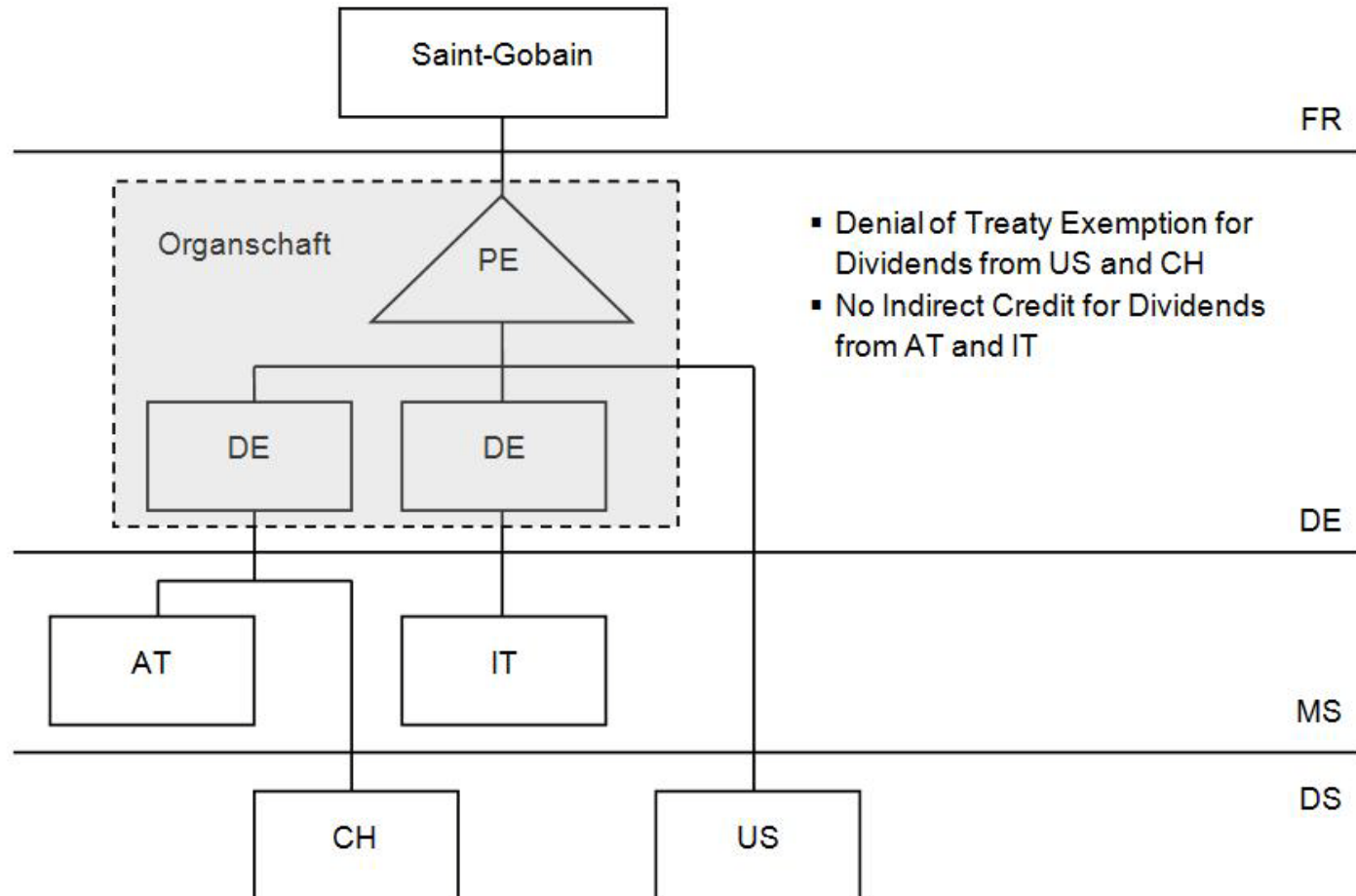
# Inbound Situations – Objective Ability to Pay

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



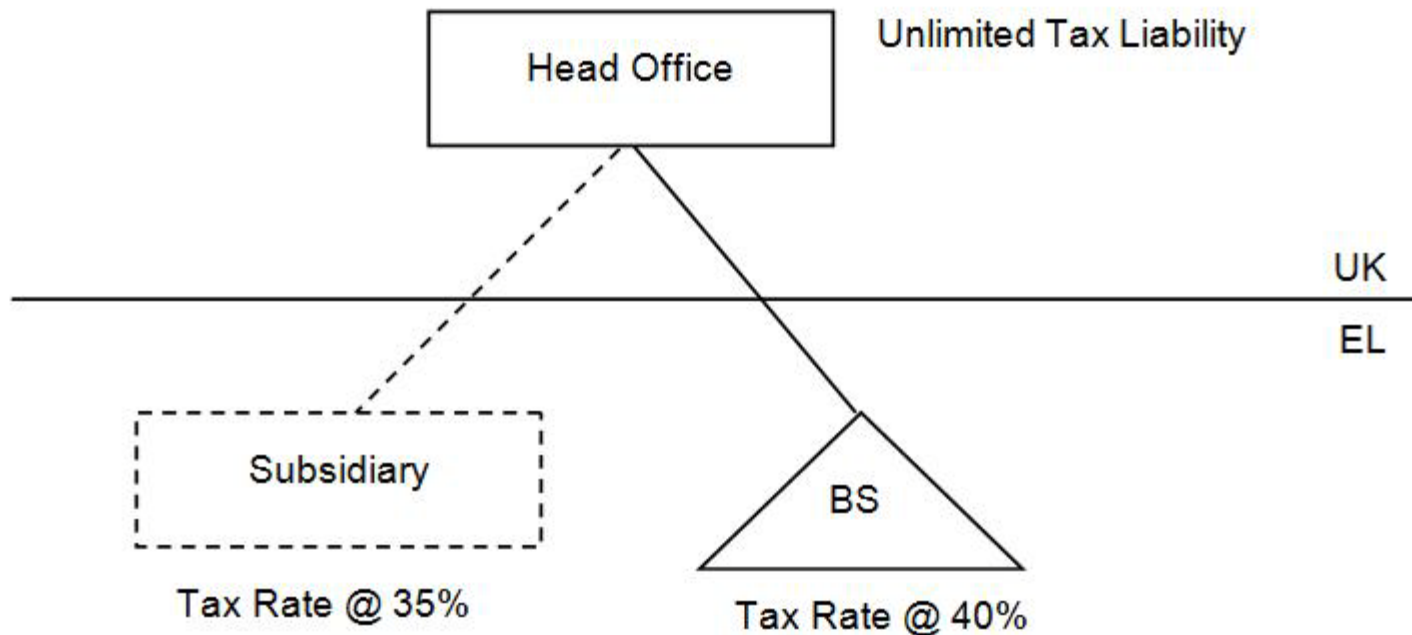
# Inbound Situations – Objective Ability to Pay

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



# Inbound Situations – Objective Ability to Pay

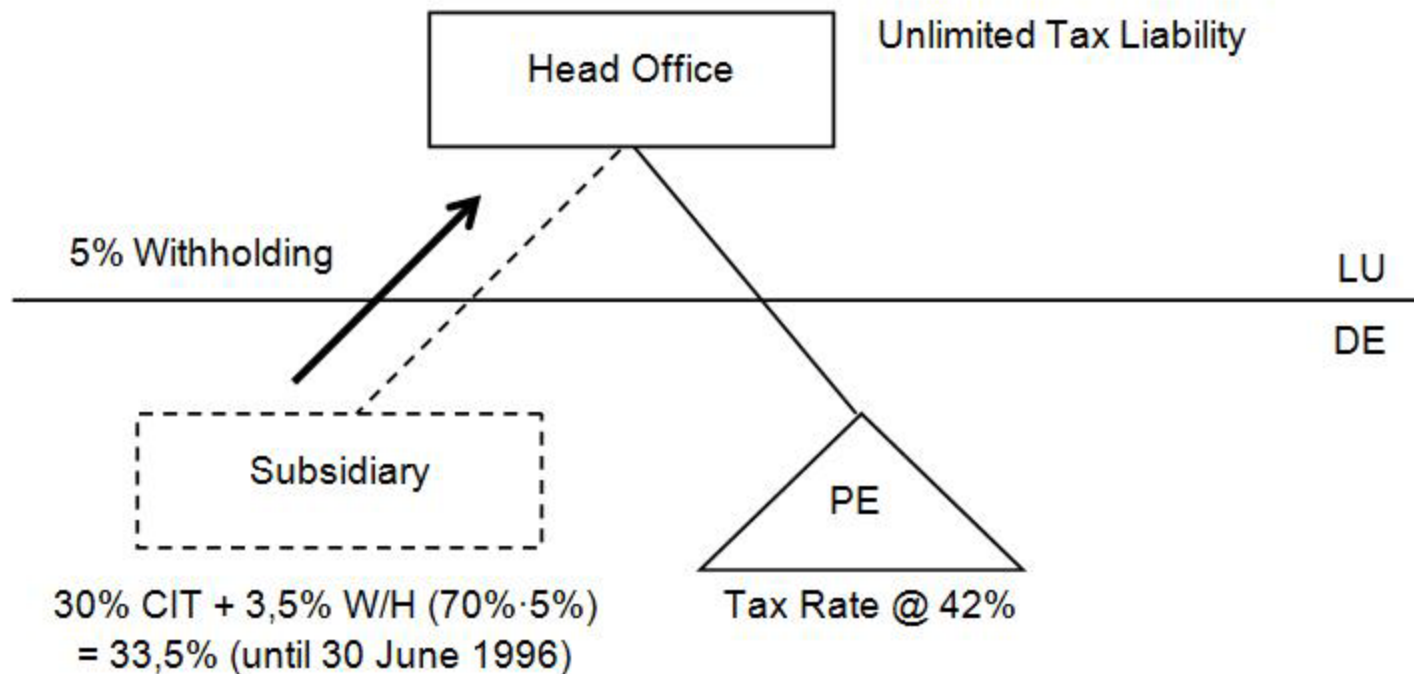
- **Tax Rate** — ECJ, 29 April 1999, C-311/97, *Royal Bank of Scotland* [1999] ECR I-2651





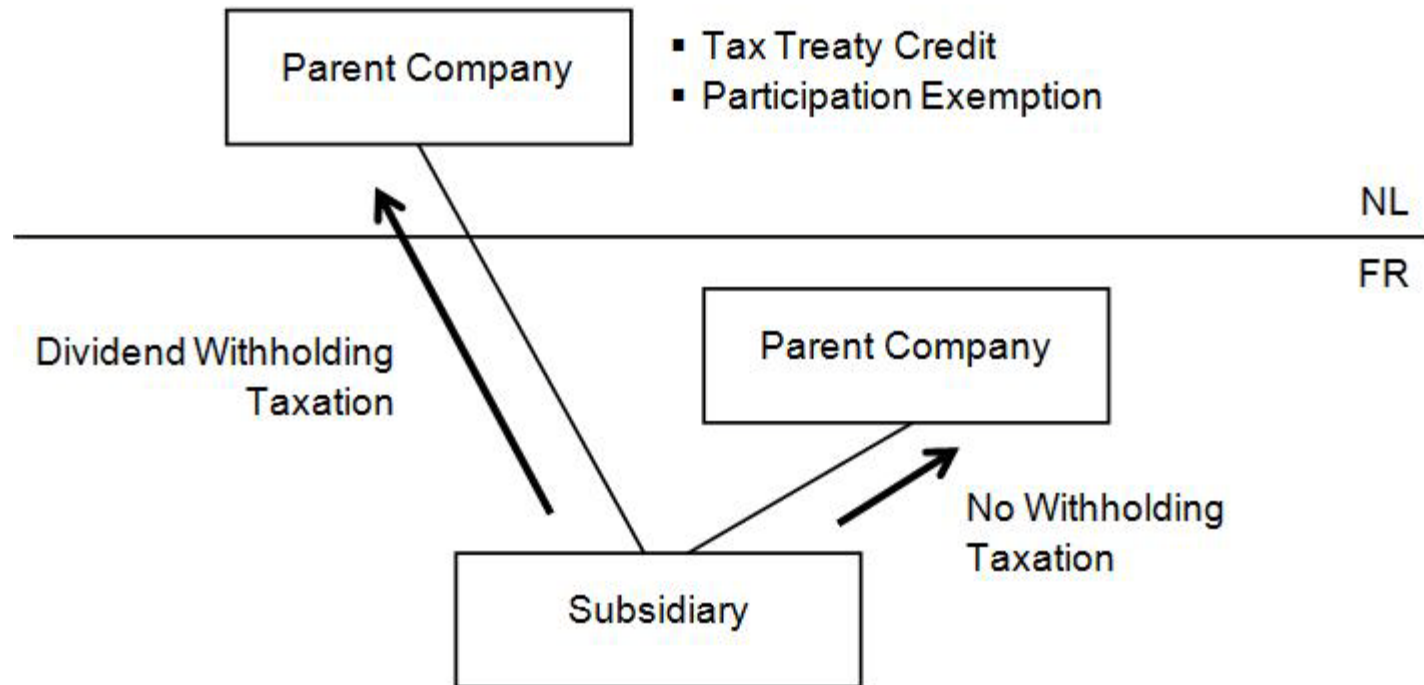
# Inbound Situations – Objective Ability to Pay

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

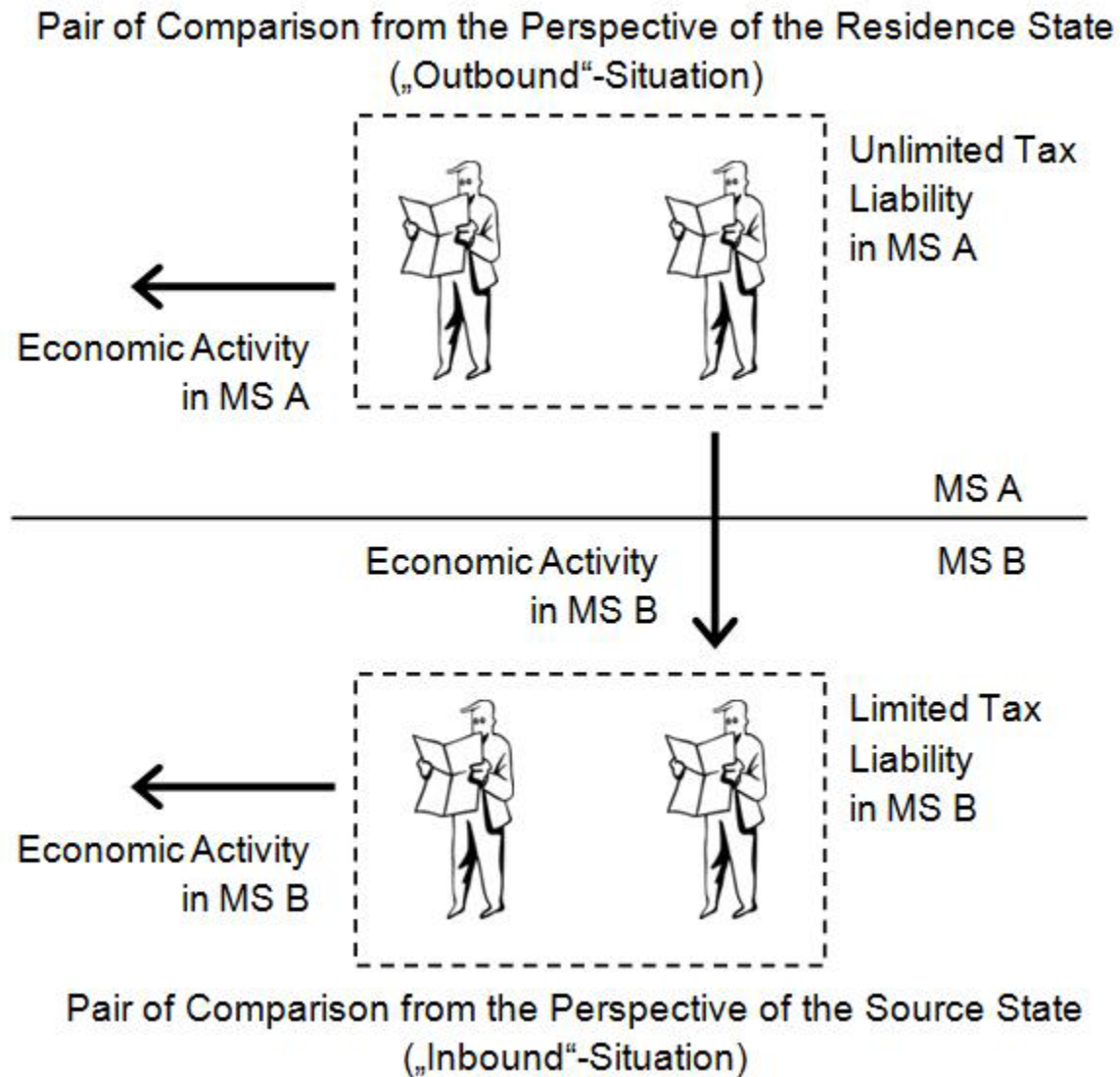


# Inbound Situations – Objective Ability to Pay

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

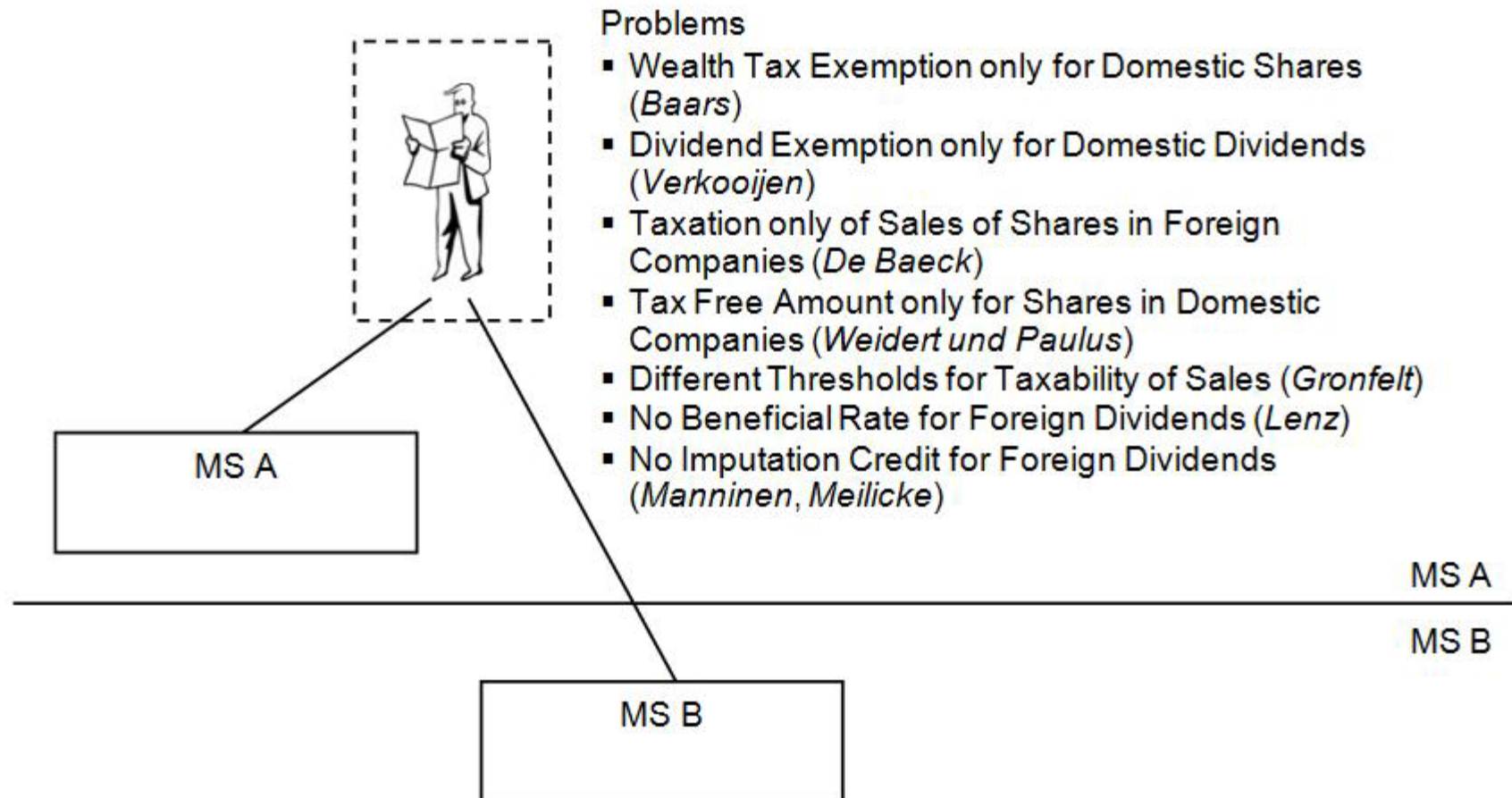


# Outbound Situations



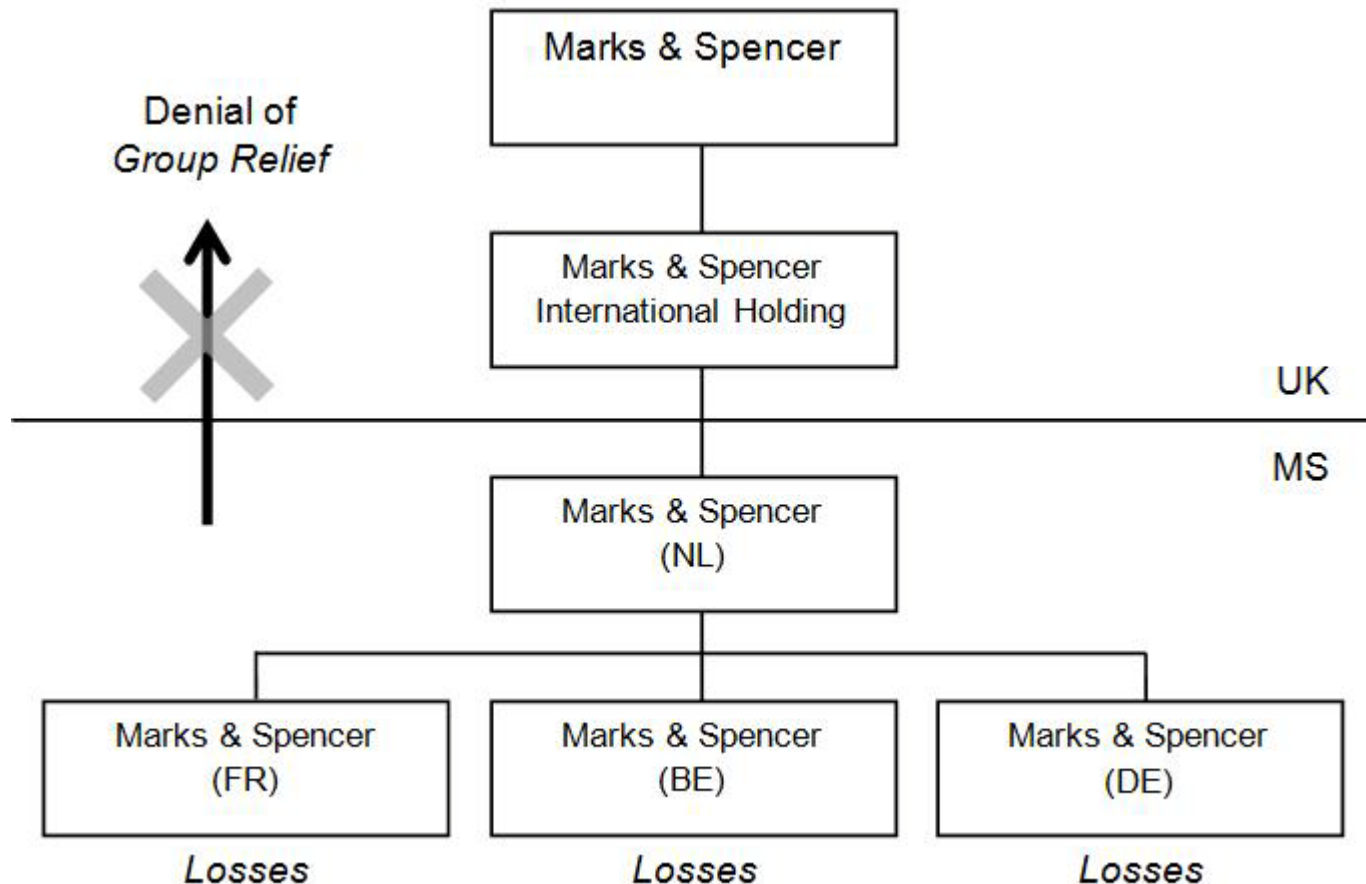
# Outbound Situations

- Holdings in Foreign Companies



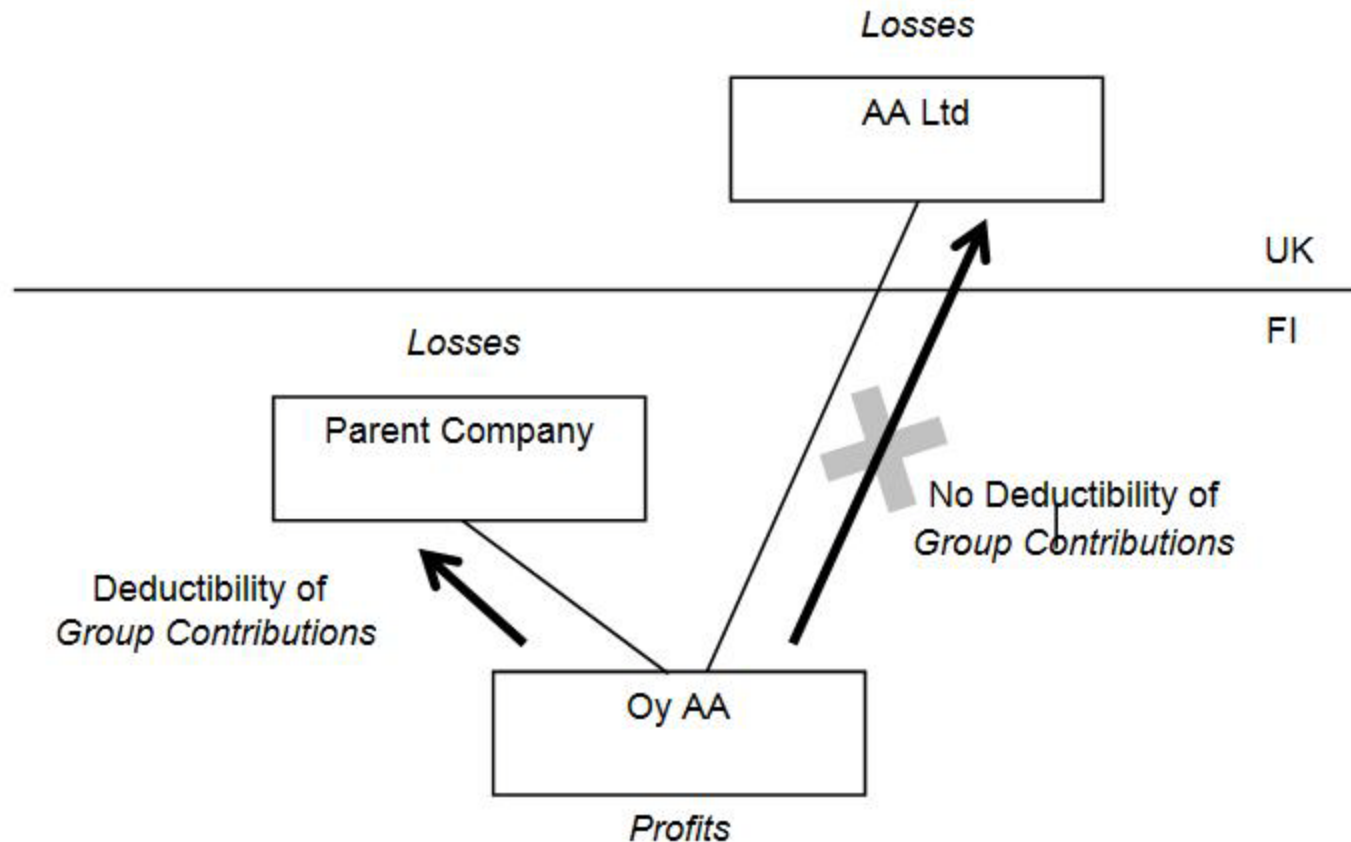
# Outbound Situations

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



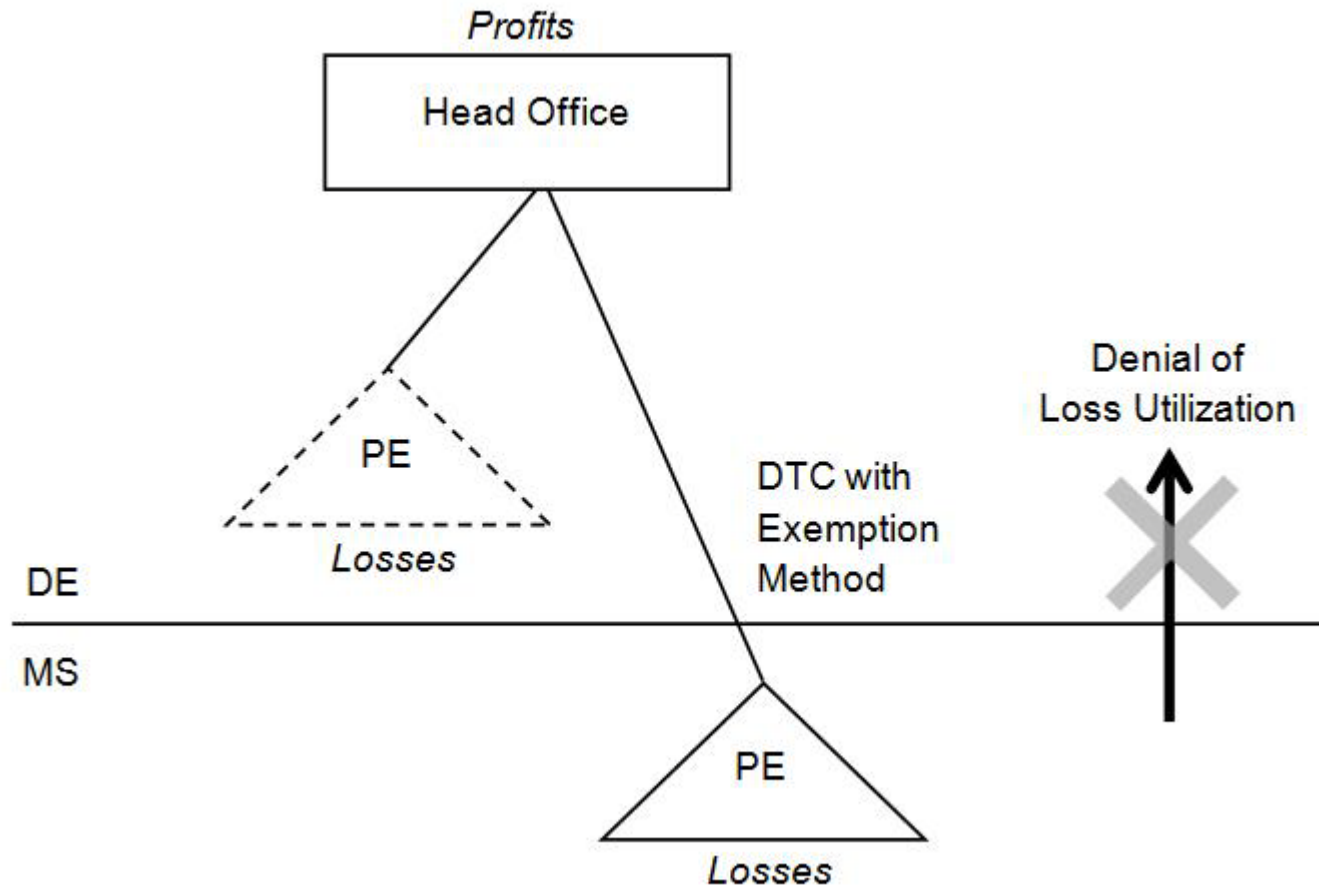
# Outbound Situations

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



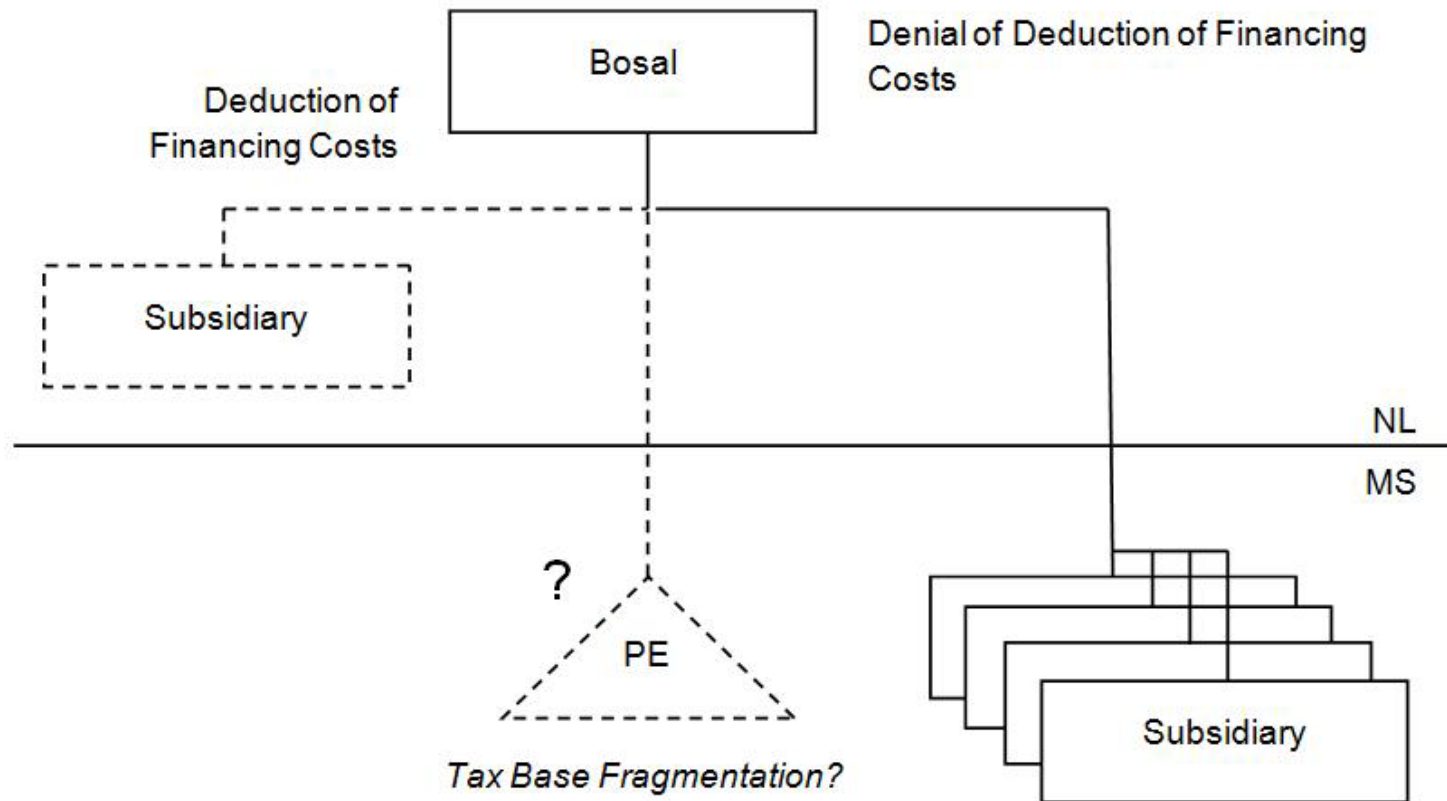
# Outbound Situations

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



# Outbound Situations

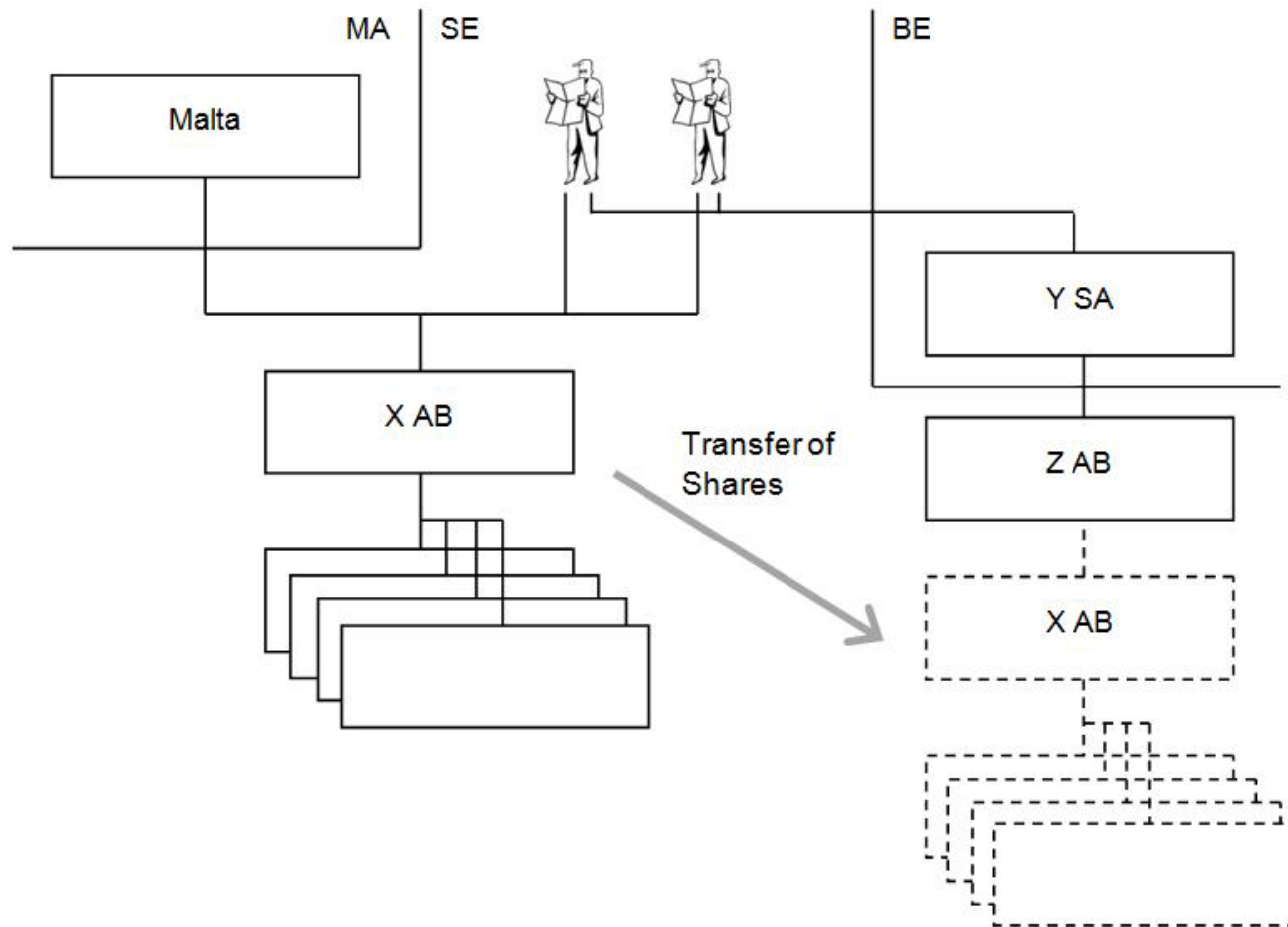
- **Financing Costs and Exempt Income** — ECJ, 18 September 2003, C-168/01, **Bosal** [2003] ECR I-9409, and ECJ, 23 February 2006, C-471/04, **Keller Holding** [2006] ECR I-2107 → **Symmetry and “Tax Base Fragmentations”?**





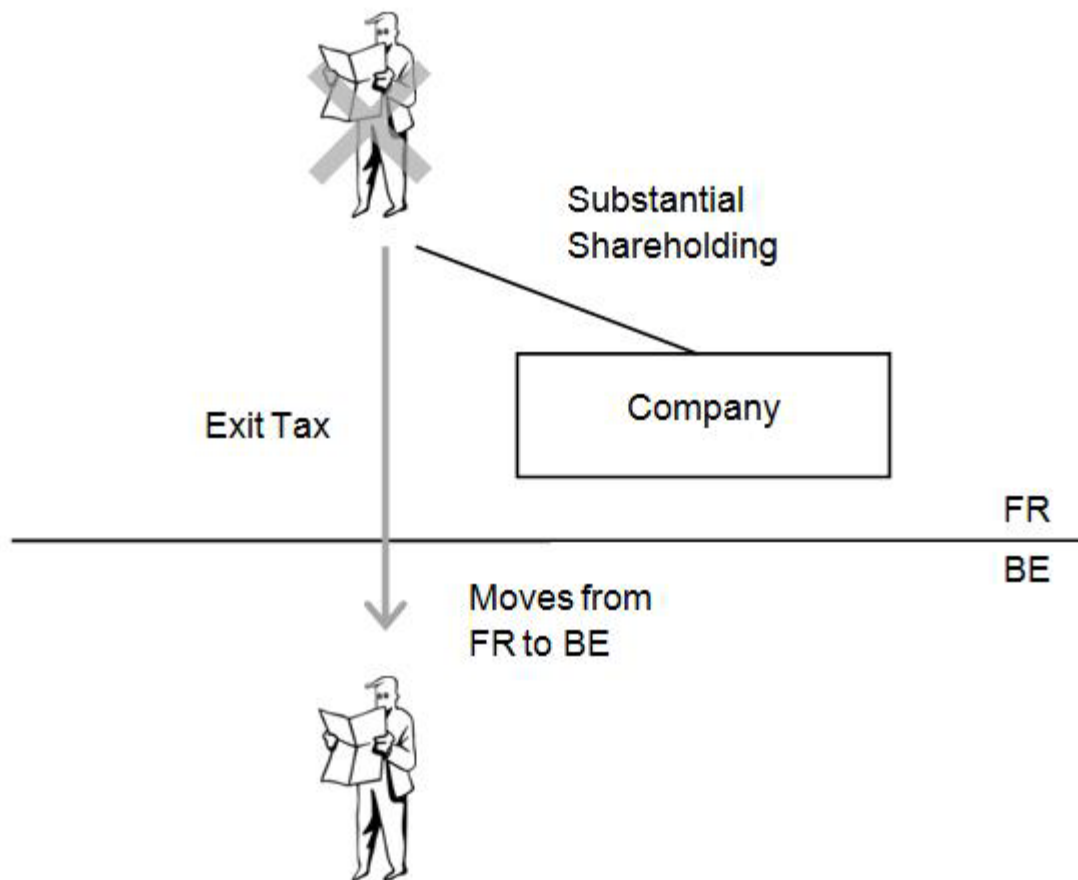
# Outbound Situations

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



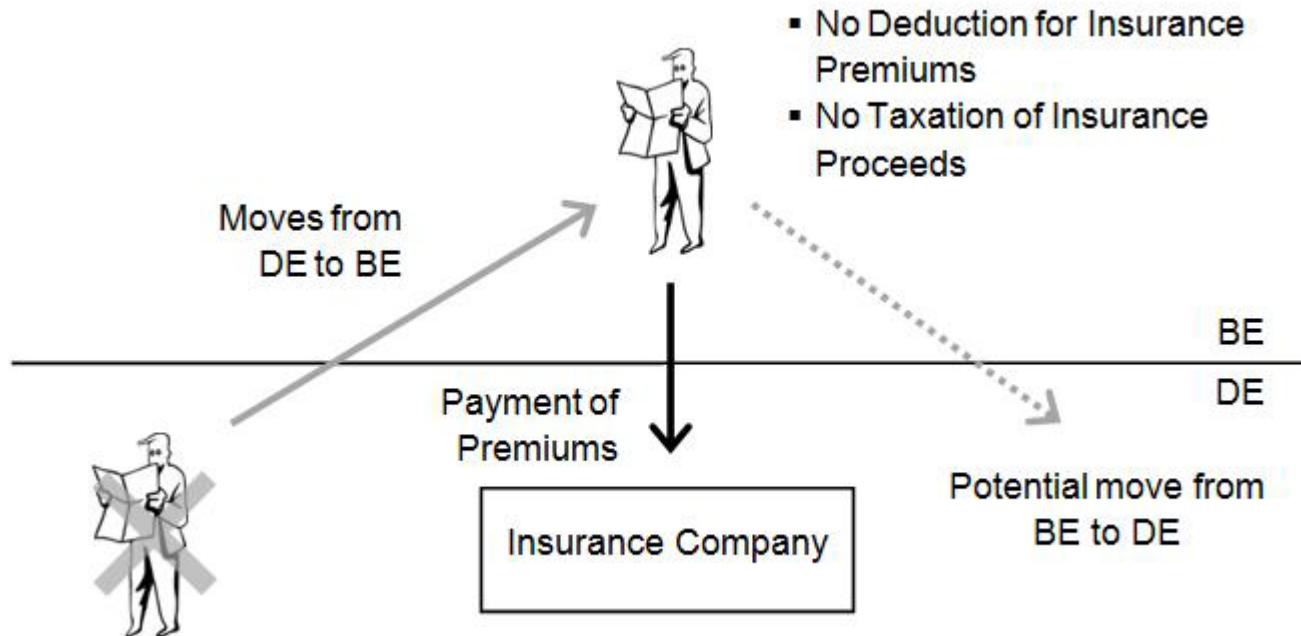
# Outbound Situations

- **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



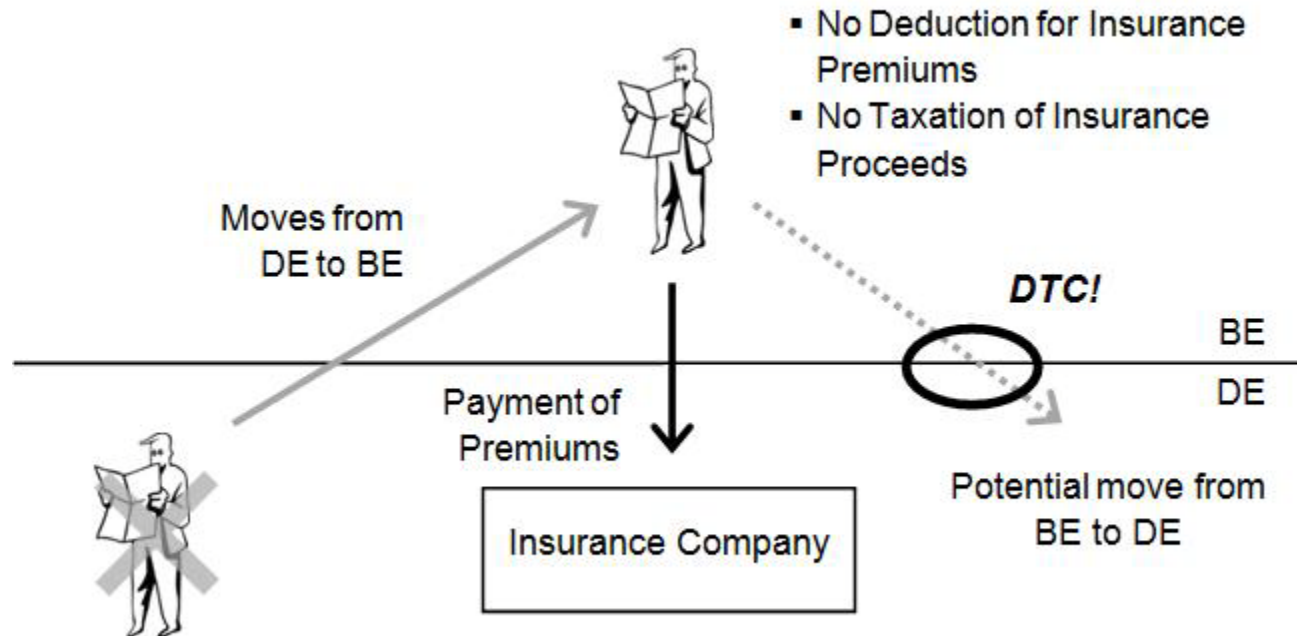
# Justifications

- **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!**



# Justifications

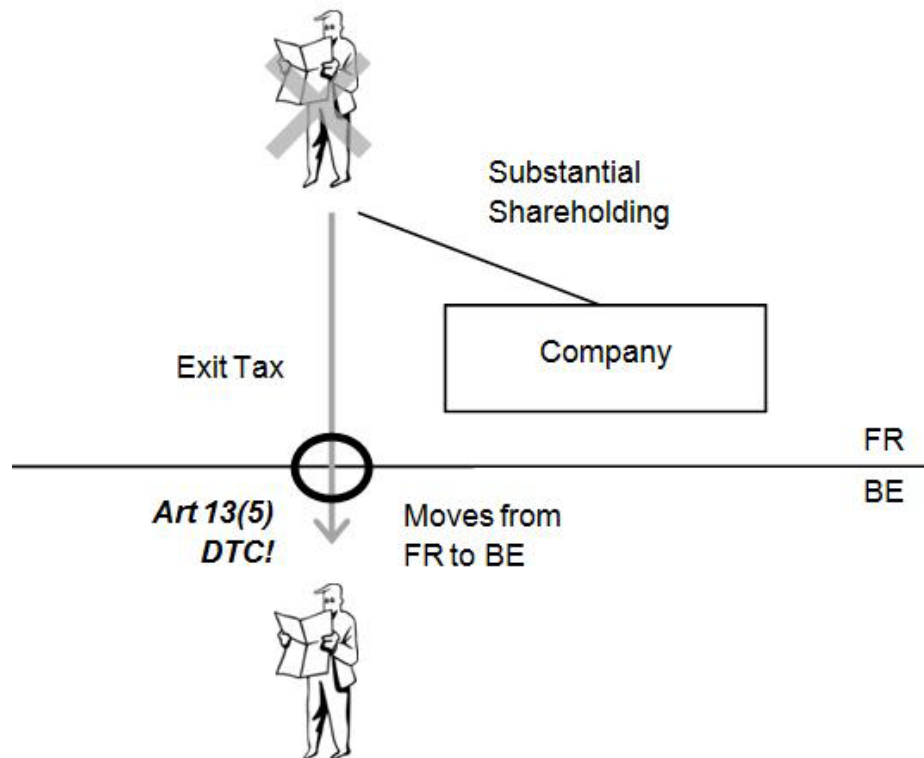
- **Coherence of the Tax System** — ECJ, 28 January 1992, C-204/90, *Bachmann* [1992] ECR I-249, and ECJ 28 January 1992, C-300/90, *Commission v. Belgium* [1992] ECR I-305 → **But: ECJ, 11 August 1995, C-80/94, *Wielockx* [1995] ECR I-2493**



# Justifications

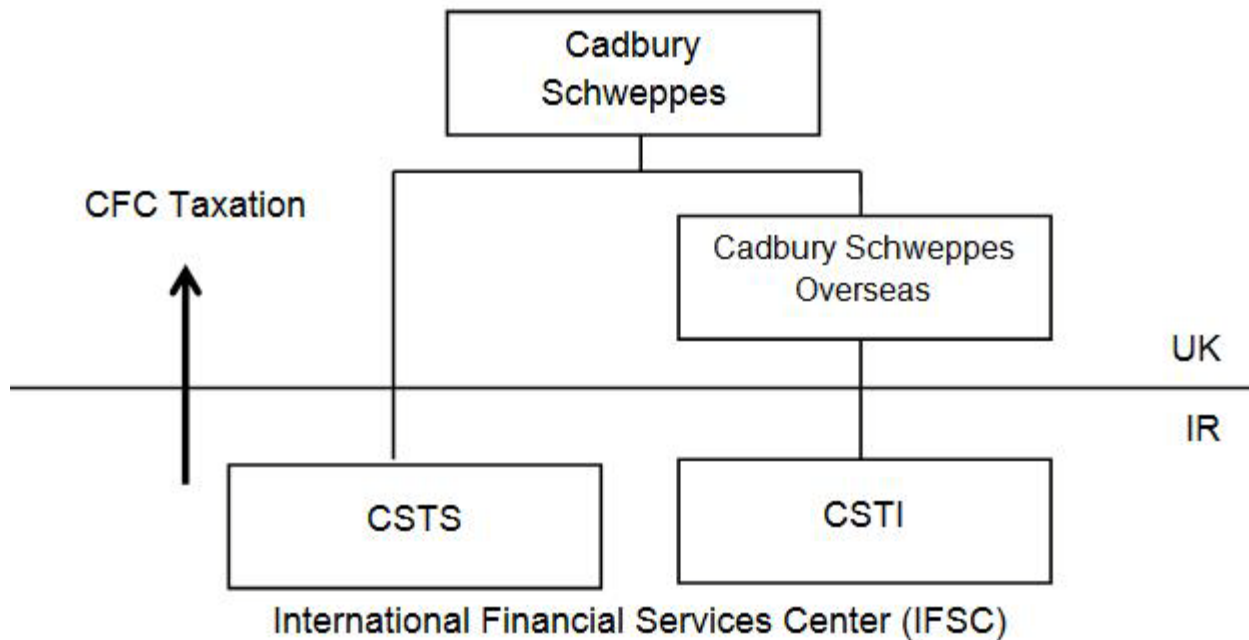
- “Macro-Coherence” and Exit Taxation

- **Principle of Territoriality** → ECJ, 7 September 2006, C-470/04, *N* [2006] ECR I-7409
- **Free Movement of “Hidden Reserves”** → ECJ, 21 November 2002, C-436/00, *X and Y* [2002] ECR I-10829



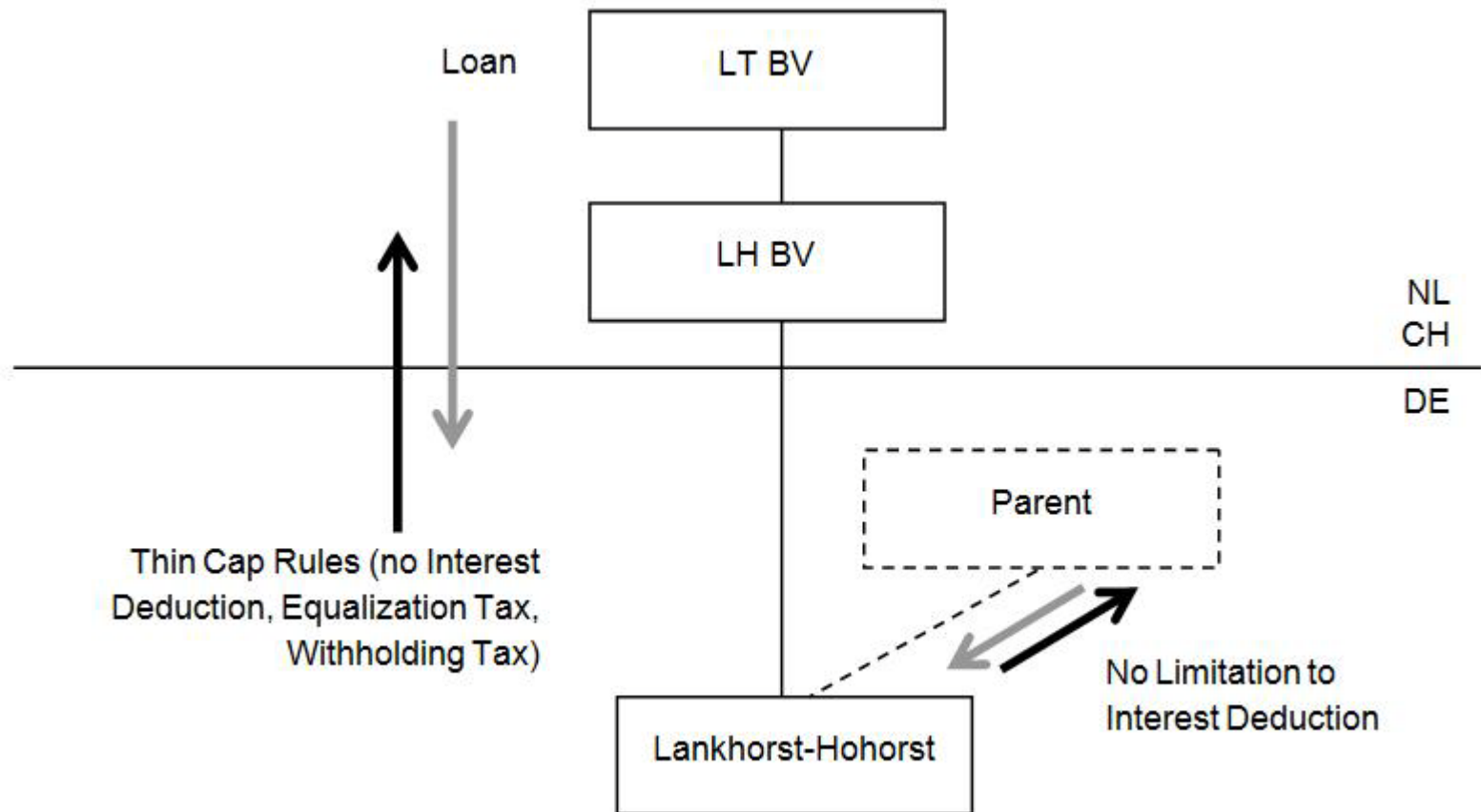
# Justifications

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



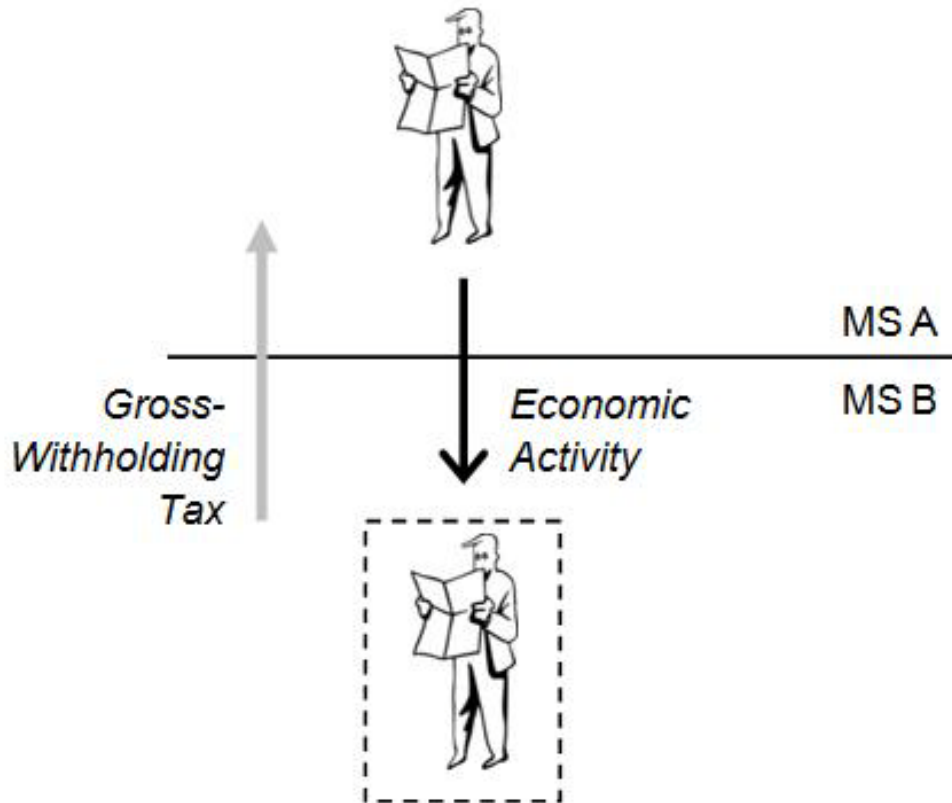
# Justifications

- **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

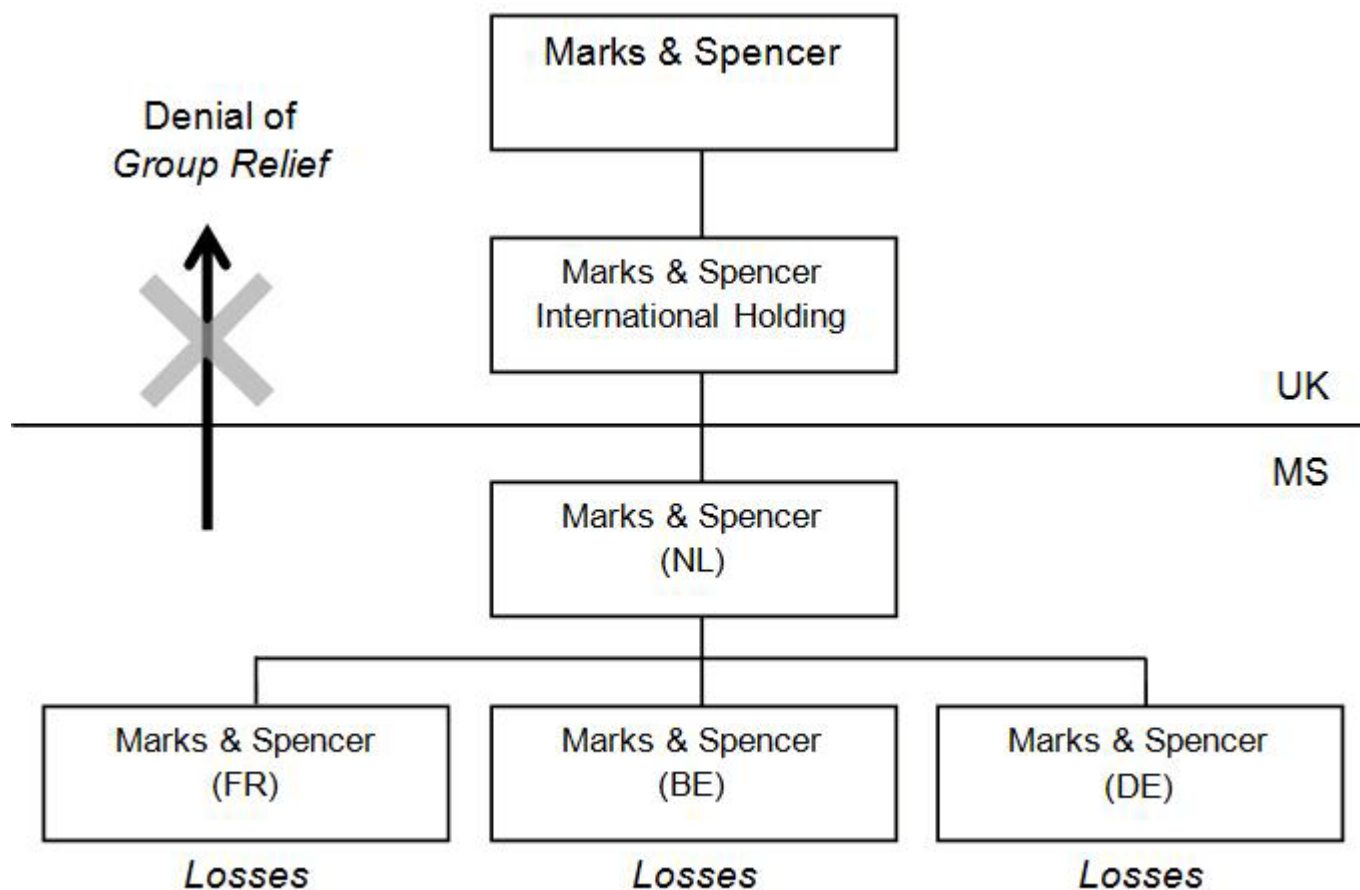
- **Effectiveness of Tax Collection** — ECJ, 3 October 2006, C-290/04, **Scorpio** [2006] ECR I-9461 → **Impact of Recovery Directive?**





# Justifications

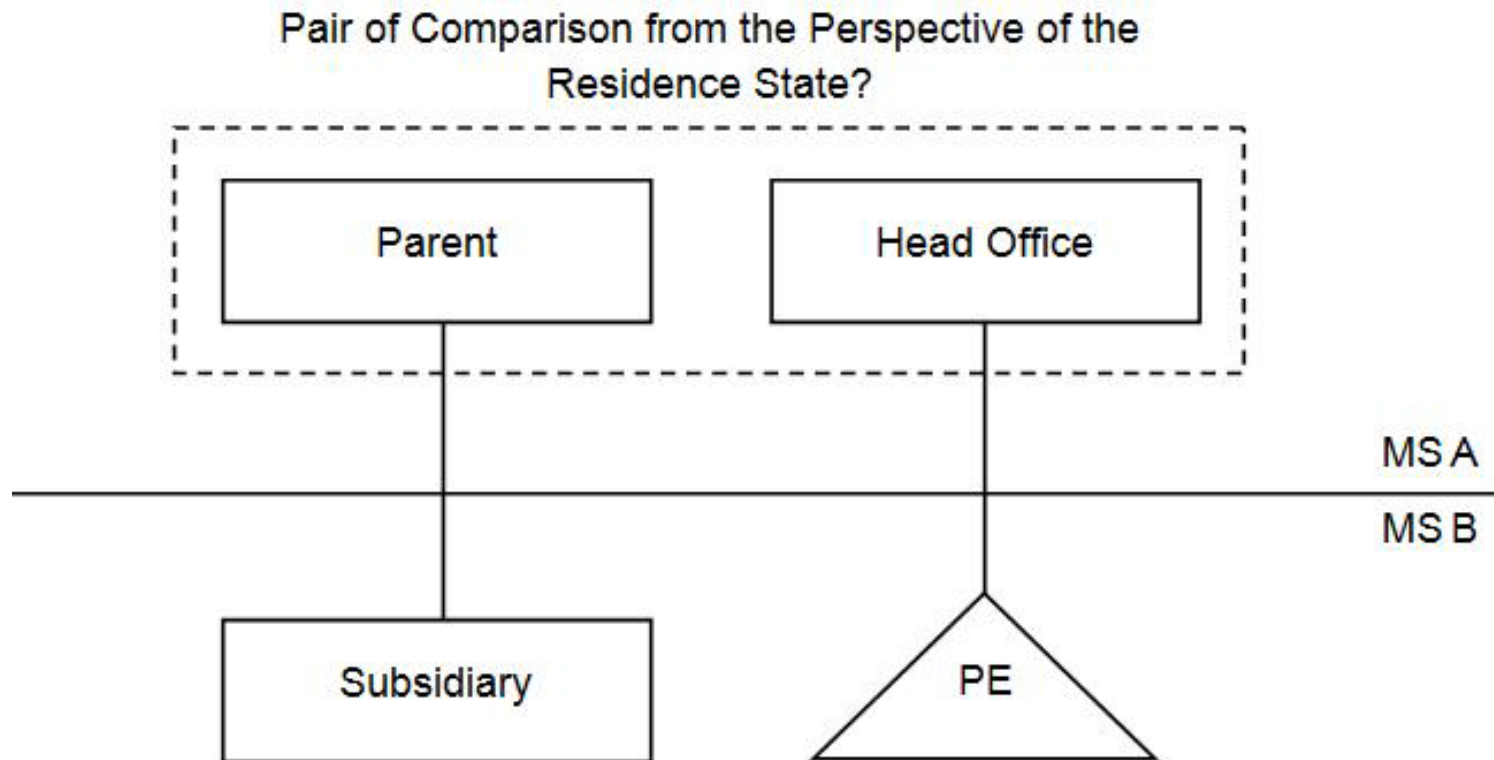
- **Balanced Allocation of Taxing Rights (“Inter-Nation Equity”)** — ECJ, 5 July 2005, C-376/03, *D* [2005] ECR I-5821, and ECJ, 13 December 2005, C-446/03, *Marks & Spencer* [2005] ECR I-10837



# Recent Issues

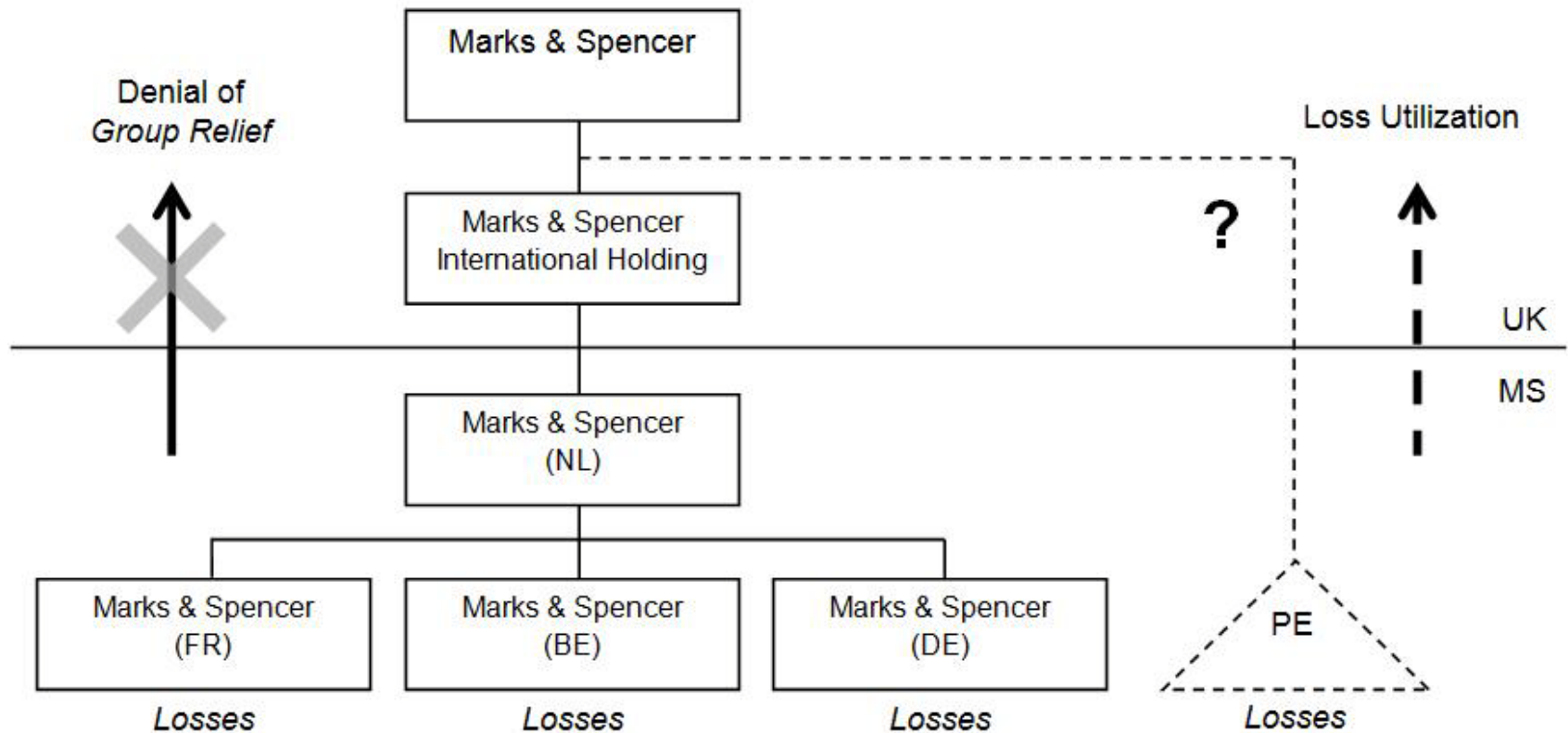
- **Horizontal Discrimination**
  - **Neutrality of the Legal Form**
  - **“Most Favored Nation Treatment”** → *Part III-3*
- **Symmetry and Tax Base Fragmentations**
- **Internal Consistency versus Discrimination**
- **“Single Country” versus “Overall Approach”**
  - **Factual Situations and Comparability** (*Schumacker, Marks & Spencer, Manninen*)
  - **Cross-Border Compensation** → *Part III-3*

# Recent Issues – Neutrality of Legal Form



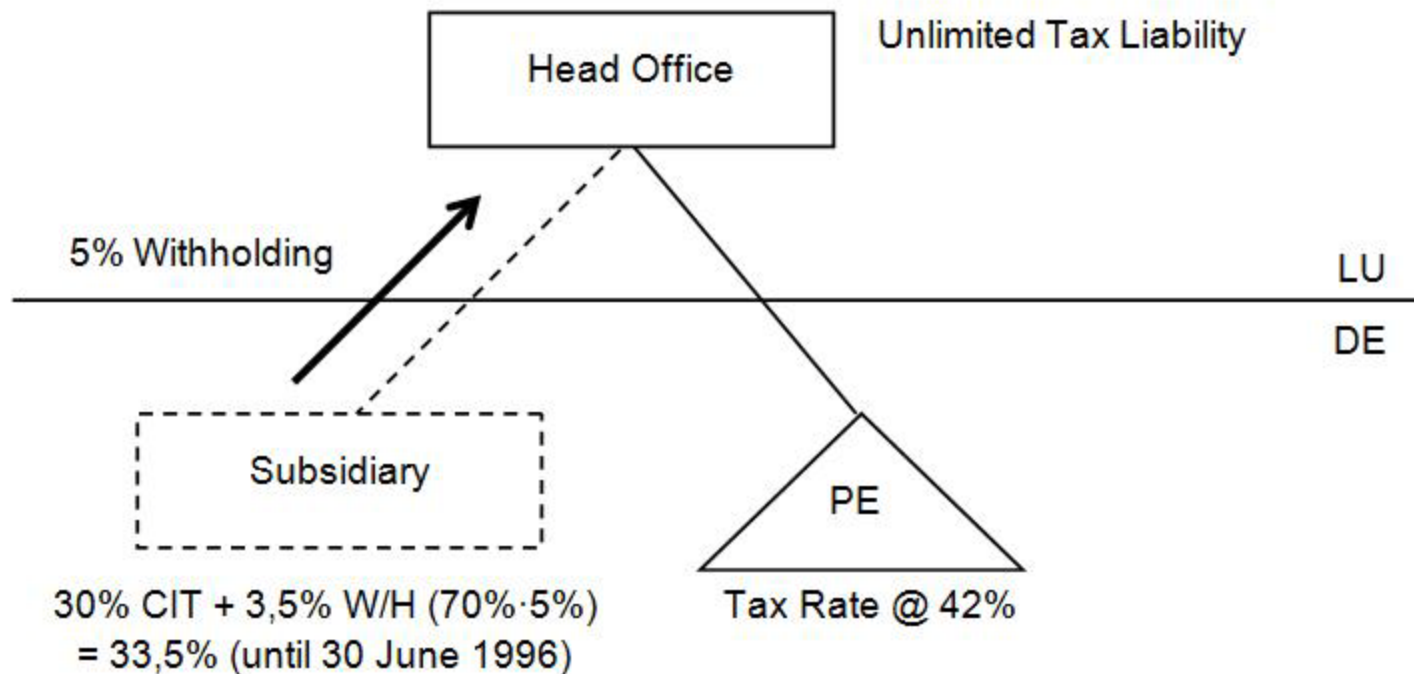
# Recent Issues – Neutrality of Legal Form

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



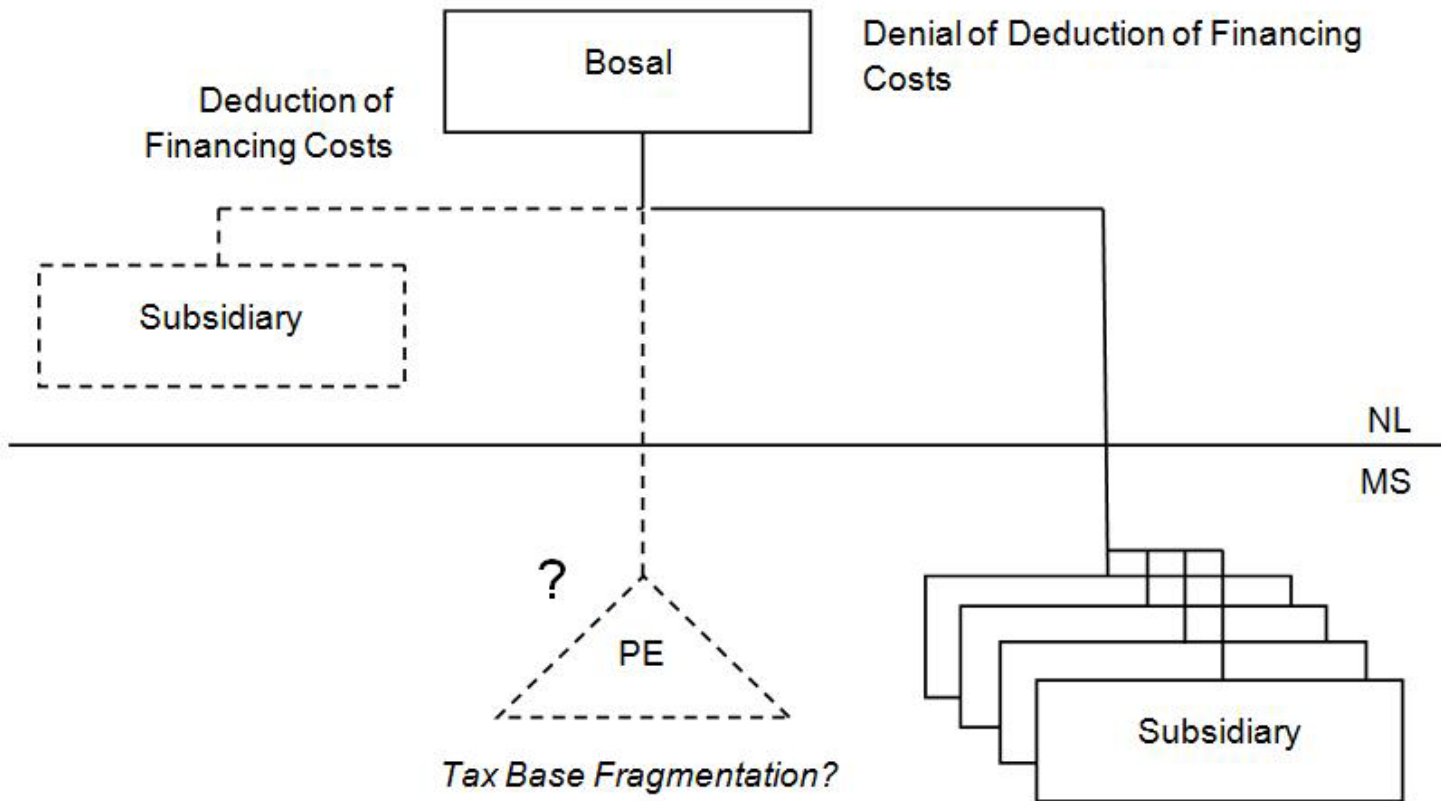
# Recent Issues – Neutrality of Legal Form

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



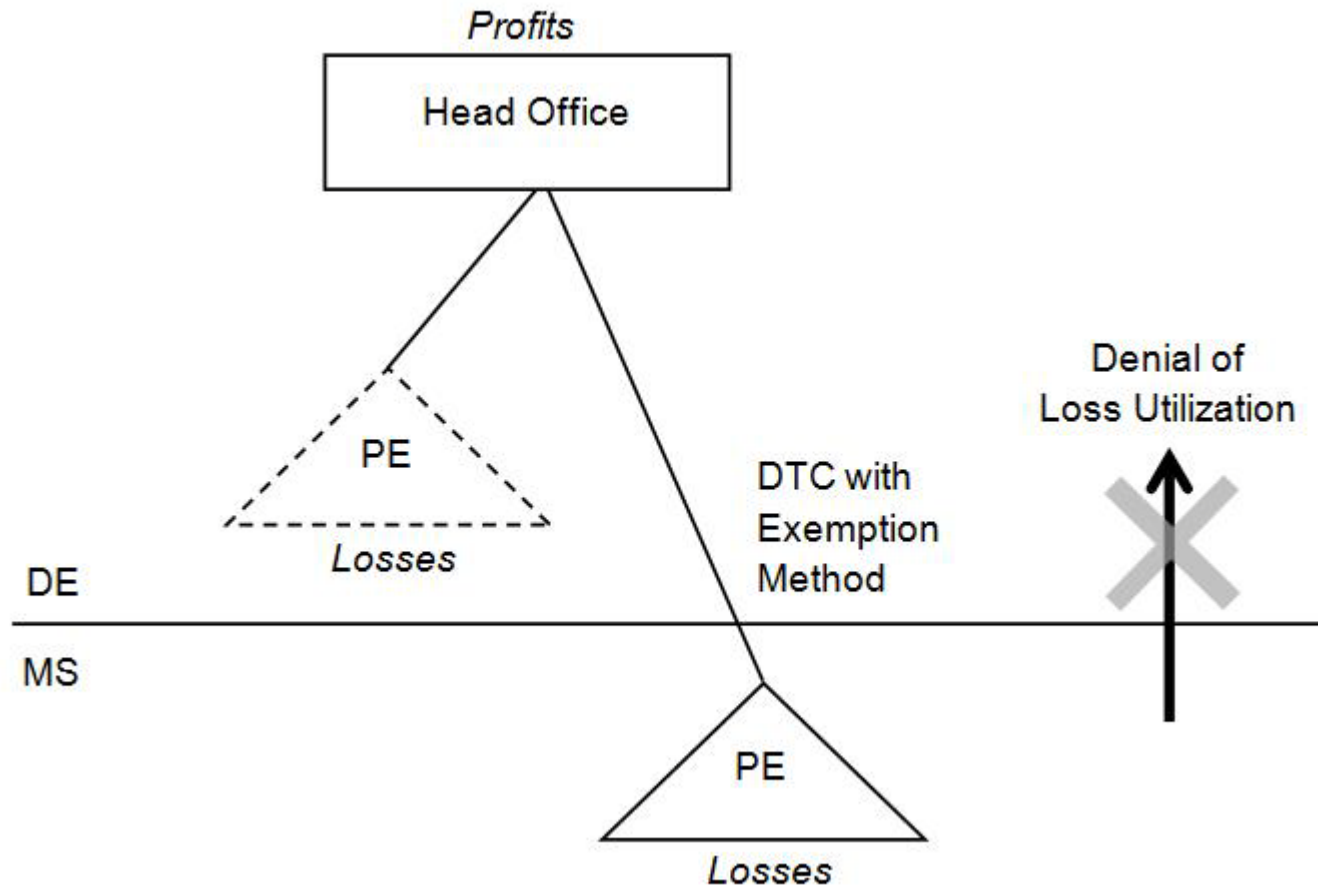
# Recent Issues – Tax Base Fragmentation

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



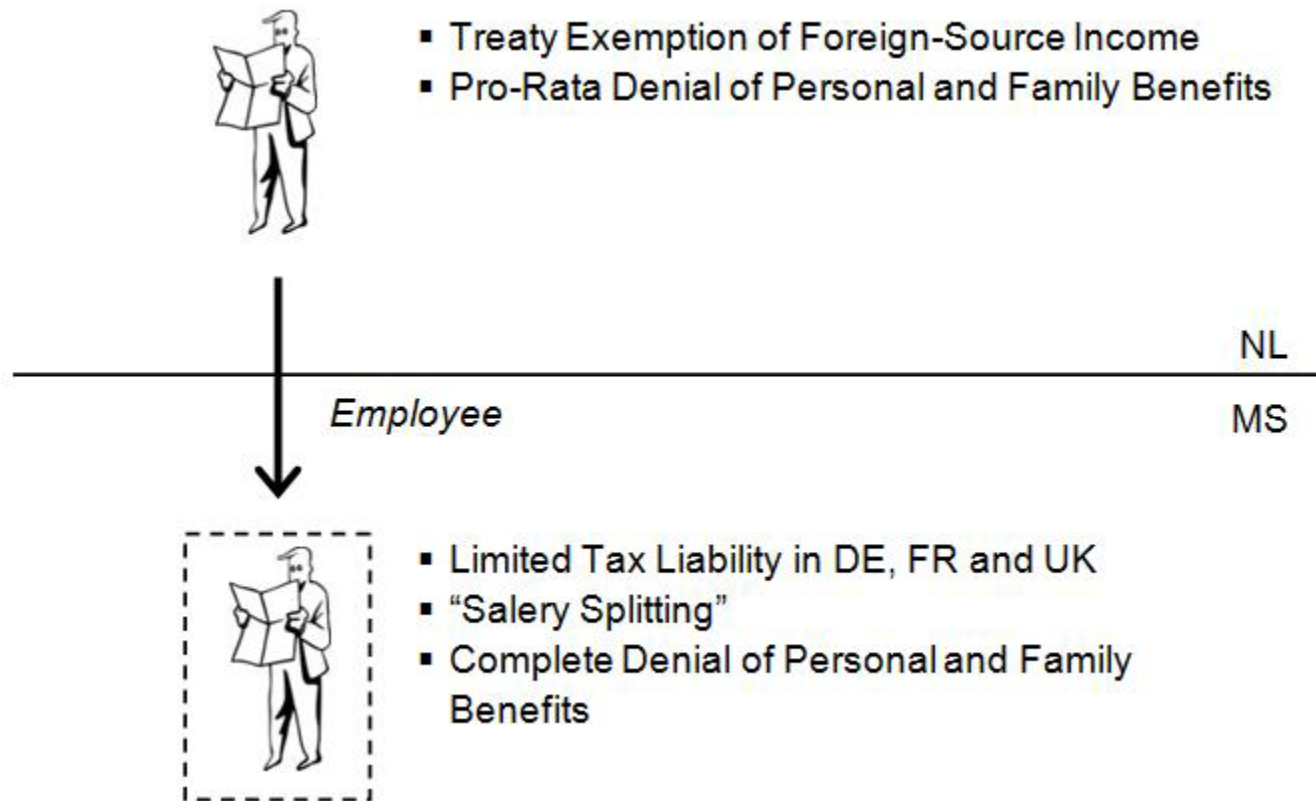
# Recent Issues – Tax Base Fragmentation

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



# Recent Issues – Internal Consistency

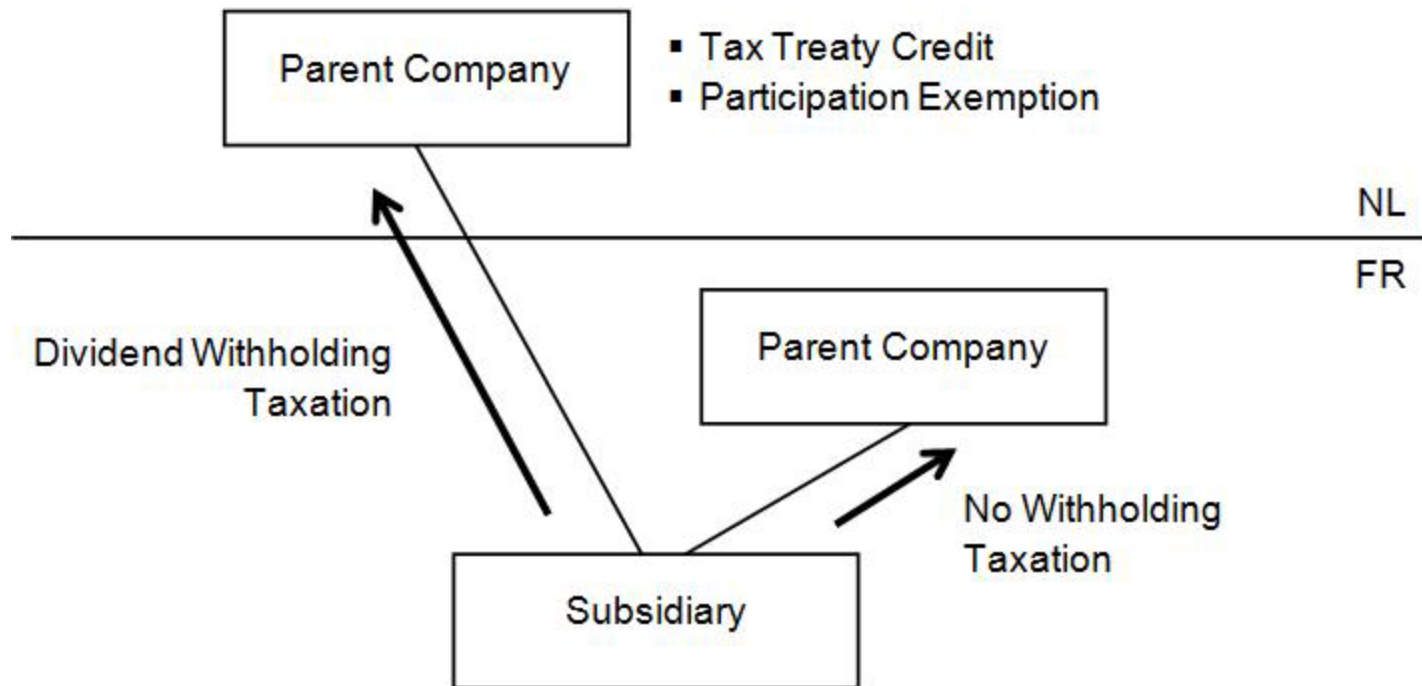
- **Internal Consistency versus Discrimination** — ECJ, 12 December 2002, C-385/00, *De Groot* [2002] ECR I-11819





# Recent Issues – “Neutralization”

- “Single Country” versus “Overall Approach”
  - **Factual Situations and Comparability** (*Schumacker, Marks & Spencer, Manninen*)
  - **Cross-Border Compensation** → *Part III-4 (Denkavit Internationaal, Amurta)*



*Part III-2*  
**Third Country Situations**

# Framework

- **Art 67 EEC Treaty**

- Art 67 (1) EEC Treaty → “During the transitional period and to the extent necessary to ensure the proper functioning of the common market, Member States **shall progressively abolish between themselves all restrictions on the movement of capital** belonging to **persons resident in Member States** and any **discrimination based on the nationality or on the place of residence of the parties or on the place where such capital is invested.**”
- Art 69 EEC Treaty → “The Council shall, on a proposal from the Commission, [...] issue the **necessary directives for the progressive implementation of the provisions of Article 67** [...]”.
- No direct applicability (see Case 267/86, *Van Eycke*)

- **Council Directive 88/361/EEC**

- Art 1(1) → “Without prejudice to the following provisions, **Member States shall abolish restrictions on movements of capital taking place between persons resident in Member States.** To facilitate application of this Directive, capital movements shall be classified in accordance with the Nomenclature in Annex I.”
- Directly applicable from **1 July 1990** (see Joined Cases C-358/93 and C-416/93, *Bordessa et al.*)

# Framework

- **Maastricht Treaty on European Union**
  - Replacement of Arts 67 to 73 EEC Treaty by the new **Arts 73b to 73g EC Treaty** with effect of **1 January 1994**
  - Art 73b (1) EC Treaty → “Within the framework of the provisions set out in this Chapter, **all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.**”
- **Treaty of Amsterdam**
  - Renumbering of the provisions of Arts 73b to 73g EC Treaty into **Arts 56 to 60 EC**
  - Art 56(1) EC → “**Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.**”
  - Nomenclature in Annex I to Council Directive 88/361/EEC still has indicative value as to what is capital movement within the meaning of Art 56 EC (see, e.g., Case C-222/97, *Trummer and Mayer*)
- **Treaty of Lisbon**
  - Renumbering of Arts 56 to 60 EC to **Art 63 EC** et seq.
  - Secure Member State’s Interests

# Objective and Subjective Scope

- **Art 56(1) EC**

- “Within the framework of the provisions set out in this Chapter, **all restrictions** on the movement of capital ***between Member States*** and ***between Member States and third countries*** shall be prohibited.”
- Persons invoking the freedom of capital movement need not be nationals or residents of a Member State (compare Art 56(1) EC with Art 67 EEC; see also C-484/93, *Svensson and Gustavsson*, and Joined Cases C-358/93 and C-416/93, *Bordessa et al.*)
- “**Erga Omnes Effect**” → No distinction between the prohibition of restrictions on the movement of capital “**between Member States**” on the one hand, and such “**between Member States and third countries**” on the other
  - Art 57(1) → The provisions of Article 56 shall be without prejudice to the **application to third countries of any restrictions which exist on 31 December 1993** under national or Community law adopted in respect of the movement of capital **to or from third countries** involving **direct investment** – including in real estate – establishment, the provision of financial services or the admission of securities to capital markets. In respect of restrictions existing under national law in Bulgaria, Estonia and Hungary, the relevant date shall be **31 December 1999**.

# Restriction and Justification

- **Art 58(1) EC**

- “The provisions of Article 56 shall be without prejudice to the right of Member States:
  - “to apply the relevant provisions of their tax law which **distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested;**”
  - “to take all requisite measures to prevent infringements of national law and regulations, **in particular in the field of taxation** and the prudential supervision of financial institutions, or to lay down procedures for the declaration of capital movements for purposes of administrative or statistical information, or to take measures which are justified on grounds of public policy or public security.”
- **Art 58(1) EC** → “The measures and procedures referred to in paragraphs 1 and 2 shall not constitute **a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 56.**”

- **Scope of Justification?**

- Art 58(1) clearly intended to safeguard national systems, especially corporate imputation systems
- But: ECJ views Art 58(1) and (3) as **codification of its prior case-law** (see, e.g., *Verkooijen*, *Lenz*, *Manninen*)
  - Non-Comparable Situation or
  - “Rule of Reason”-Justification (e.g., coherence, fiscal supervision, anti-avoidance) and strict Proportionality Test

# Overview

	Arts 39, 43 and 49 EC	Art 56 EC
<b>Direct Application</b>	Since 1 January 1970	Since 1 January 1994 (Directive 88/361/EEC, since 1 July 1990)
<b>EU-Nationality Required</b>	✓	x
<b>Requirement of “EU Dimension”</b>	✓	✓
<b>Protection of Active and Passive Market Participants</b>	✓	✓
<b>Protection in In- and Outbound Situations</b>	✓	✓
<b>Protection in Third- Country Situations</b>	x	✓ (?)

# Third Countries

- **Art 56(1) EC**

- “Within the framework of the provisions set out in this Chapter, **all restrictions** on the movement of capital *between Member States* and ***between Member States and third countries*** shall be prohibited.”
- “**Erga Omnes Effect**” → No distinction between the prohibition of restrictions on the movement of capital “**between Member States**” on the one hand, and such “**between Member States and third countries**” on the other

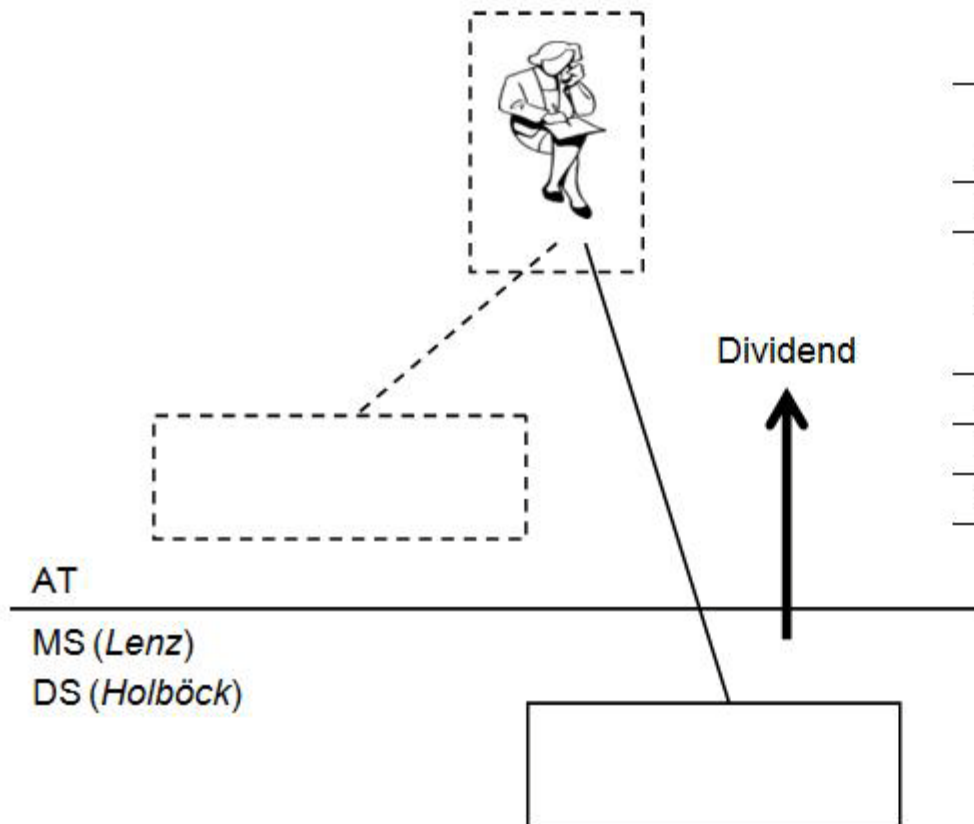
- **Art 57(1) EC**

- “The provisions of Article 56 shall be without prejudice to the **application to third countries of any restrictions which exist on 31 December 1993** under national or Community law adopted in respect of the movement of capital **to or from third countries** involving **direct investment** – including in real estate – establishment, the provision of financial services or the admission of securities to capital markets. In respect of restrictions existing under national law in Bulgaria, Estonia and Hungary, the relevant date shall be **31 December 1999.**”



# Third Countries – Which Freedom?

- **Which Freedom Applies?** → ECJ, 24 May 2007, C-157/05, **Holböck** [2007] ECR I-4051



	AT	MS
Corporate Tax Base	100	100
/ Corporate Tax (34%)	(34)	(34)
= Dividend	66	66
= Income Tax Base	66	66
/ Income Tax (25%/50%)	(16,5)	(33)
= Income Tax in AT	16,5	33
= Overall Burden	50,5	67
= Net	49,5	33

# Third Countries – Which Freedom?

**Does the domestic measure only cover establishment situations (e.g., permanent establishments, controlling shareholdings)?**

No

Freedom of Capital Movement and Freedom of Establishment are both applicable (e.g., *Holböck*; *Burda*).

**Is the transaction factually an establishment (e.g., a controlling shareholding)?**

No

Freedom of Capital Movement applies (also to direct investments that are not controlling shareholdings) (e.g., *FII Group Litigation*; *Orange European Smallcup Fund*). **Is it an „old“ restriction within the meaning of Art 57(1) EC?**

No

**Comparability of situations, justifications?**  
(See, e.g., *FII Group Litigation*, A)?

Yes

Exclusive application of the Freedom of Establishment, no protection in third-country situations (e.g., *Cadbury Schweppes*; *Lasertec*; *Stahlwerk Ergste Westig*).

Yes

Exclusive application of the Freedom of Establishment, no protection in third-country situations (*Burda*, *KBC Bank*; but see: *Glaxo Wellcome*).

Yes

“Grandfathered” (e.g., *FII Group Litigation*; *Orange European Smallcup Fund*).

# Third Countries – Art 57 EC

- **Art 57(1) EC – Issues of Interpretation (*FII Group Litigation, Holböck*)**
  - “***Application to third countries***” → No restrictions of Art 57(1) EC in respect to investments *from* third countries into the Community; rather, grandfathering of restrictive measures on in- as well as on outbound investments.
  - “***Restrictions ... in respect of the movement of capital to or from third countries***” → Not to be interpreted strictly as only grandfathering *direct* restrictions of certain investments but rather extends to restrictions concerning payments flowing from such an investment, such as dividends.
  - “***In respect of the movement of capital to or from third countries***” → Safeguards general provisions in respect of their application to third countries (no specificity required).
  - “***Direct investment***” → Nomenclature of the capital movements in Annex I to Council Directive 88/361/EEC → Shares held enable the shareholder, “*either pursuant to the provisions of the national laws relating to companies limited by shares or in some other way, to participate effectively in the management of that company or in its control.*”

# Third Countries – Art 57 EC

- **Art 57(1) EC – Issues of Interpretation (*FII Group Litigation*, *Holböck*)**
  - **Any restrictions which “exist” on 31 December 1993 →**
    - Restrictions are deemed to have “existed” on 31 December 1993 even if the restrictive measure has subsequently been amended, but only if it is, in substance, identical to the previous legislation, or limited to reducing or eliminating an obstacle in the earlier legislation.
    - Relevance of adoption, entering into force or effective application of domestic rules? → *Lasertec*
    - Pre-existing restriction that was temporarily disapplied by domestic legislation? → *Stahlwerk Ergste Westig GmbH*
  - **Any restrictions which exist on “31 December 1993” →**
    - Stated date relevant irrespective of date of accession of the respective Member State.
    - Recent amendment of Art. 57(1) EC, adding that “[in] respect of restrictions existing under national law in Bulgaria, Estonia and Hungary, the relevant date shall be 31 December 1999”.

# Third Countries – Roadmap

- **Art 56(1) EC**
  - “Within the framework of the provisions set out in this Chapter, **all restrictions** on the movement of capital *between Member States* and ***between Member States and third countries*** shall be prohibited.”
- **Roadmap**
  - Is Art 56(1) 2<sup>nd</sup> Situation EC directly applicable in direct tax cases? → ✓
  - Is Art 56(1) 2<sup>nd</sup> Situation EC applicable in the specific direct tax case? → ***Lasertec, A and B, Stahlwerk Ergste Westig***
  - Is the restriction at issue grandfathered by Art 57(1) EC? → ***FII Group Litigation, Holböck***
  - Does Art 56(1) 2<sup>nd</sup> Situation EC prohibit the restriction at issue?
    - Comparability Standard? → Art 56, 58(1) EC → ***FII Group Litigation (?)***
    - Justification Standard? → Art 58(1) EC → ***FII Group Litigation (?), A***
    - Proportionality Standard? → Art 58(3) EC
  - Are there any other sources of law prohibiting the restriction?
    - Art 40 EEA Agreement → Infringement proceedings, e.g., against Greece
    - Art 15 Swiss-EC Agreement

# Third Countries – Decided Cases

- **Third-country problems on which the ECJ has already ruled in an intra-Community context**
  - German thin capitalization → *Lankhorst-Hohorst GmbH* and ***Lasertec***
  - Taxation of foreign source dividends → *Lenz* and ***Holböck***
- **New issues that concern intra-Community and third-country situations**
  - UK Group Litigations
    - ***Test Claimants in Class IV of the ACT Group***
    - ***Test Claimants in the FII Group Litigation***
    - ***Test Claimants in the Thin Cap Group Litigation***
    - ***Test Claimants in the CFC and Dividend Group Litigation***
  - Withholding tax refunds for a Dutch investment funds → ***Orange European Smallcap Fund NV***
  - Exemption of foreign PE-losses → *Lidl Belgium GmbH & Co. KG (or M + T)* and ***Stahlwerk Ergste Westig GmbH***
  - Participation Exemption → ***Haribo*** and ***Österreichische Salinen***
- **Specific third-country issues**
  - Relevance of circumstances in a third-country PE → ***A and B***
  - Taxation of inbound dividends → ***A***

*Part III-3*  
**Double Taxation Conventions  
and EC Tax Law**

# Core Issues

- **Double Taxation Conventions in the Light of EC Law**
  - **Treaty Entitlement**
    - Triangular Cases and Permanent Establishments (*Avoir Fiscal, Saint-Gobain*)
    - Conflicts in Attribution and Qualification
    - Treaty Shopping and Limitation on Benefits (*Open Skies, Cadbury Schweppes, ACT Group Litigation*)
  - **Distributive Rules**
    - Allocation versus Discrimination (*Gilly*)
    - Cross-Border Compensation and Inter-Nation Equity (*Fokus Bank, Denkavit Internationaal, Amurta*)
  - **The Methods to Avoid Double Taxation**
    - Exemption with Progression (*De Groot*)
    - Credit Method (*Gilly, Manninen, ACT Group Litigation*)



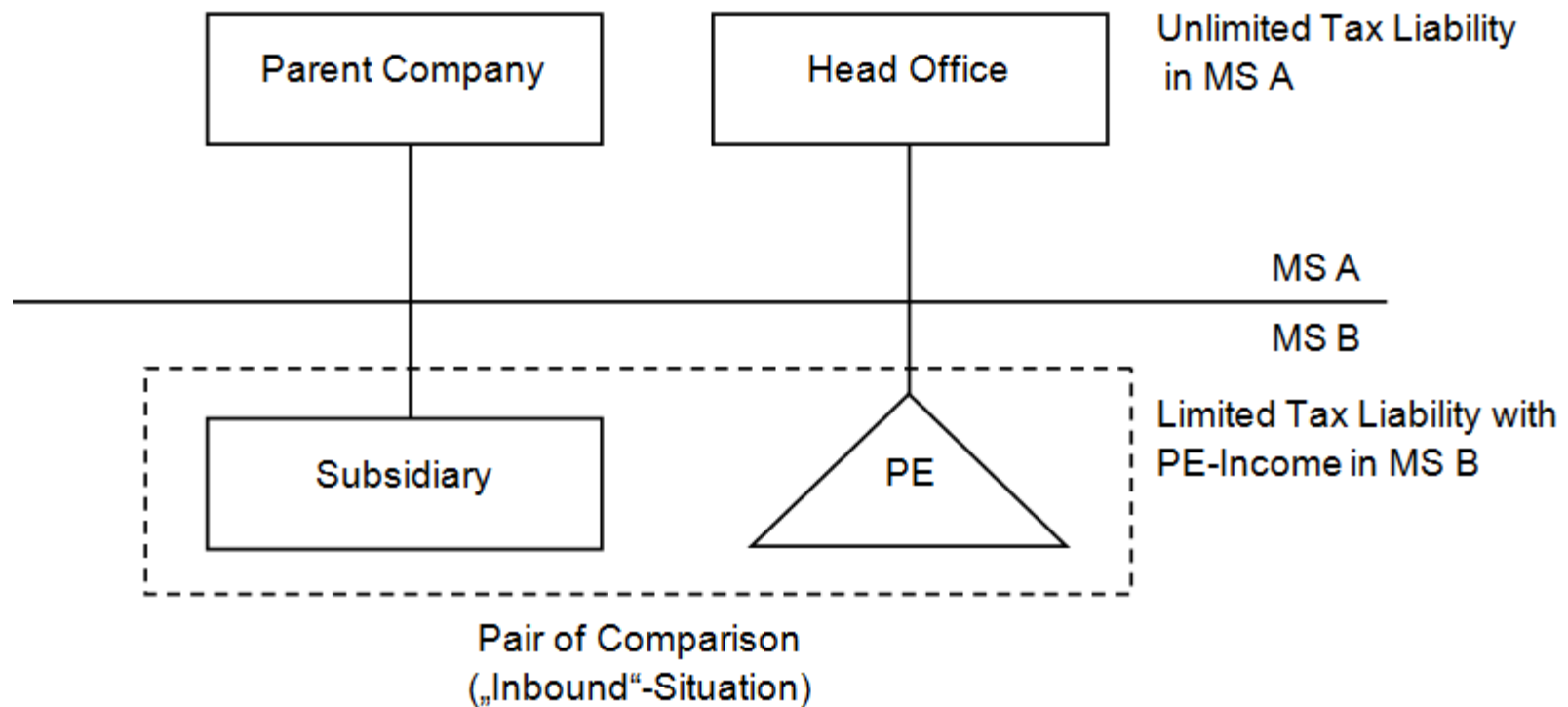
# Tax Treaties and Community Law

- **The Formal Relationship between DTCs and Community Law**
  - **International Treaties in the Framework of Community Law**
    - Community Law takes precedence over pre-existing (Art 30 Abs 3, 50 VCT) and post-accession inter-se-DTCs of the Member States, irrespective of the domestic treatment of International Law
    - Integration in compliance with pre-existing International Law (Art 307 EC), a *foriori* precedence of Community Law over post-accession treaties with third countries
      - Art 307 EC → “*The rights and obligations arising from **agreements concluded before 1 January 1958** or, for acceding States, **before the date of their accession**, between one or more Member States on the one hand, and one or more third countries on the other, shall not be affected by the provisions of this Treaty.*”

# Tax Treaties and Community Law

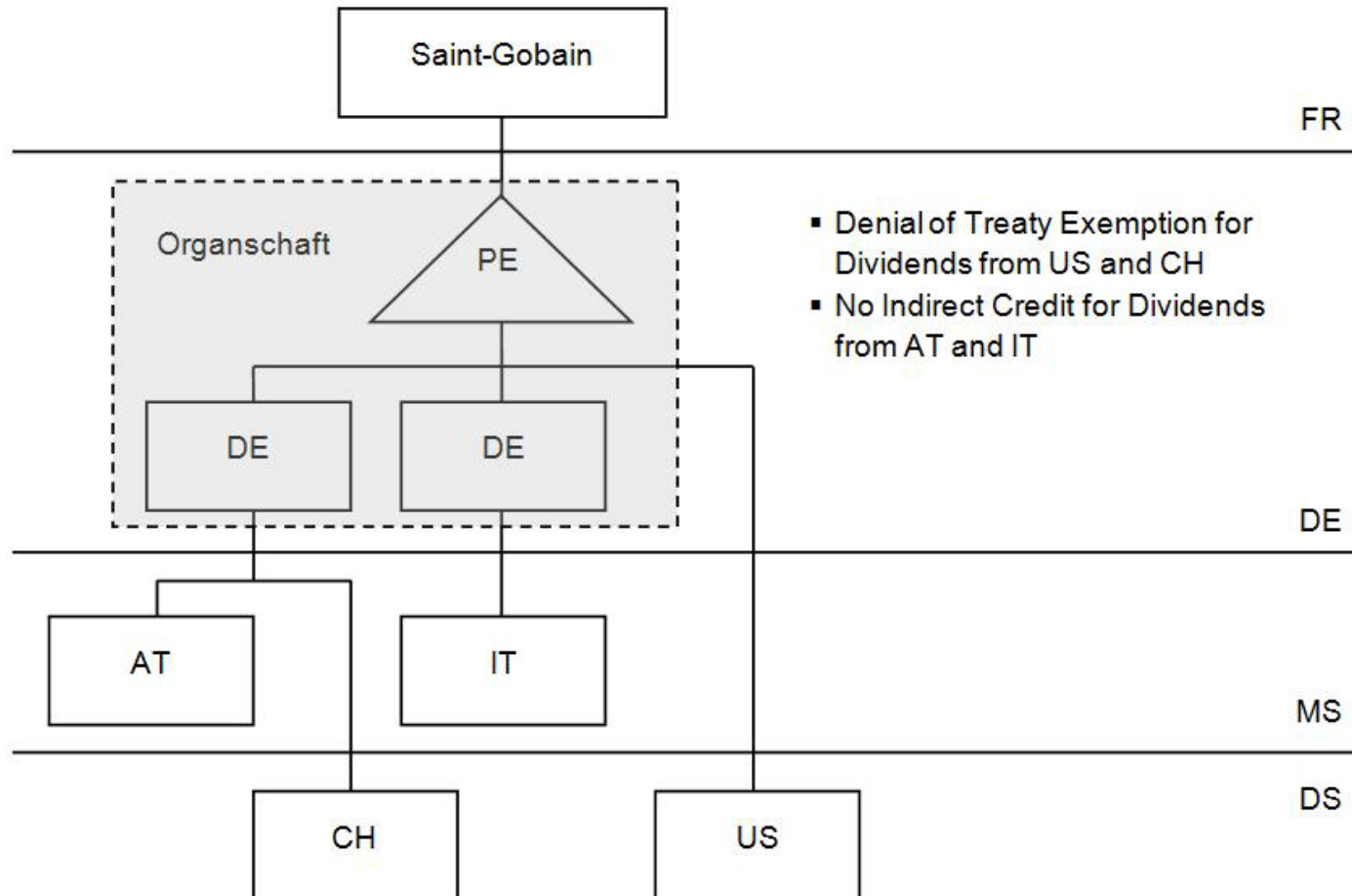
- **The Formal Relationship between DTCs and Community Law**
  - **Competence for the Conclusion of Tax Treaties**
    - Art 6 VCT, Art 94, 308 EC and possible striking of Art 293 EC
    - Treaties with Third Countries
      - *In foro interno, in foro externo*
      - *AETR* (Case 22/70) and *Rheinschiffahrt* (Opinion 1/76)
      - Third-Country Agreements and the Savings Directive
      - EC-Swiss-Agreement → Interest and Royalties
  - **Impact of Directives**

# Triangular Situations



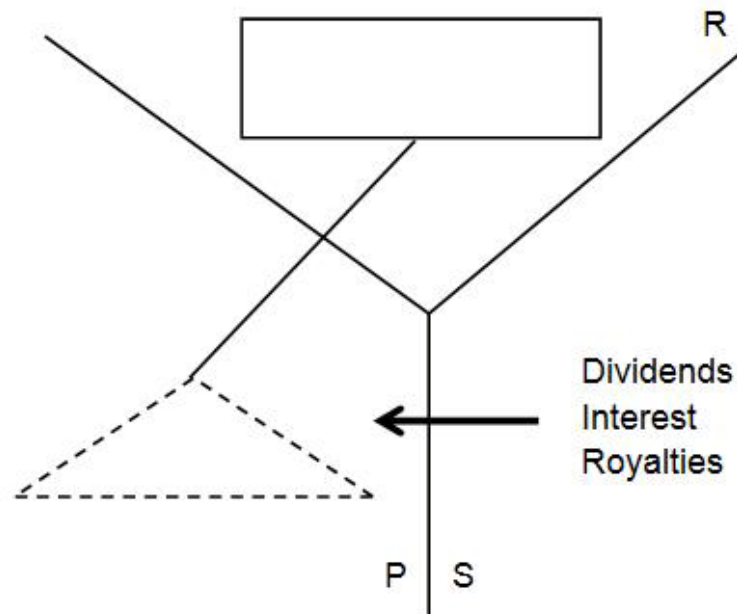
# Triangular Situations

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



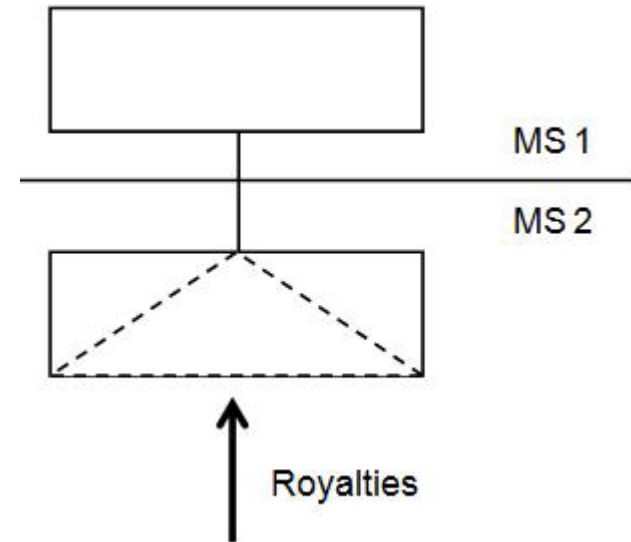
# Triangular Situations

- **PE State (P)**
  - Treaty Non-Discrimination
    - Art 24 Abs 3 P-R DTC → Art 24 Par. 49 to 54 OECD-MK
    - *Saint-Gobain*
  - Amount of credit?
    - Tax in R-S DTC < P-S DTC → Credit in the amount of R-S DTC rate
    - Tax in R-S DTC > P-S DTC → Credit in the amount of P-S-DTC rate (double taxation remains)
- **Source State (S)**
  - Reduction of withholding tax rate to rate under P-S DTC?
  - Art 10 EG? *Open Skies*?
- **Residence State (R)**
  - Exemption vs. Credit

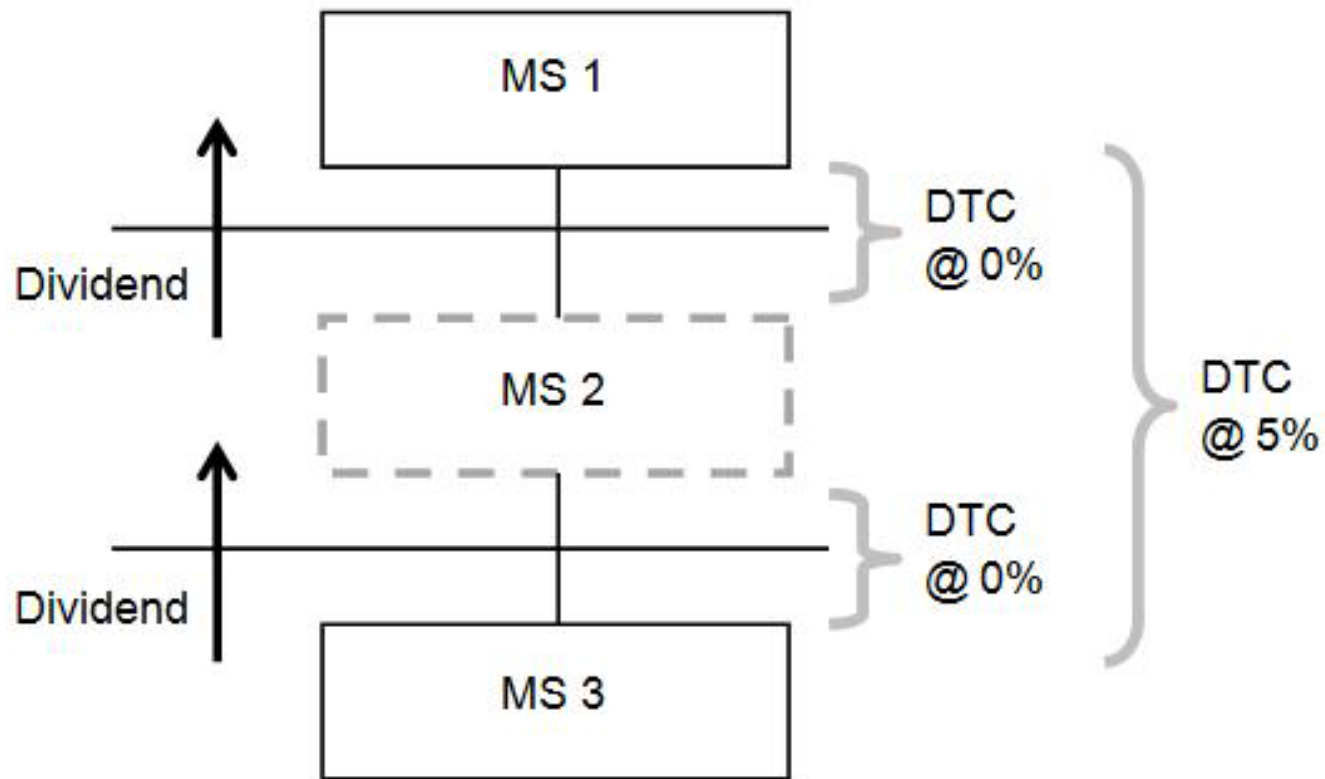


# Conflicts of Qualification

- **Conflicts in Attribution of Income**
- **Principle of Mutual Recognition**
  - **Company Law** → *Centros*, *Überseering*, *Inspire Art*
  - **Tax Law?**
    - Fundamental Freedoms? → Case C-303/07, *Aberdeen Property Fininvest Alpha Oy*?
    - Impact of Directives (e.g., Art 4(1a) PSD)?

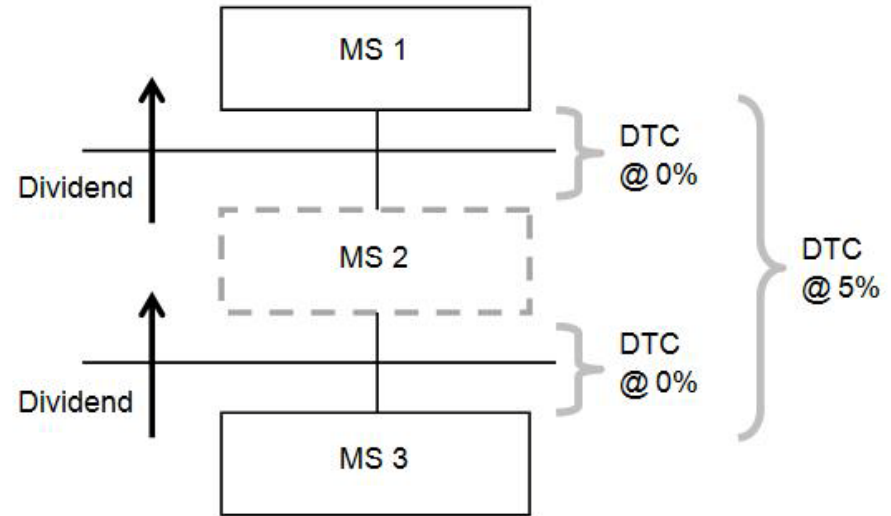


# Treaty Entitlement



# Treaty Entitlement

- 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 Entitlement

- **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

UK

DE

NL

UK

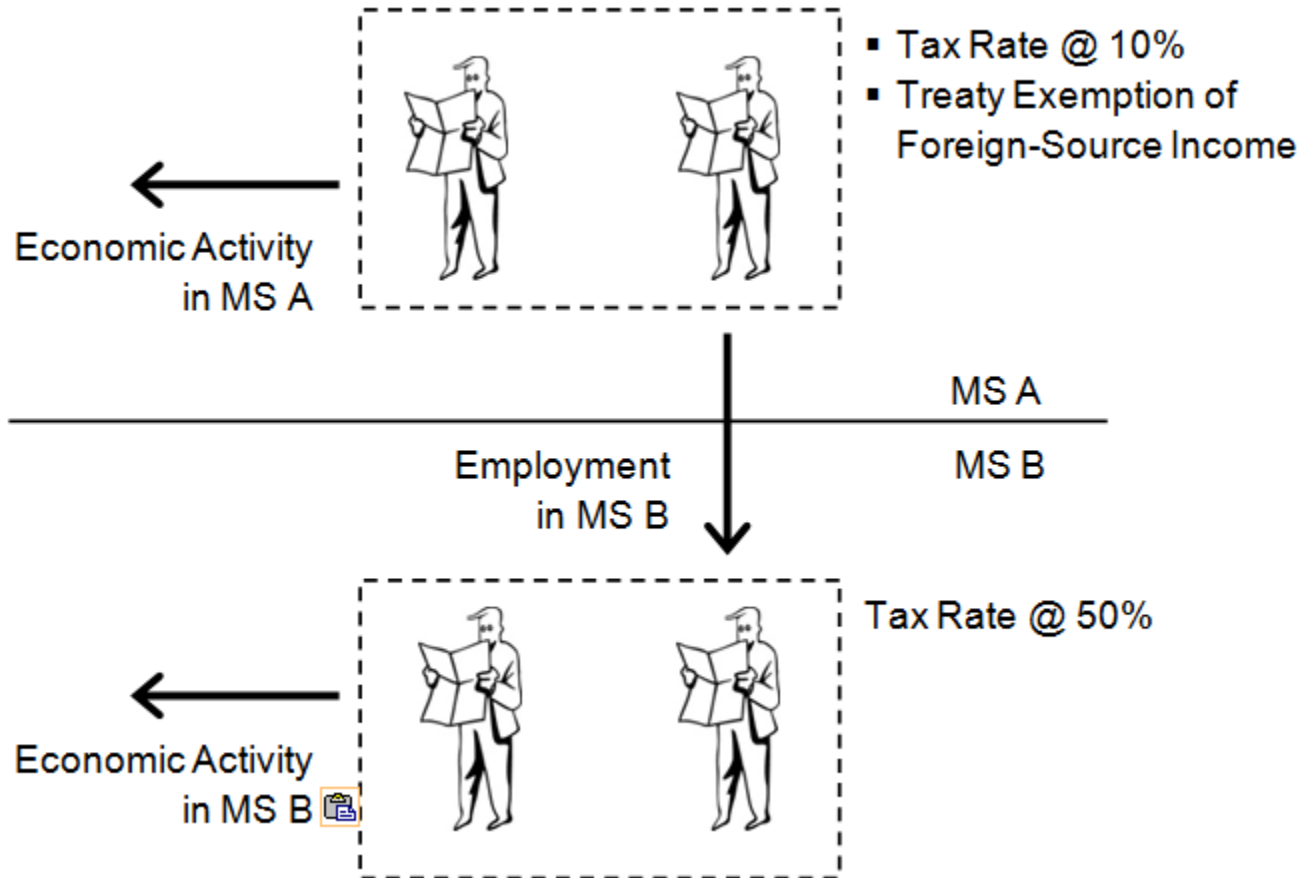
DE

NL

UK

# Distributive Rules

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

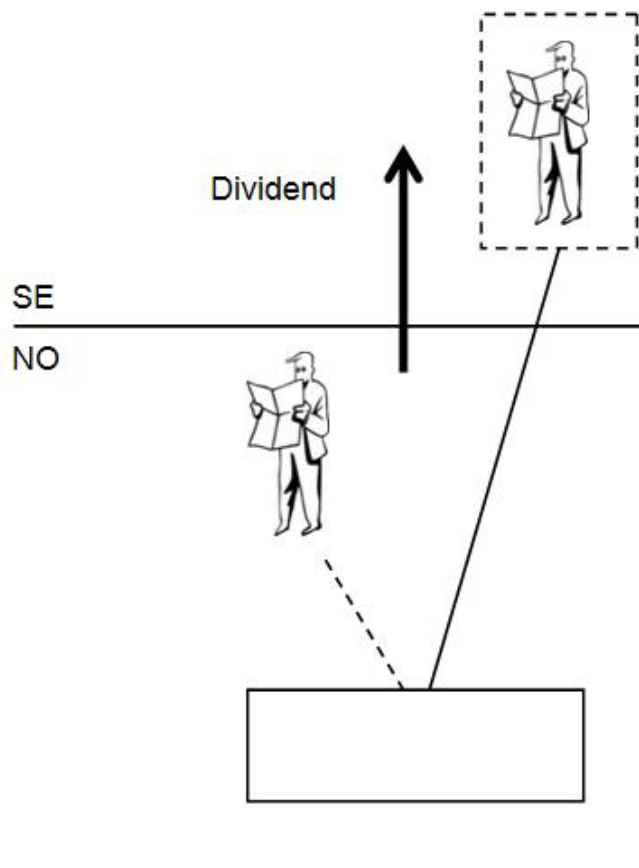


# Cross-Border Compensation

- **“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*

# Cross-Border Compensation

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



	Domestic Dividend	Outbound Dividend
CIT Base	100	100
./. CIT (28%)	(28)	(28)
= Dividend	72	72
= Income Tax Base	72	72
./. Income Tax (28% or 15%)	(20,16)	(10,8)
+ Credit (100%)	20,16	—
= Income Tax in NO	0	10,8
= Total Burden	28	38,8
= Net Dividend	72	61,2

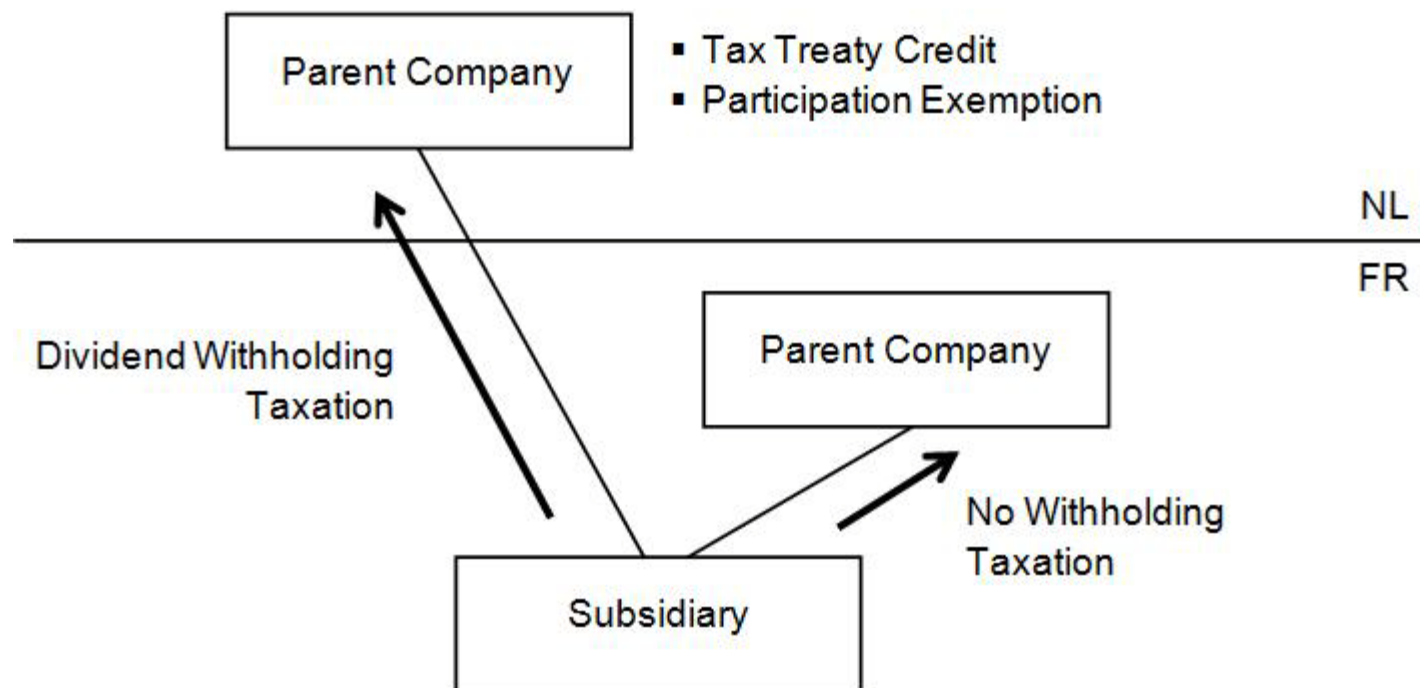
# Cross-Border Compensation

- **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	72	54	54	54

# 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?**



# 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

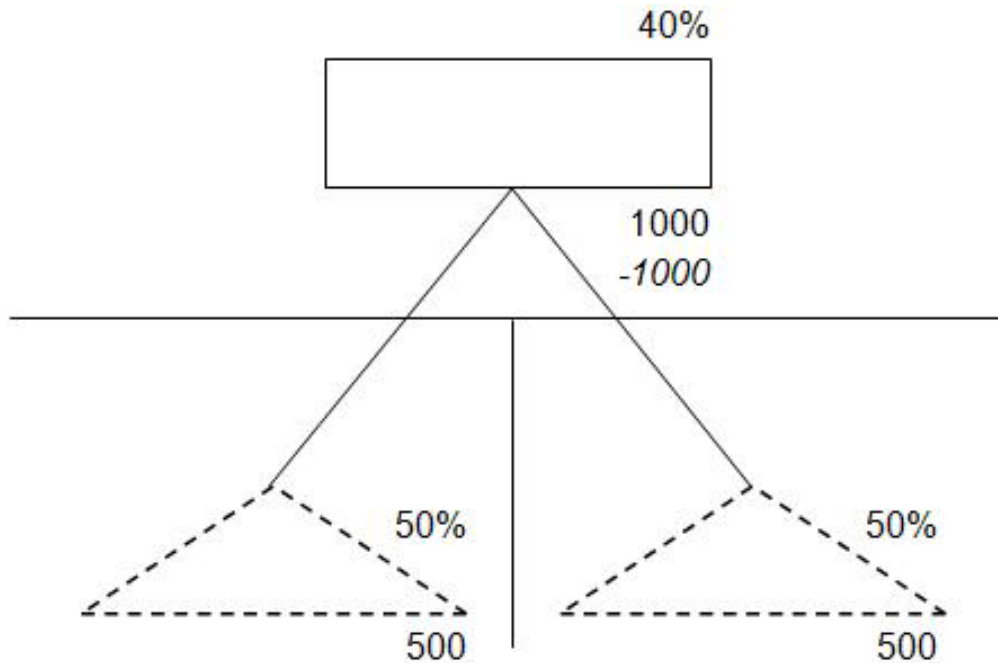
# Cross-Border Compensation

- 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



# Methods to Avoid Double Taxation

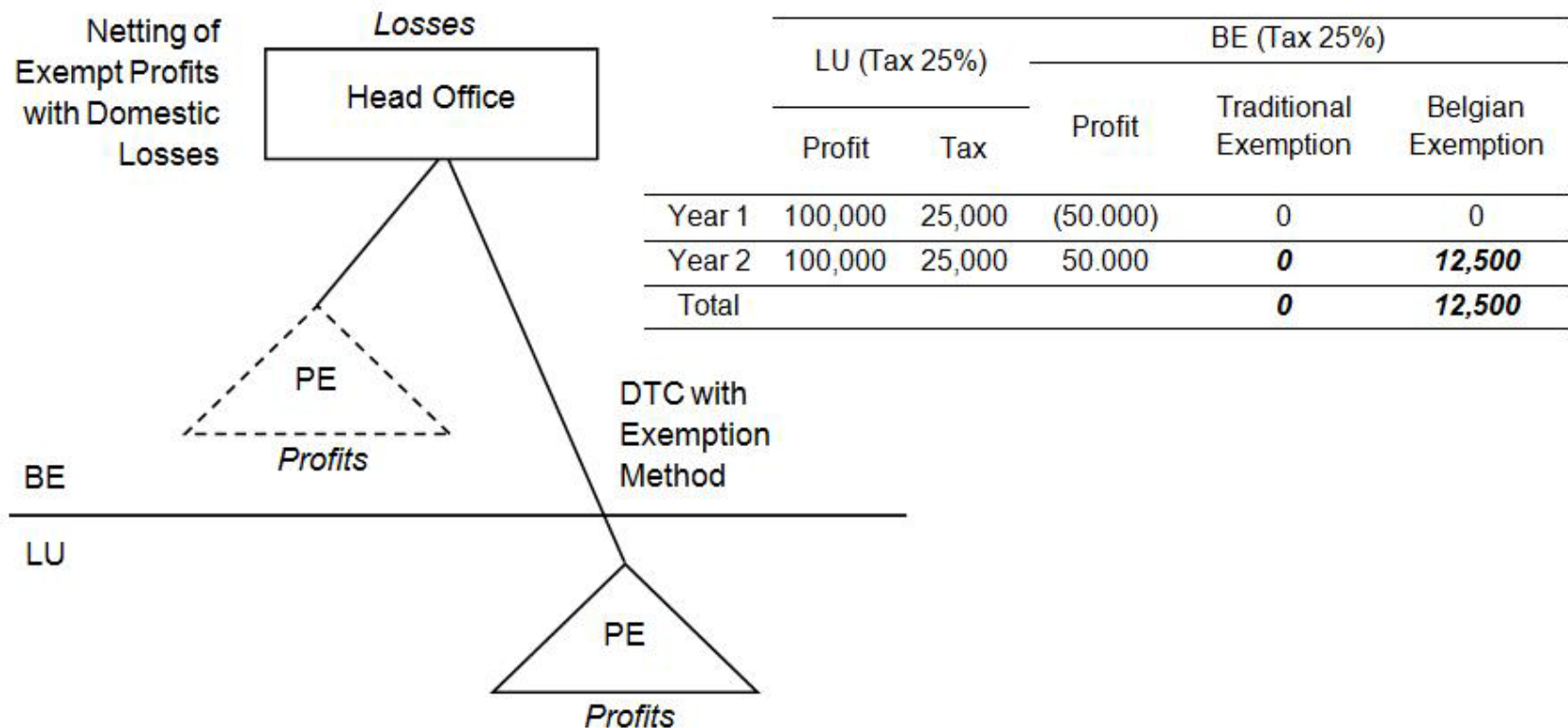
- **Credit Method – Core Issues**



- Capital Export Neutrality → Tax Level of Residence State
  - Indifference in Secondary Community Law (except EU employees)?
  - Tax competition?
  - Disparity?
- Tax Credit Limitation → *Per country limitation* versus *per Community limitation* → Carry forward?
- Credit Limitation and Cost Allocation → EFTA Court 7 May 2008, E-7/07, EFTA Court Report 2008, 174, *Seabrokers*

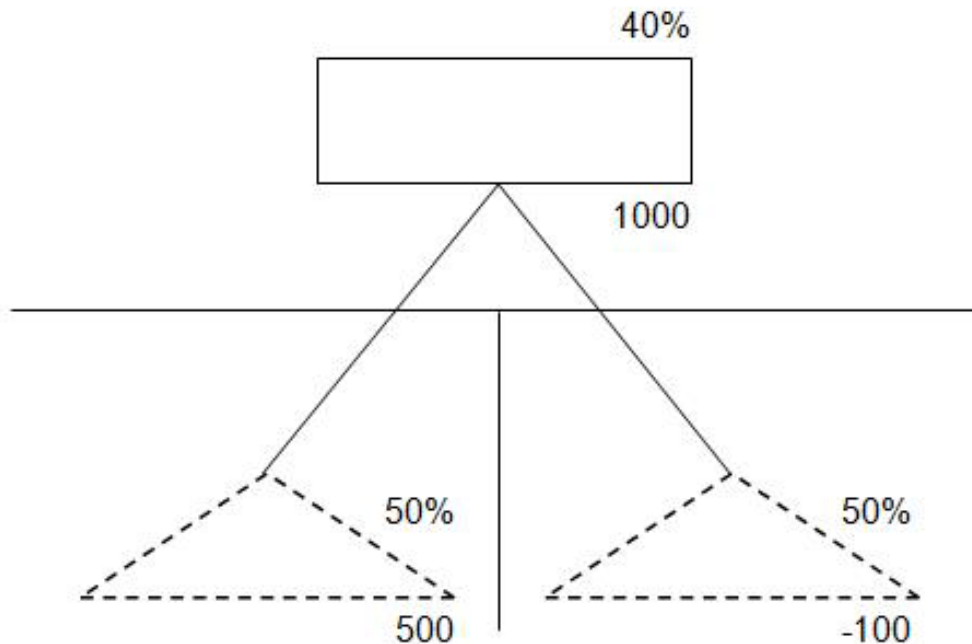
# Methods to Avoid Double Taxation

- Credit Method – Loss-Utilization in the Residence Country and the Issue of Credit Carry-Forwards (Intertemporal Double Taxation)** — ECJ, 14 December 2000, C-141/99, **AMID** [2001] ECR I-471, and ECJ, 12 September 2002, C-431/01, **Mertens** [2002] ECR I-7073



# Methods to Avoid Double Taxation

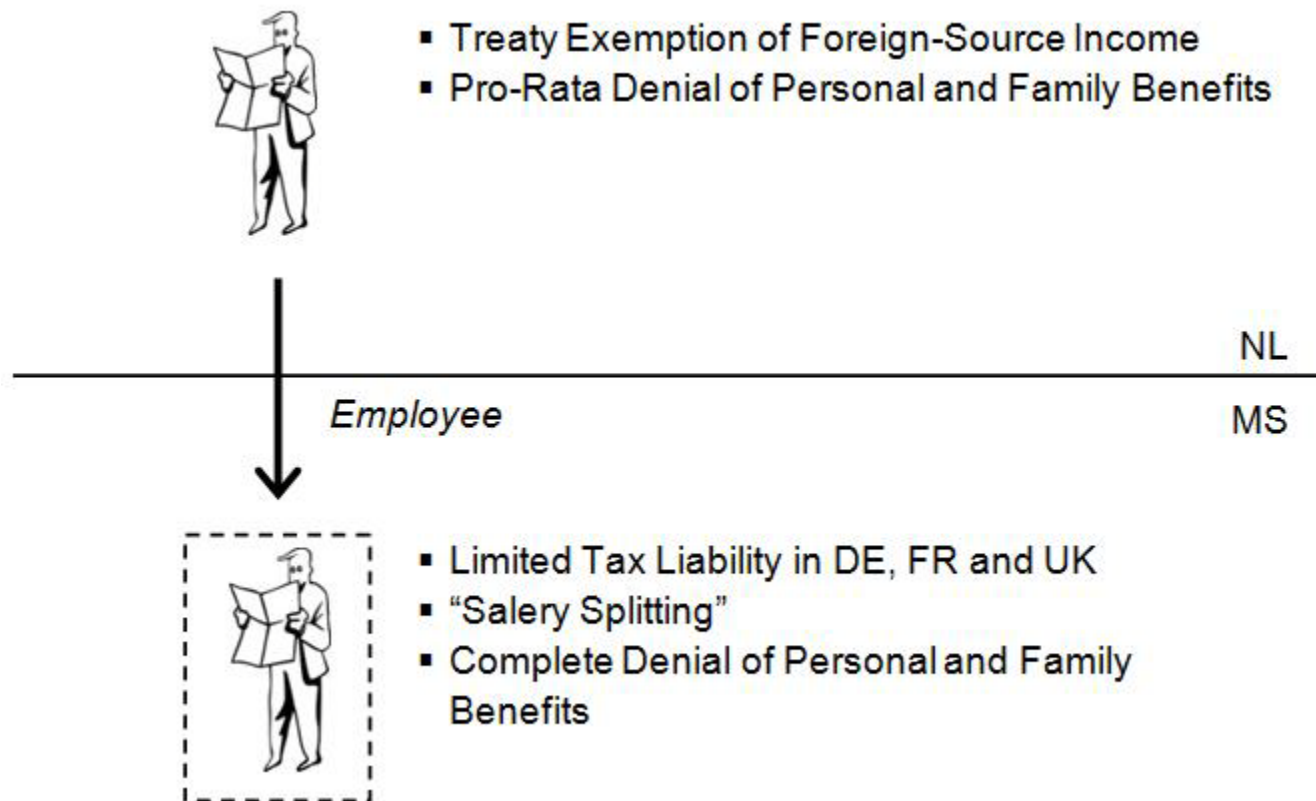
- **Exemption Method – Core Issues**



- Exemption with Progression
- Partial Exclusion of Personal and Family Benefits
- “Exemption” of Foreign Losses

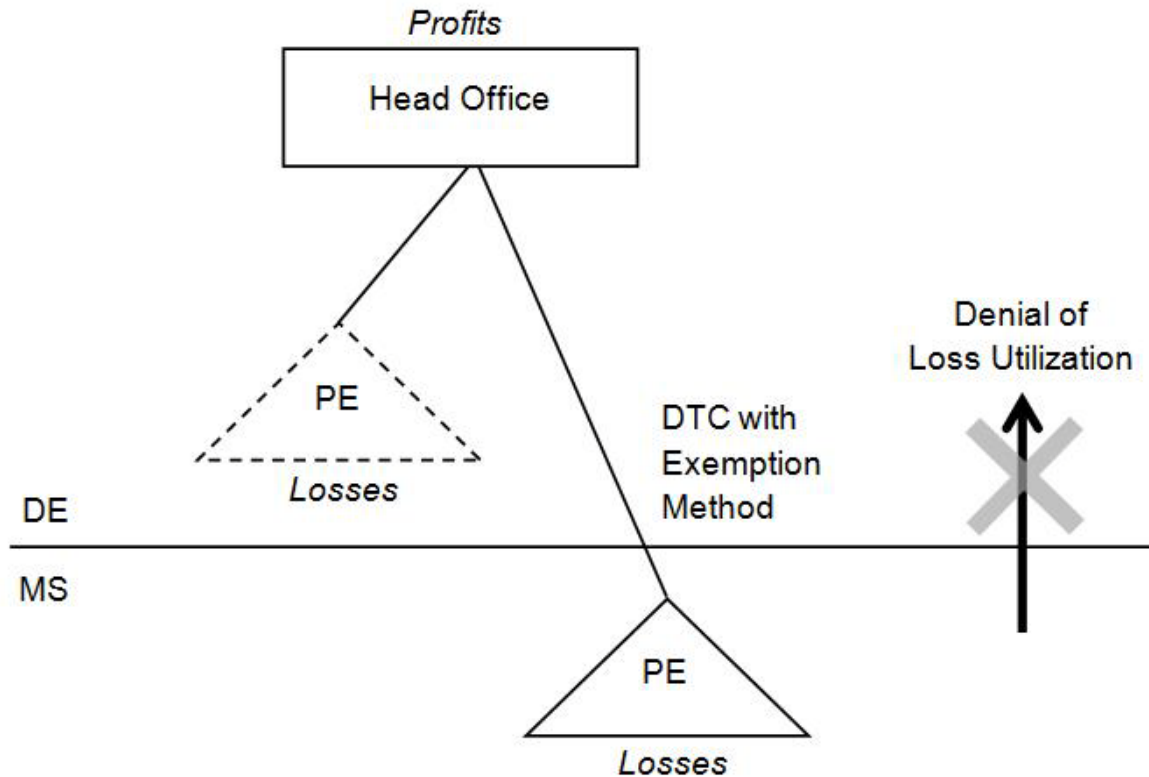
# Methods to Avoid Double Taxation

- **Exemption Method – Pro-Rata Denial of Personal and Family Deductions** — ECJ, 12 December 2002, C-385/00, *De Groot* [2002] ECR I-11819



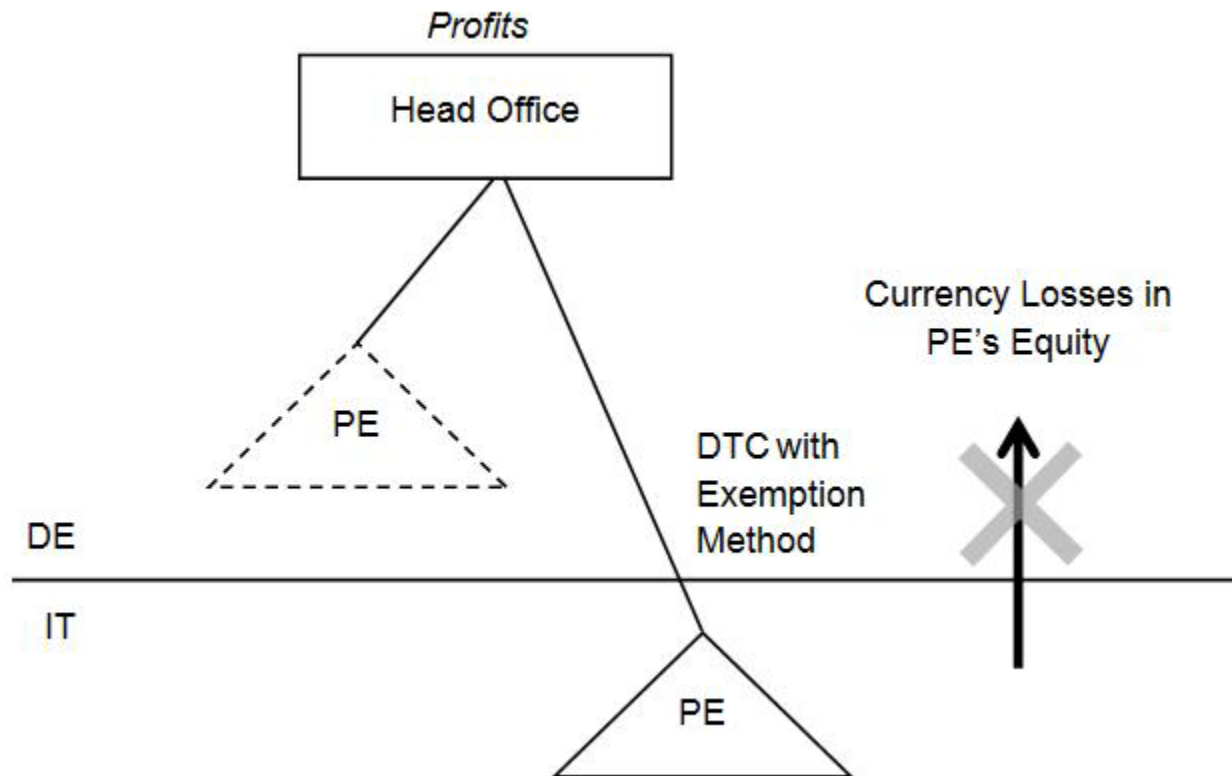
# Methods to Avoid Double Taxation

- **Exemption Method –**
  - **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*



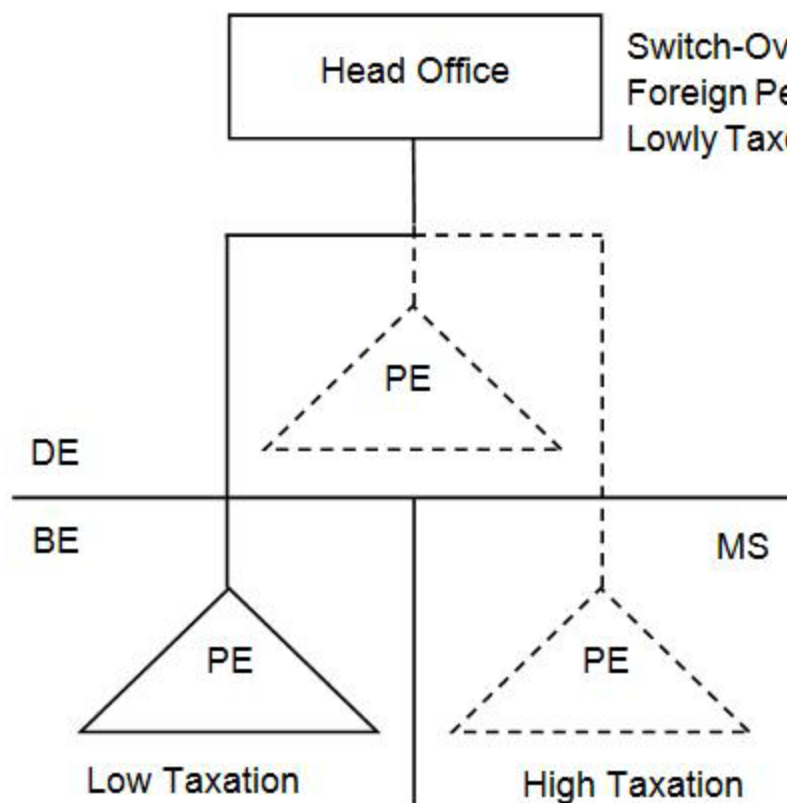
# Methods to Avoid Double Taxation

- **Exemption Method – Cross-Border Loss Relief and Permanent Establishments** — ECJ, 28 February 2008, C-293/06, *Deutsche Shell GmbH* → *Bosal*?



# Treaty Override

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



	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

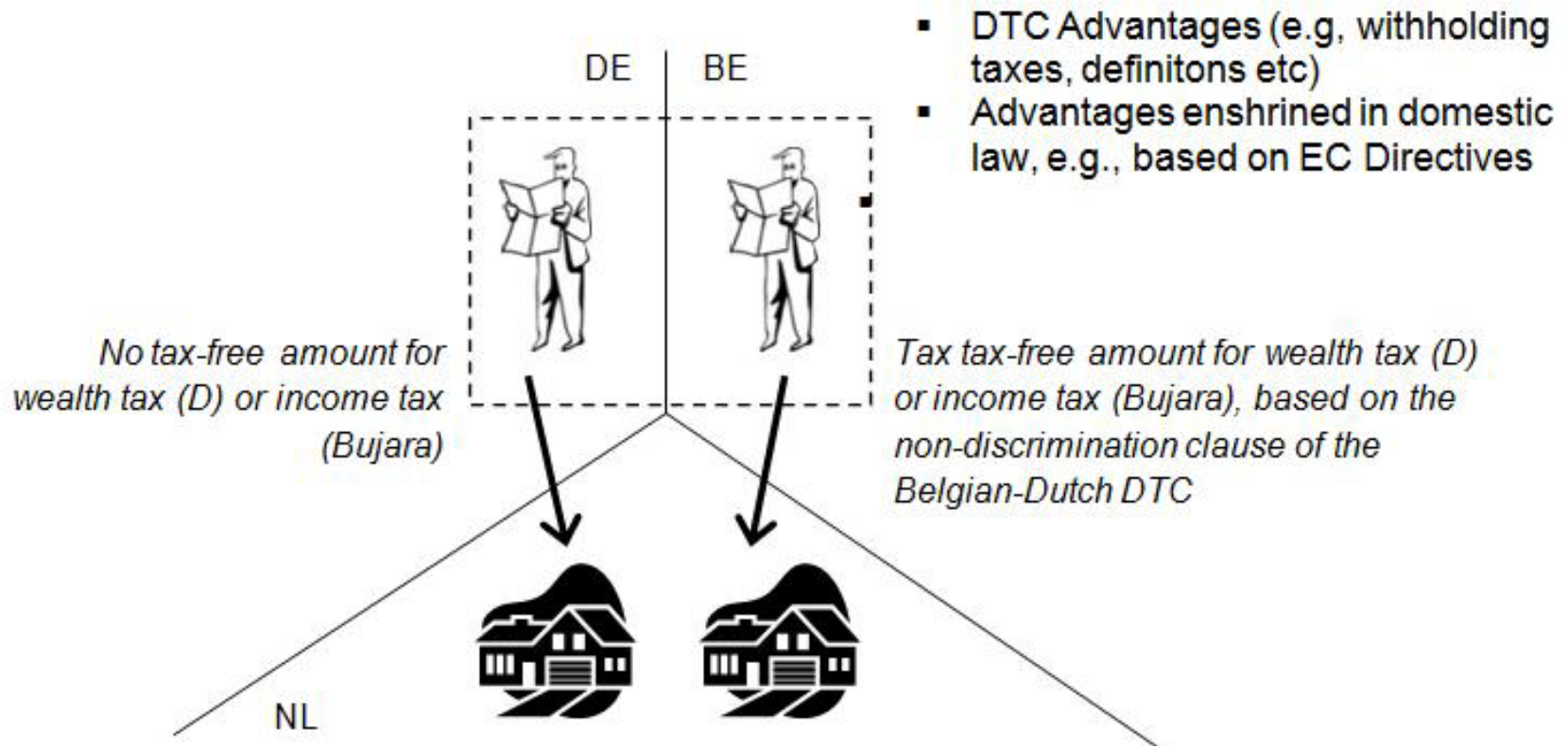
# Horizontal Discrimination

- **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*, *Commission v. Netherlands*)
    - Outbound Situations



# Horizontal Discrimination

- **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**?



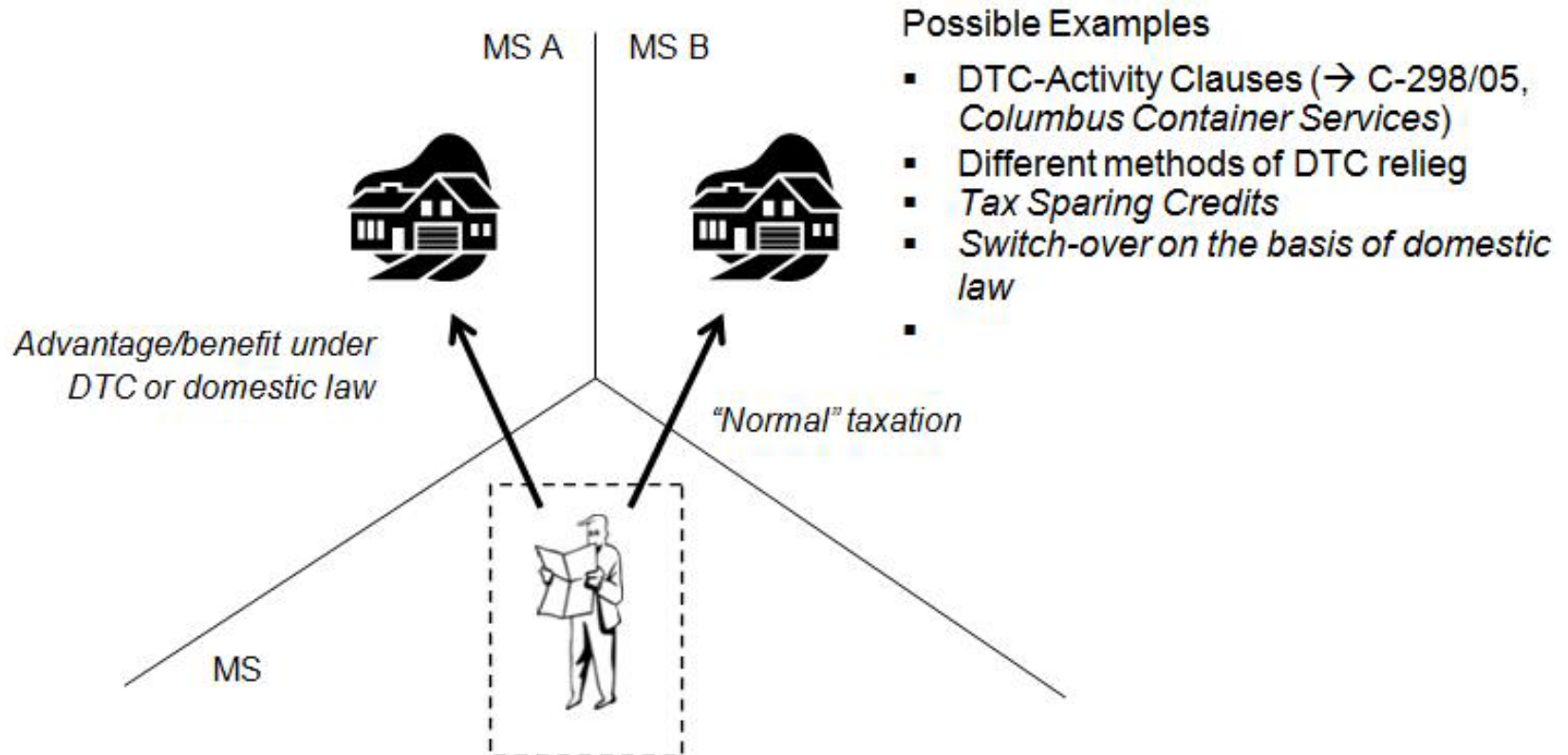
# Horizontal Discrimination

- **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

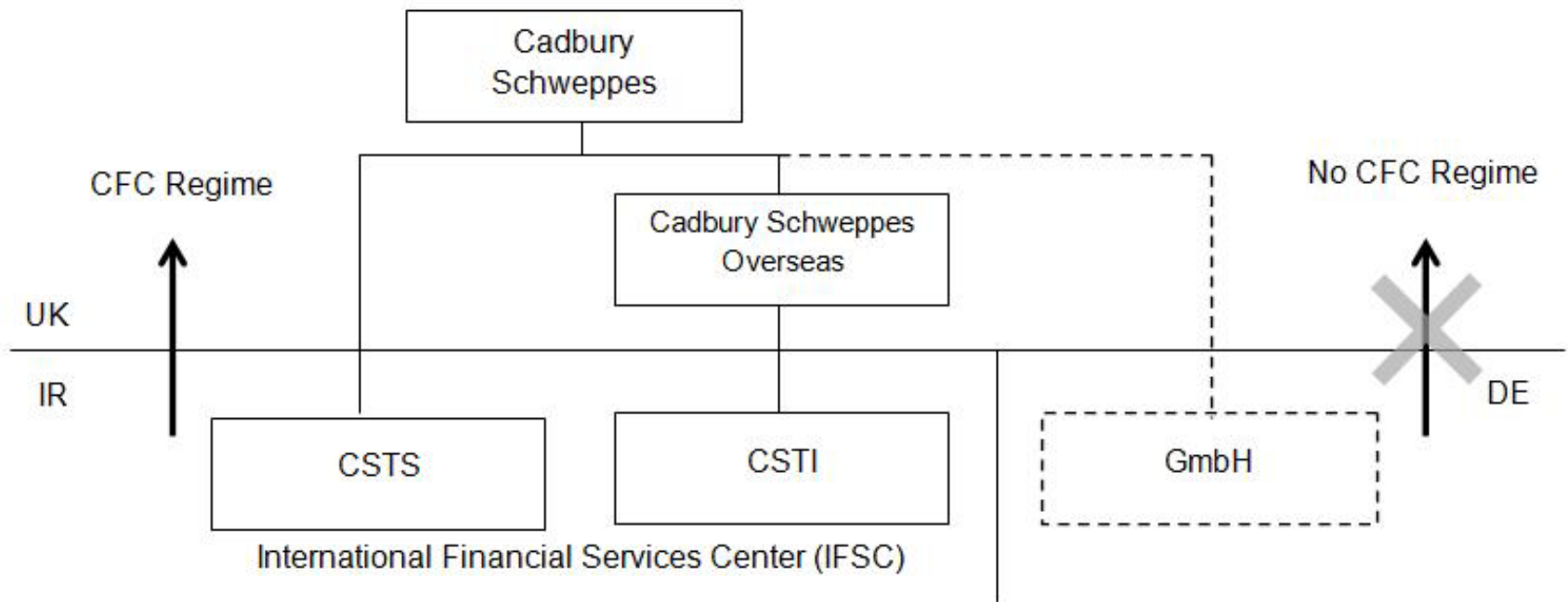
# Horizontal Discrimination

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



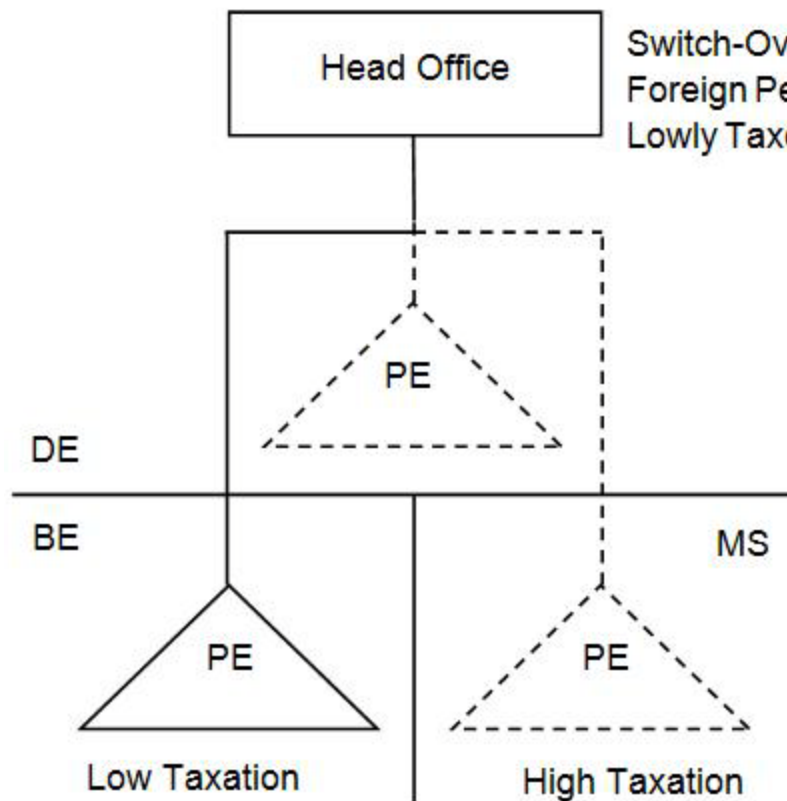
# Horizontal Discrimination

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



# Horizontal Discrimination

- **Outbound-Most-Favored Nation Treatment under Tax Treaty Law** — 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
<i>i.</i> 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

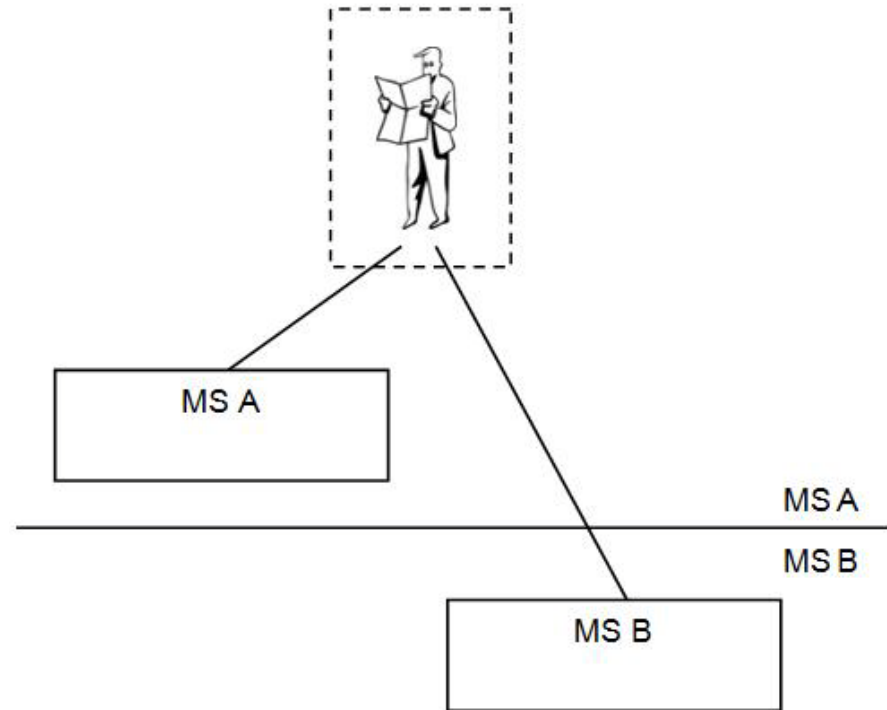
*Part III-4*  
**Cross-Border Dividends**

# Core Issues

- **Holding and Selling Shares in Foreign Companies**
  - Tax Free Amount for Wealth Taxes → *Baars*
  - Capital Gains → *De Baeck, Weidert and Paulus, Commission/Spain, Bouanich, Gronfelt*
- **Cross-Border Dividends**
  - **Inbound Dividends**
    - Schedular Systems → *Verkooijen, Lenz, Kerckhaert-Morres, Holböck, A*
    - Imputation Systems → *Manninen, Meilicke*
    - Participation Privilege → *FII Group Litigation*
  - **Outbound Dividends and Withholding Taxation** → *Fokus Bank, Denkavit Internationaal, ACT Group Litigation, Amurta*

# Capital Gains

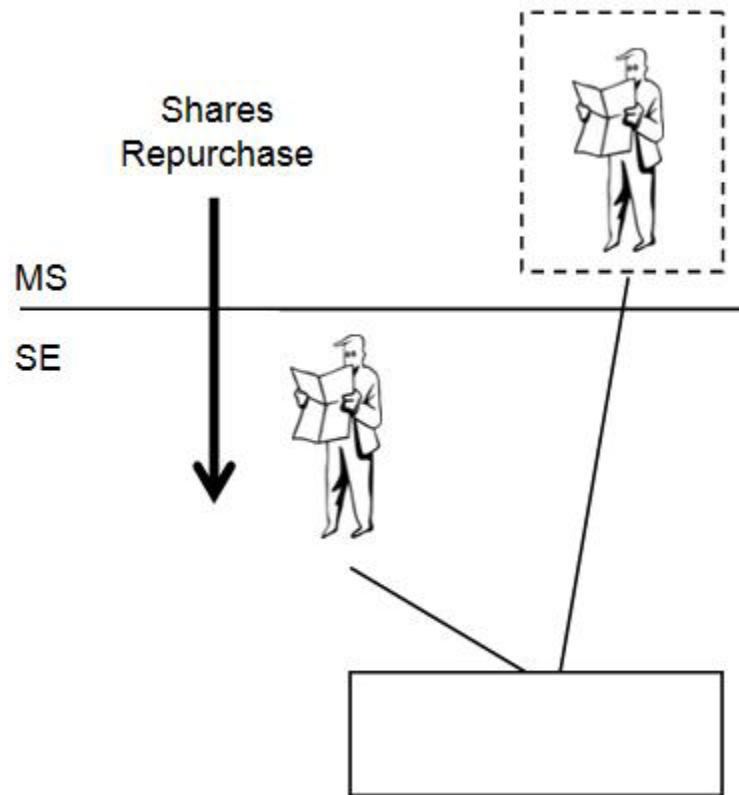
- Beneficial tax treatment only for holdings in domestic companies → ECJ 13 April 2000, C-251/98, **Baars** [2000] ECR I-2878
- Taxable event only if a substantial holding in a domestic company is sold to a foreign company → ECJ 8 June 2004, C-268/03, **De Baeck** [2004] ECR I-5961
- Tax free amount only in case of the purchase of shares in domestic companies → ECJ 15 July 2004, C-242/03, **Weidert und Paulus** [2004] ECR I-7379





# Capital Gains

- Impact of Double Taxation Conventions → ECJ, 19 January 2006, C-265/04, *Bouanich* [2006] ECR I-923



	Sale by SE Resident	Sale by Foreigner		
		Domestic Law	Tax Treaty	
			Situation 1	Situation 2
Revenue	100	100	100	100
Purchase Price/ Nominal Value	60	—	10	—
= Tax Base	40	100	90	100
= Income Tax (30% or 15% DTC)	(12)	(30)	(27)	(15)
= Income Tax in SE	<b>12</b>	<b>30</b>	<b>15</b>	
= Net	<b>28</b>	<b>10</b>	<b>25</b>	

# Cross-Border Dividends

- **Overview: Corporate-Shareholder-Integration** → Assume a corporate tax rate of 33,3%, an income tax rate of 50%, a 25% schedular rate, and a *gross-up* in an imputation system:

		Classical	Schedular System		Full Imputation	Exemption
			Tax Rate	Tax Base		
1	Income	100	100	100	100	100
2	Corporate Tax Rate 33,3%	33.3	33.3	33.3	33.3	33.3
3	Dividend (1 <i>.l.</i> 2)	66.7	66.7	66.7	66.7	66.7
4	Income Tax Base	66.7	66.7	33.35	100	0
5	Income Tax Rate (50% of 4.)	33.35	—	16.7	50	—
6	Full Imputation (2)	—	—	—	33.3	—
7	Remaining Income Tax (5 <i>.l.</i> 6)	—	—	—	16.7	—
8	Schedular Tax (25% of 4)	—	16.7	—	—	—
9	Net Dividend (3 <i>.l.</i> 5, 7, 8)	33.35	50	50	50	66.7
10	Overall Tax Burden	66.65%	50%	50%	50%	33.3%

# Cross-Border Dividends

- **Economic Double Taxation**

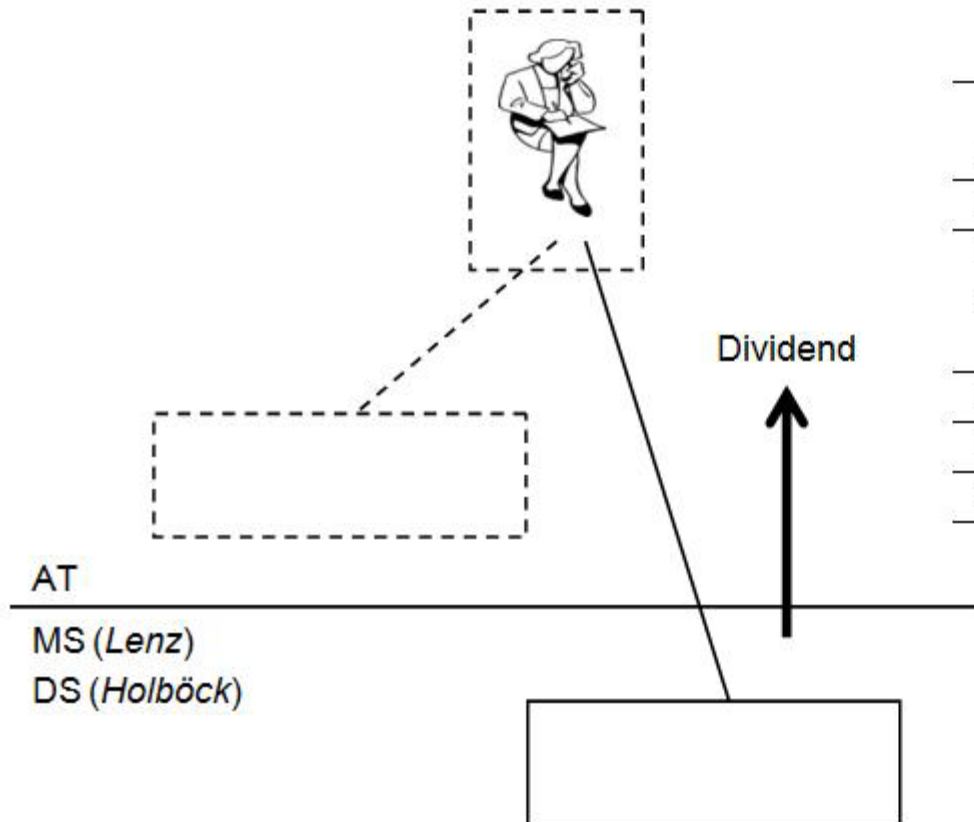
- Corporate Level Tax in one State and Shareholder Level Tax in the other State
- Solutions
  - Usually no solution in DTCs (but: participation privileges)
  - Extension of the domestic integration system to cross border-dividends → ***Freedom of Capital Movement***
  - Prohibition of economic double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

# Inbound Dividends

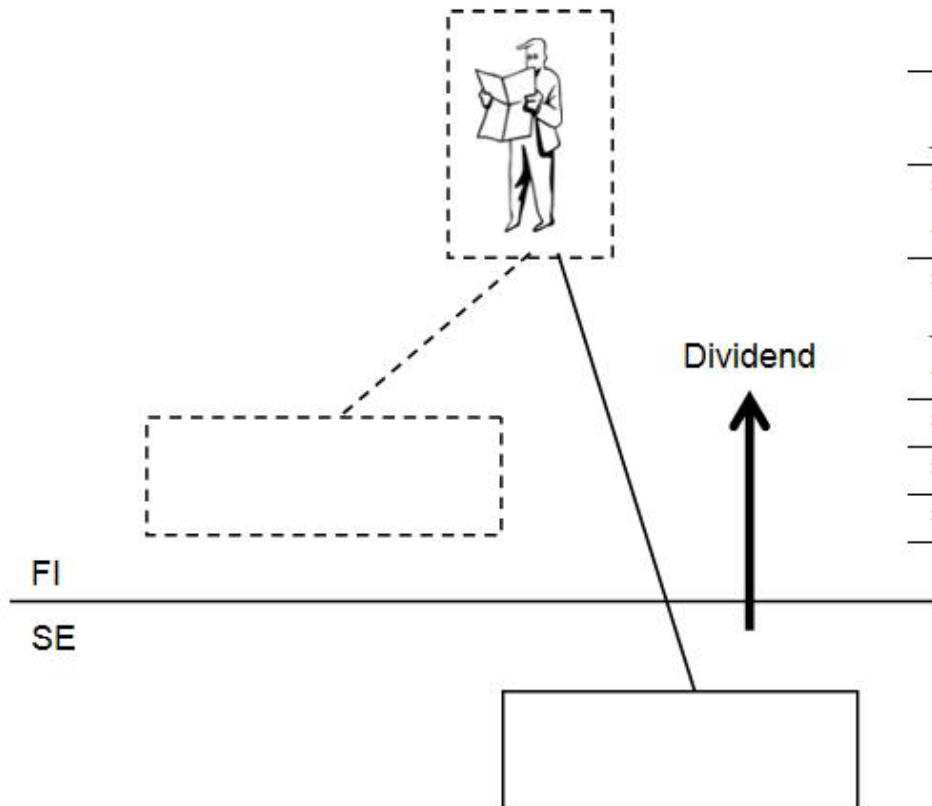
- **Schedular Relief Systems** — ECJ, 15 July 2004, C-315/02, **Lenz** [2004] ECR I-7063



	AT	MS
Corporate Tax Base	100	100
/ Corporate Tax (34%)	(34)	(34)
= Dividend	66	66
= Income Tax Base	66	66
/ Income Tax (25%/50%)	(16,5)	(33)
= Income Tax in AT	16,5	33
= Overall Burden	50,5	67
= Net	49,5	33

# Inbound Dividends

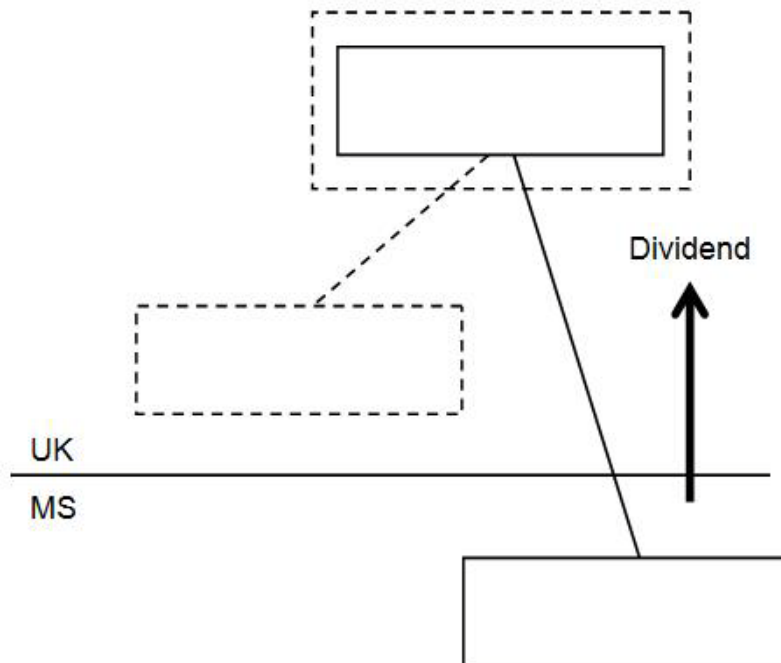
- **Imputation Systems** — ECJ, 7 September 2004, C-319/02, **Manninen** [2004] ECR I-7477, and ECJ, 6 March 2007, C-292/04, **Meilicke**, [2007] ECR I-1835



	FI Dividend	SE Dividend
Corporate Tax Base	100	100
<i>J.</i> Corporate Tax (29%)	(29)	(29)
= Dividend	71	71
+ Credit (29/71)	29	—
= Income Tax Base	100	71
<i>J.</i> Income Tax (29%)	(29)	(20.59)
+ Credit (29/71)	29	—
= Income Tax in FI	0	20.59
= Overall Burden	29	49.59
= Net	71	50.41

# Inbound Dividends

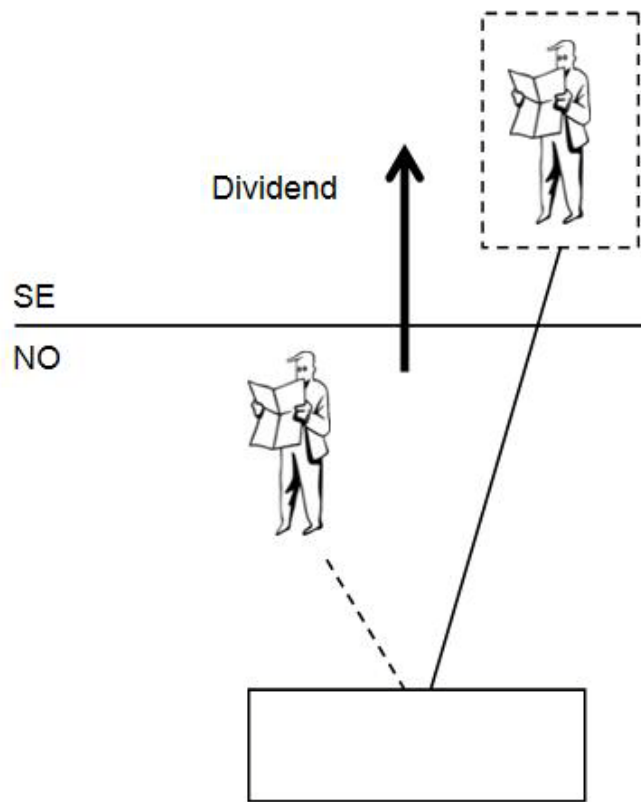
- **Different Systems for Domestic and Foreign Source Dividends** — ECJ, 12 December 2006, C-446/04, *FII Group Litigation* [2006] ECR 11753 — But see pending Cases C-436/08, *Haribo* (UFS Linz 29 September 2008, RV/0611-L/05), und C-437/08, *Österreichische Salinen* (UFS 29 September 2008, RV/0493-L/08)



	UK Dividend	MS Dividend
Corporate Tax Base (Subsidiary)	100	100
/ Corporate Tax Base (Subsidiary) (35% or 10%)	(35)	(10)
= Gross Dividend	65	90
/ Withholding Tax (e.g., 10%)	—	(9)
= Corporate Tax Base (Parent)	65	100
/ Corporate Tax (Subsidiary) (35%)	(0)	(35)
/ Credit	—	19
= Tax in UK	35	16
= Overall Burden	35	35
= Net Dividend	65	65

# Outbound Dividends

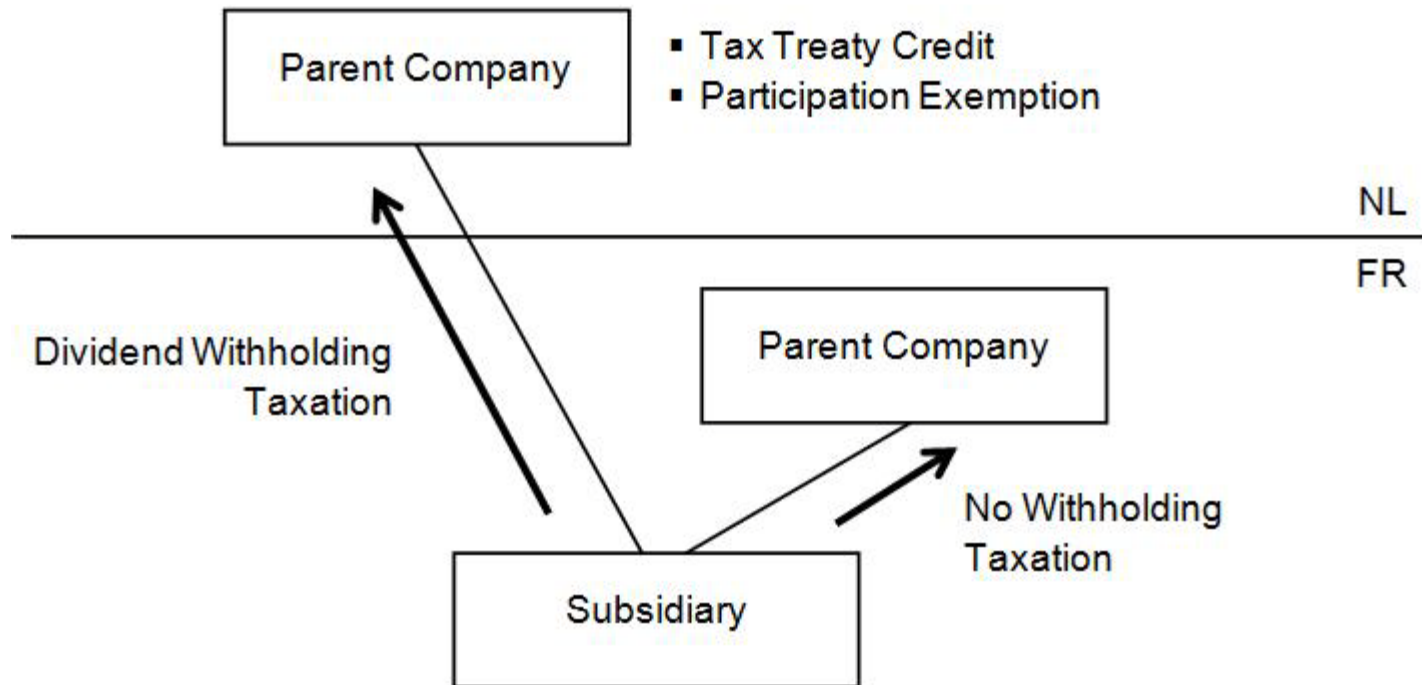
- **Strict Single Country Approach** —EFTA-Court, 23 November 2004, E-1/04, **Fokus Bank ASA** [2004] EFTA Court Report 11



	Domestic Dividend	Outbound Dividend
CIT Base	100	100
/ CIT (28%)	(28)	(28)
= Dividend	72	72
= Income Tax Base	72	72
/ Income Tax (28% or 15%)	(20,16)	(10,8)
+ Credit (100%)	20,16	—
= Income Tax in NO	0	10,8
= Total Burden	28	38,8
= Net Dividend	72	61,2

# Outbound Dividends

- “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





# Outbound Dividends

- ECJ, 12 December 2006, C-374/04, **ACT Group Litigation**, [2006] ECR I-11673

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

The diagram illustrates the flow of dividends across three countries: DE (Germany), NL (Netherlands), and UK (United Kingdom). A vertical arrow on the left, labeled "Dividend", points upwards, indicating the direction of the dividend flow. On the right side, three horizontal lines represent the borders of DE, NL, and UK. On the left side, three boxes represent UK individuals. The flow is as follows: DE Company (DE) sends dividends to DE and UK individuals; NL Company (NL) sends dividends to NL and UK individuals; UK Company (UK) sends dividends to UK individuals.

# Summary

		Classical System	Schedular System	Full Imputation System	Exemption System
Shareholder's Residence State		—	<ul style="list-style-type: none"> <li>Same treatment as for domestic dividends (<i>Verkooijen, Lenz</i>)</li> </ul>	<ul style="list-style-type: none"> <li>Credit for foreign corporate tax (<i>Manninen, Meilicke, FII Group Litigation</i>)</li> <li>Limited by the level of domestic corporate tax (<i>FII Group Litigation</i>)</li> </ul>	<ul style="list-style-type: none"> <li>Same treatment as for domestic dividends (<b>A</b>)</li> <li>However, a Member State may decide to grant an indirect foreign tax credit instead (<i>FII Group Litigation – But: Haribo and Salinen</i>)</li> </ul>
Source State = Company's Residence State	Taxation of Non-Resident Shareholder	—	<ul style="list-style-type: none"> <li>Same treatment as for resident shareholders</li> </ul>	<ul style="list-style-type: none"> <li>Same treatment as for resident shareholders (<i>Avoir Fiscal, Saint-Gobain, Fokus Bank, ACT Group Litigation</i>),</li> <li>Only to the extent to cancel domestic economic double taxation (<i>ACT Group Litigation</i>)</li> <li>“Neutralization”? (<i>Denkavit, Amurta</i>)</li> </ul>	<ul style="list-style-type: none"> <li>Same treatment as for resident shareholders (<i>Saint-Gobain, Denkavit, Amurta, Commission v. Netherlands, Aberdeen, Gaz de France</i>)</li> <li>“Neutralization”? (<i>Denkavit, Amurta</i>)</li> </ul>
	Taxation of Company's Profits	Not affected by fundamental freedoms ( <i>ACT Group Litigation</i> )			

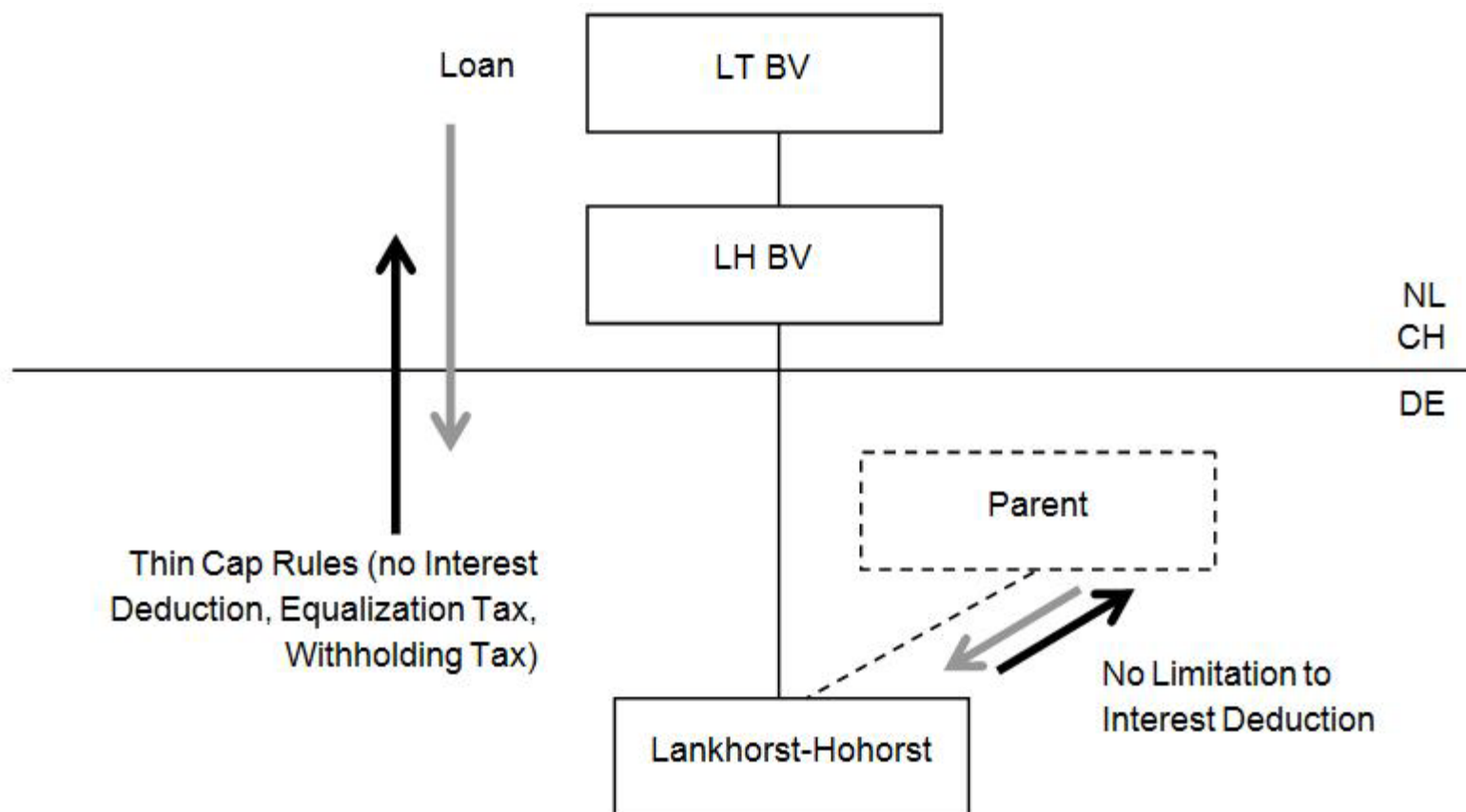
***Part III-5***  
**Anti-Avoidance Provisions**

# Anti-Avoidance

- **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

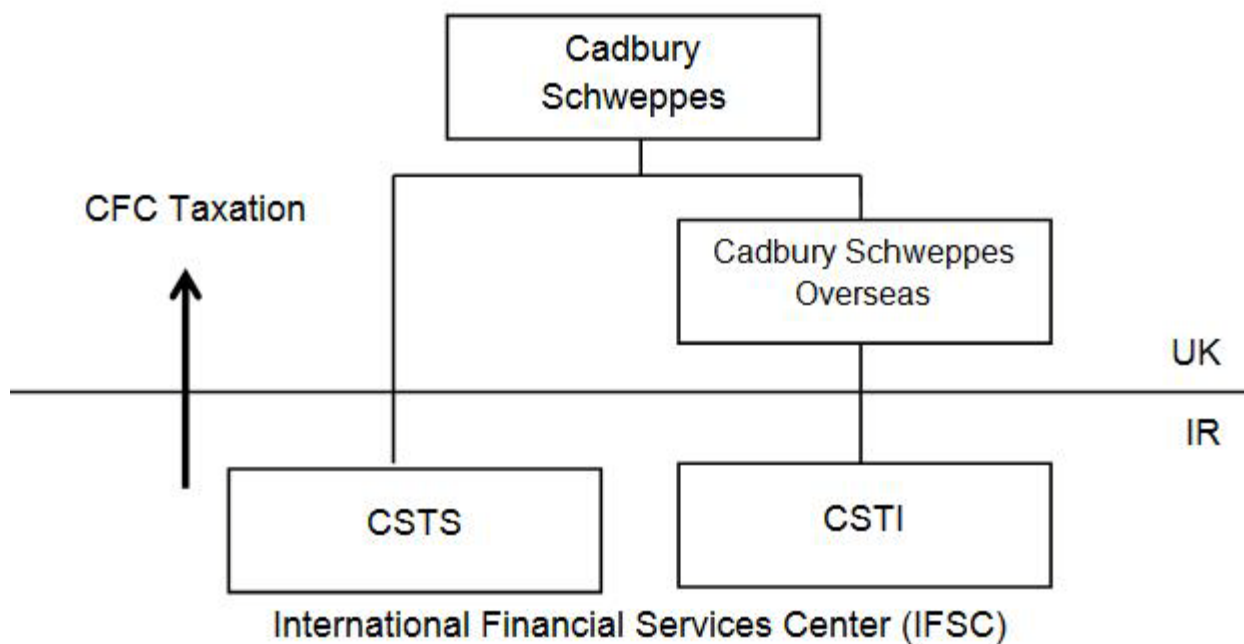
# Thin Capitalization

- **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



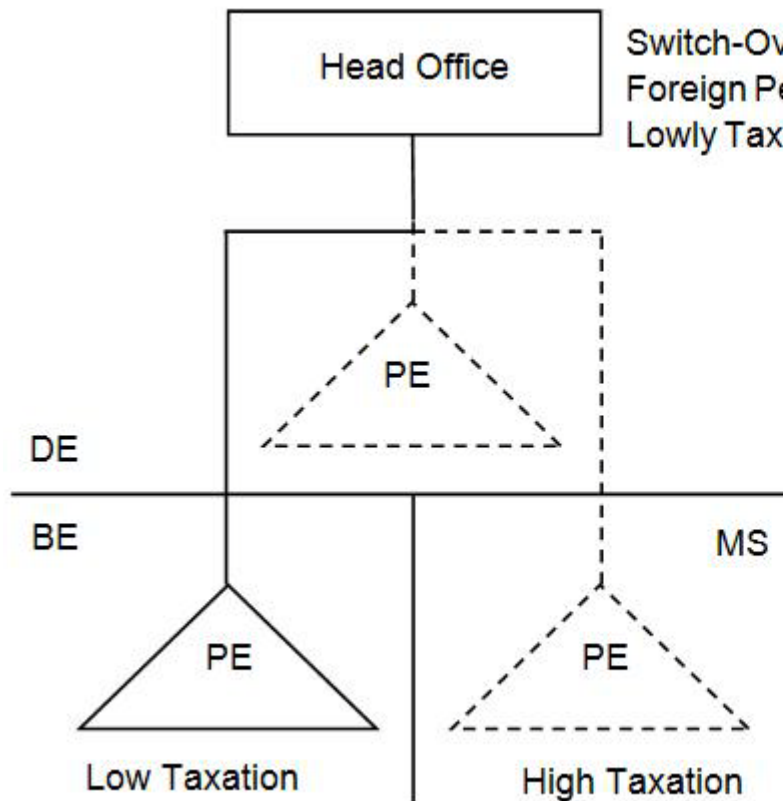
# CFC Rules

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



# Switch Over Clauses

- **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

*Part IV*  
**Secondary EC Tax Law**

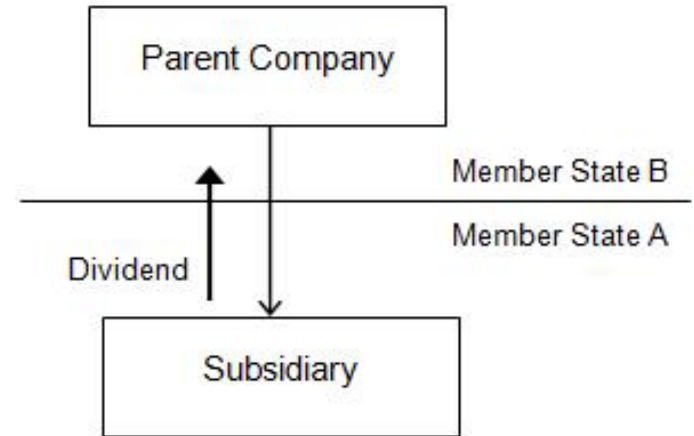


*Part IV-1*  
**Parent Subsidiary Directive**

# Cross-Border Distributions

- **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***



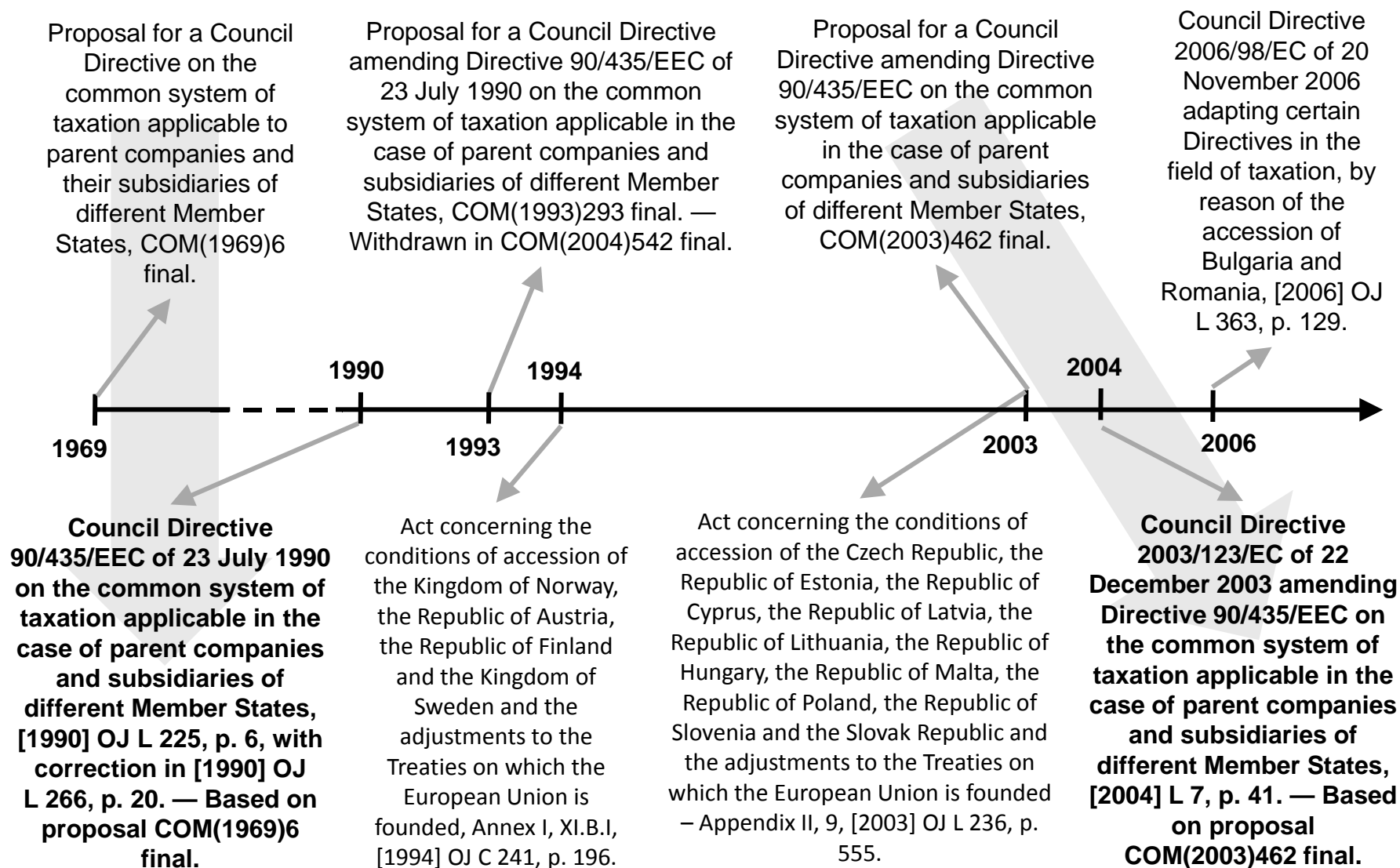
- **Juridical Double Taxation**

- 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.
  - Codification in 2009?

# Timeline

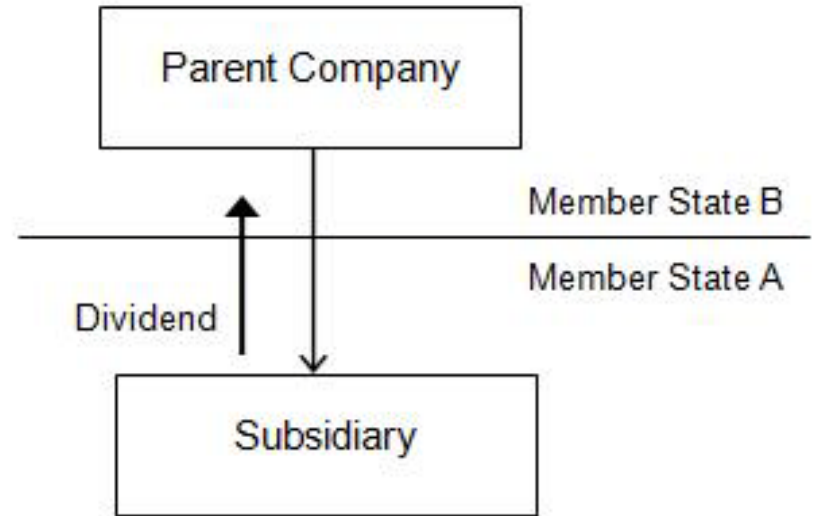


# Structure of the Directive

- **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

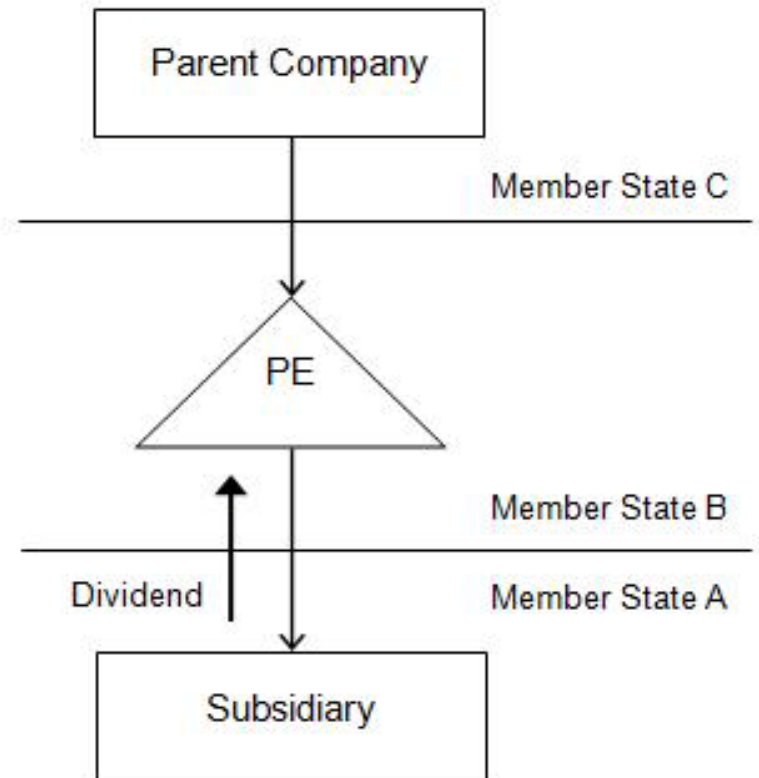
# Scope of Application

- **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



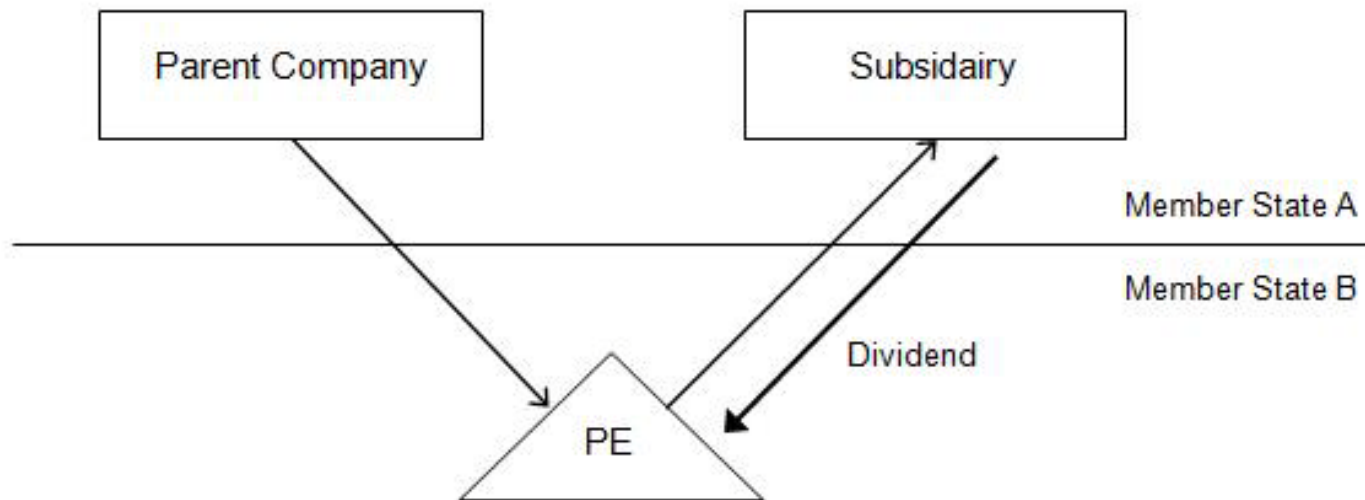
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# Scope of Application

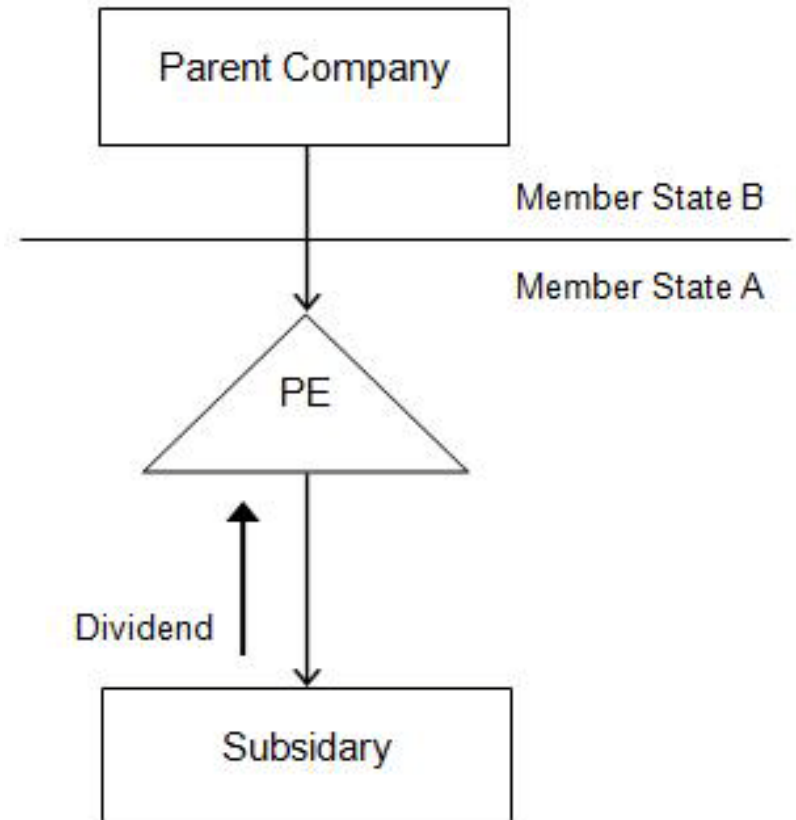
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  - ***to distributions of profits by companies of that State to permanent establishments situated in another Member State of companies of the same Member State of which they are subsidiaries***





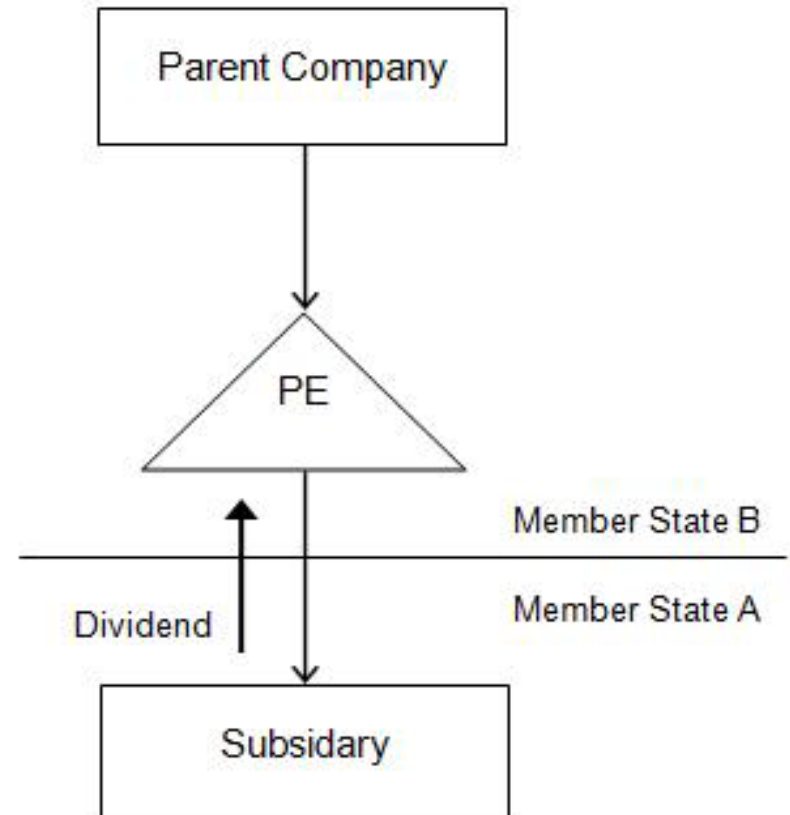
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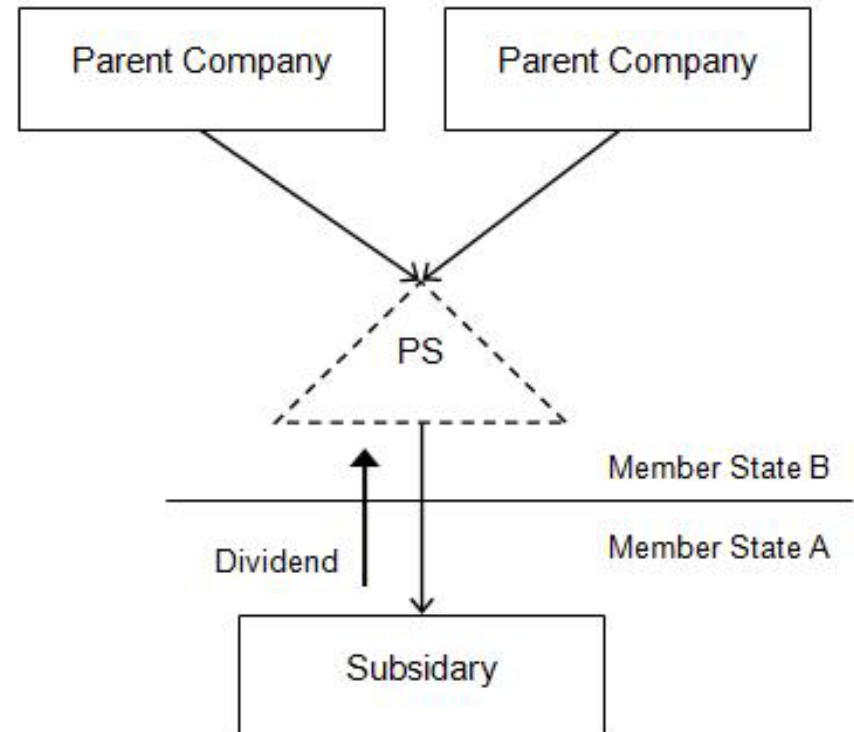
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  - ***to distributions of profits by companies of that State to companies of other Member States of which they are subsidiaries***
  - to distributions of profits received by permanent establishments situated in that State of companies of other Member 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



# 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))
    - Not: Usus fructus → ECJ, 22 December 2008, C-48/07, *Les Vergers du Vieux Tauves SA*

## ▪ 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**

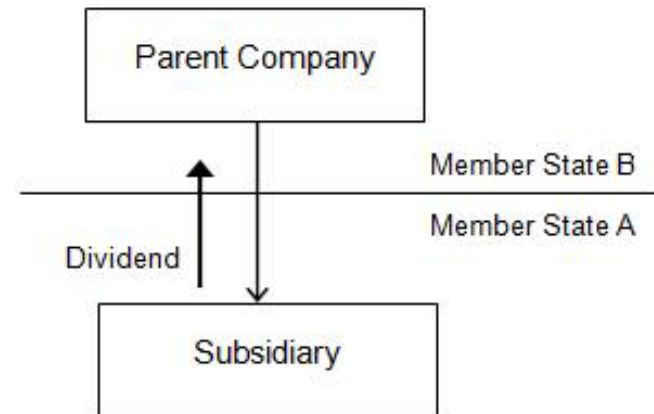
- Exemption at the Parent Level → Art 4(1) 1st intend
  - No Netting with Losses → ECJ, 12 February 2009, C-138/07, *Cobelfret*
- Indirect Tax Credit at the Parent Level → Art 4(1) 2nd intend

- **“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

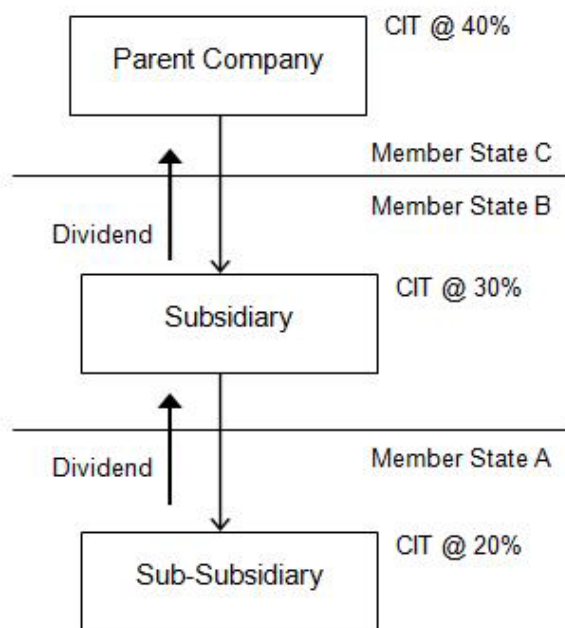
- **Art 4(1)** → Where a parent company or its permanent establishment, by virtue of the association of the parent company with its subsidiary, receives distributed profits, the State of the parent company and the State of its permanent establishment shall, except when the subsidiary is liquidated, either:
  - **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>



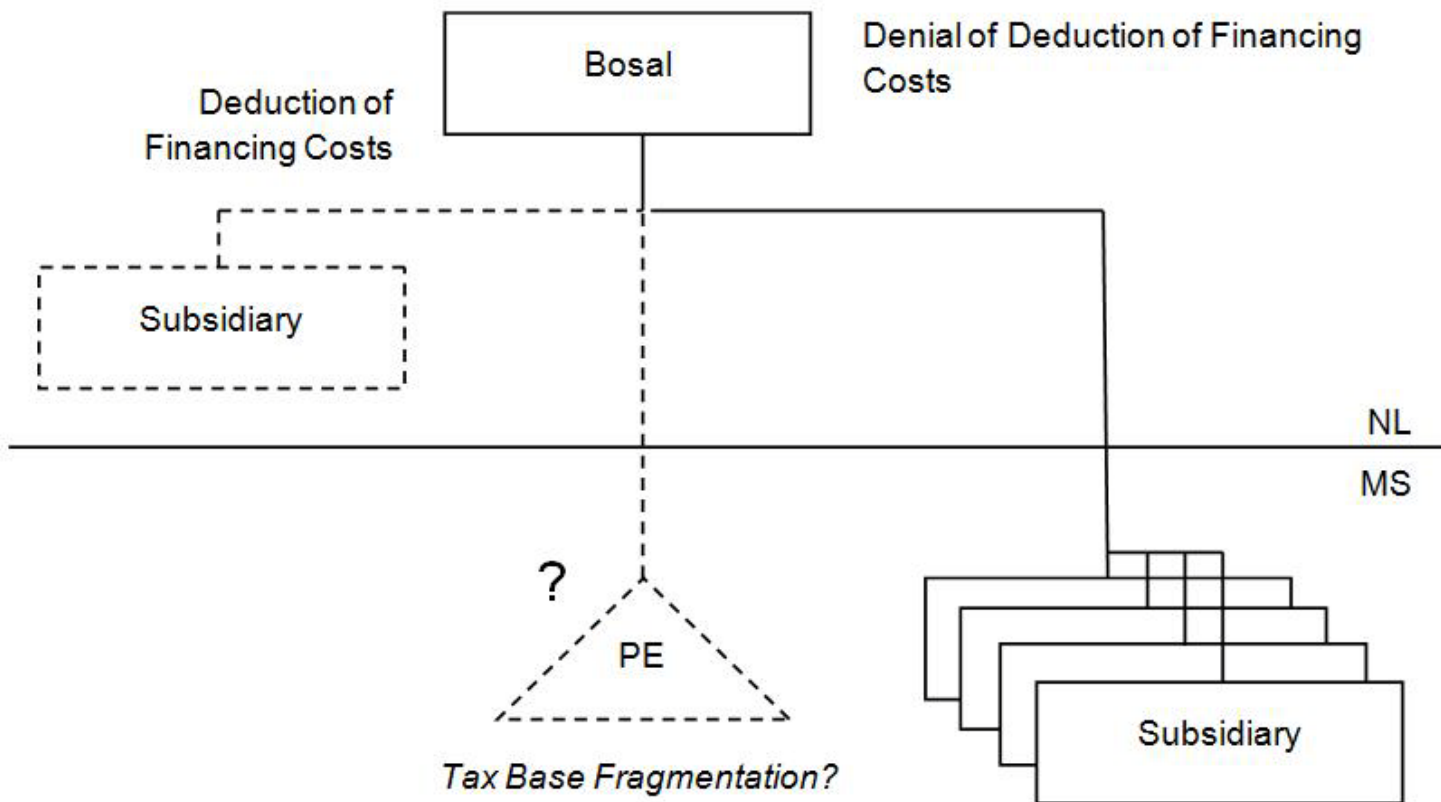
# Economic Double Taxation

- **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*

# 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*

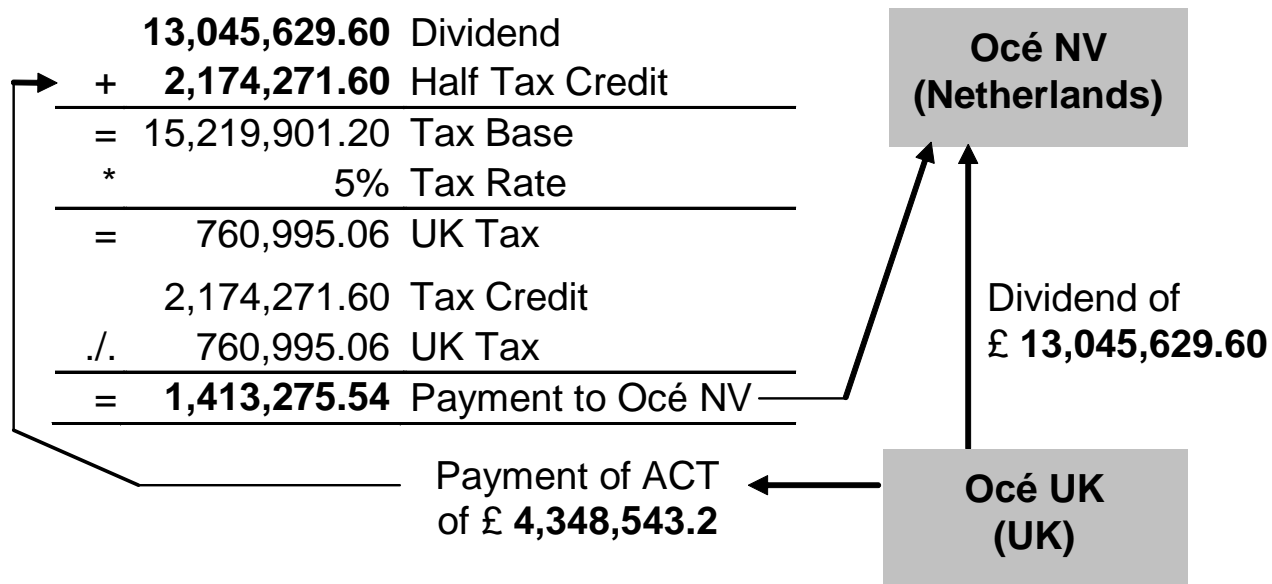
- **Art 7(2)**

- “*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

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



*Part IV-2*  
**Interest Royalties Directive**

# Overview

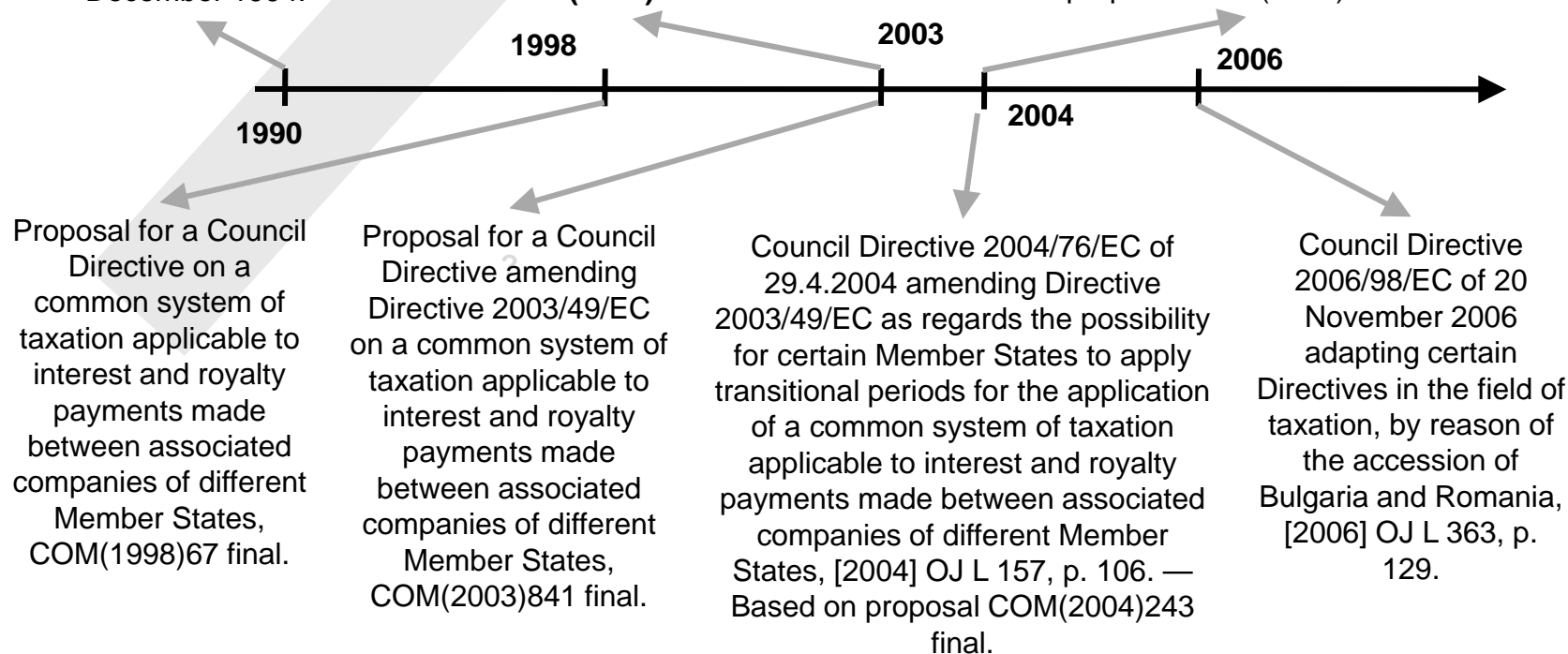
- **Objective**
  - Part of the Tax Package to Tackle Harmful Tax Competition
  - Avoidance of double taxation through removal of withholding taxes on interest and royalty payments made between associated companies of different Member States → Art 1(1)
  - Safeguard effective taxation at the level of 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.

# 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.



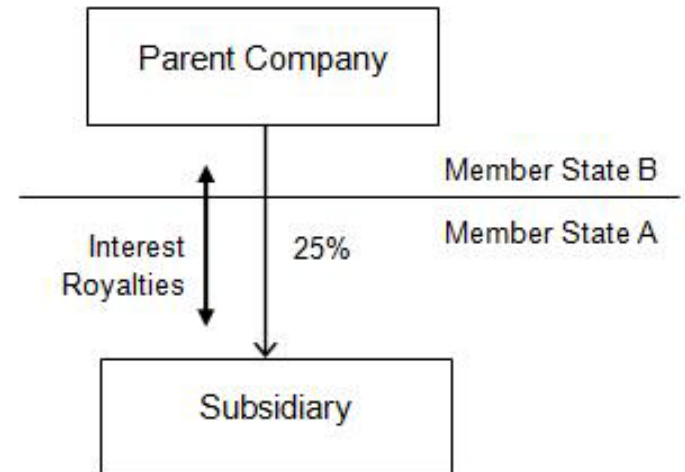


# Structure of the Directive

- **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

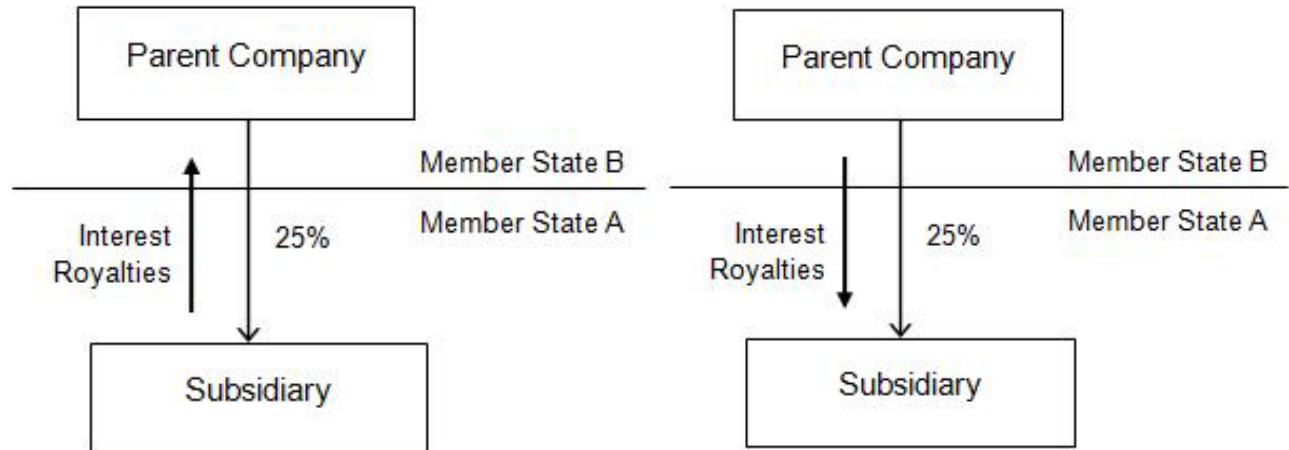
- **Precedence of the PE** → Art 1(6) → “Where a **permanent establishment** of a company of a Member State is treated as the payer, or as the beneficial owner, of interest or royalties, **no other part of the company shall be treated as the payer, or as the beneficial owner**, of that interest or those 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

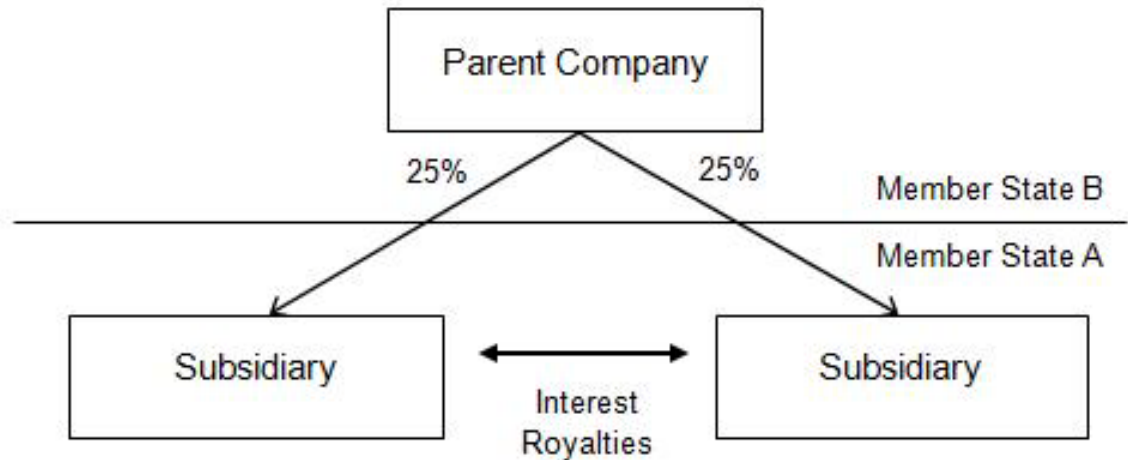
- The exemption under Art 1(1) requires that “*the company which is the payer, or the company whose permanent establishment is treated as the payer, of interest or royalties **is an associated company** of the company which is the beneficial owner, or whose permanent establishment is treated as the beneficial 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

## Payment Between Parent and Subsidiary

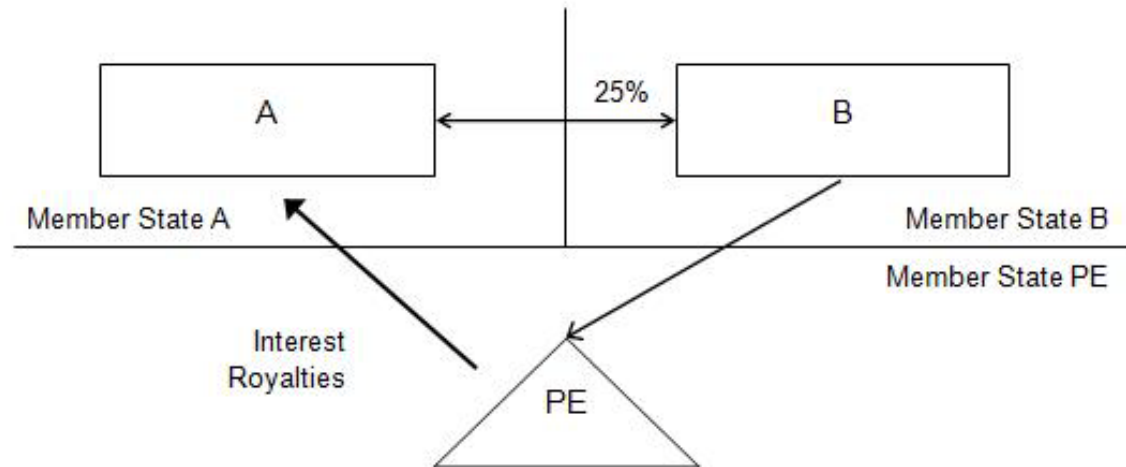


## Payments Between Sister Companies

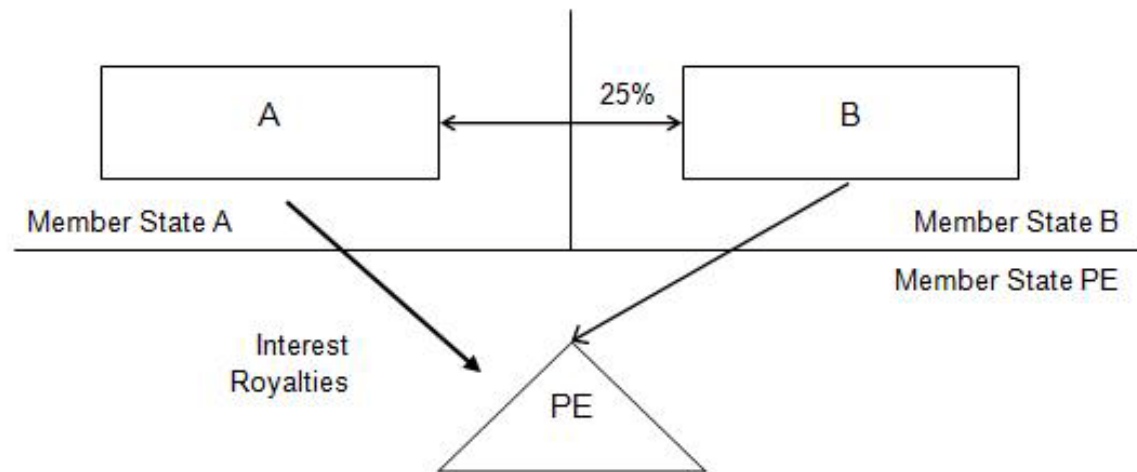


# Scope of Application

Permanent  
Establishment as  
Payor



Permanent  
Establishment as  
Beneficial Owner



# Definitions

- **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-3***  
**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.
- Codification in 2009

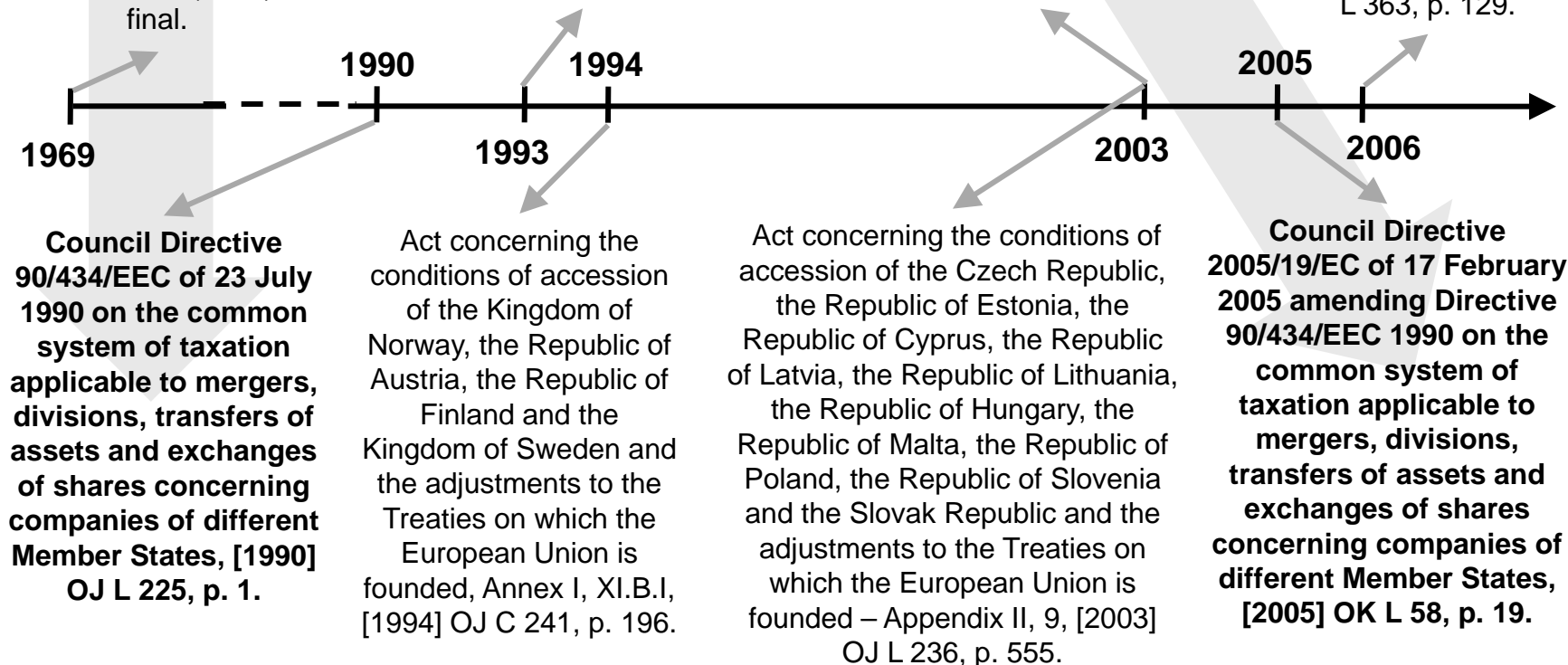
# Timeline

Proposal for a Council Directive on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States, COM(1969)5 final.

Proposal for a Council Directive amending 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, COM(1993)293 final. — Withdrawn in COM(2004)542 final.

Proposal for a Council Directive amending 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, COM(2003)613 final.

Council Directive 2006/98/EC of 20 November 2006 adapting certain Directives in the field of taxation, by reason of the accession of Bulgaria and Romania, [2006] OJ L 363, p. 129.

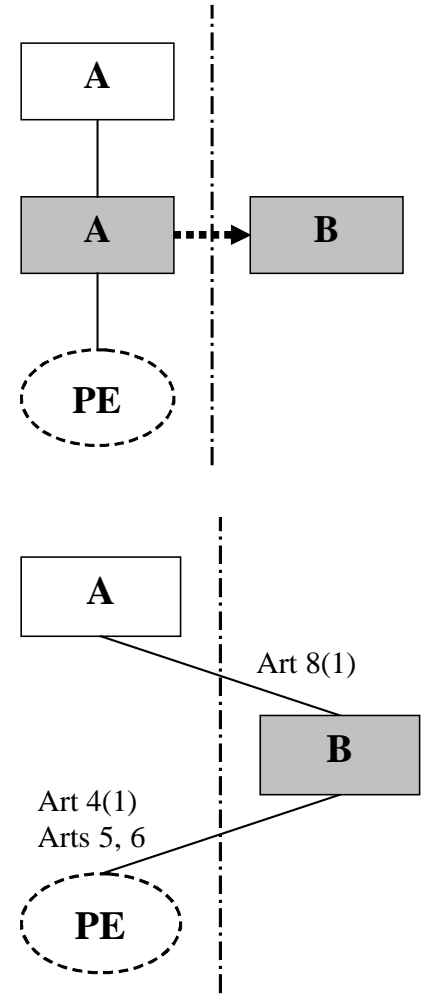


# Structure of the Directive

- **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

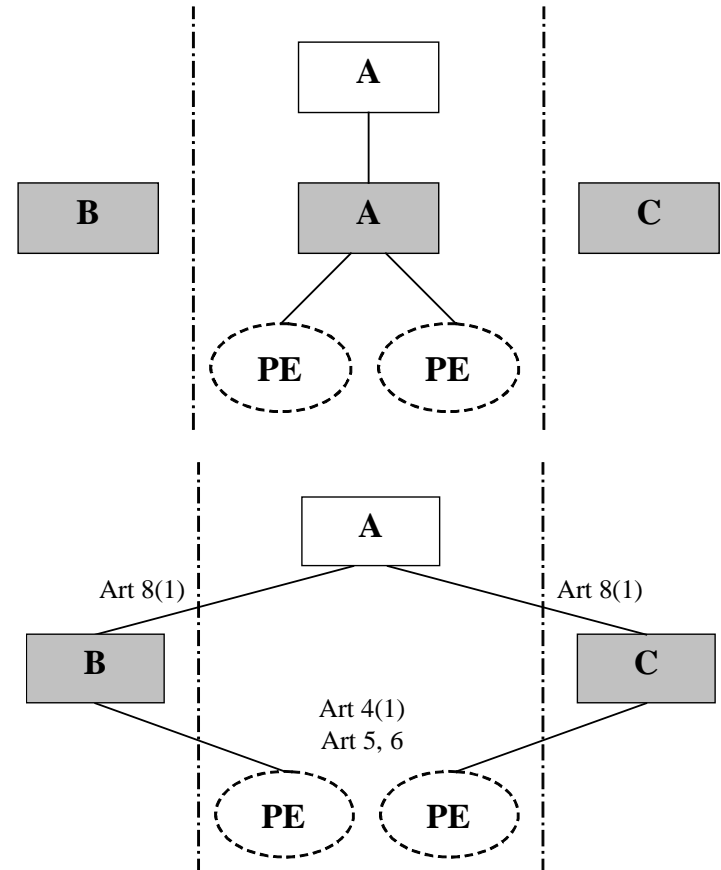
# Scope of Application

- **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)



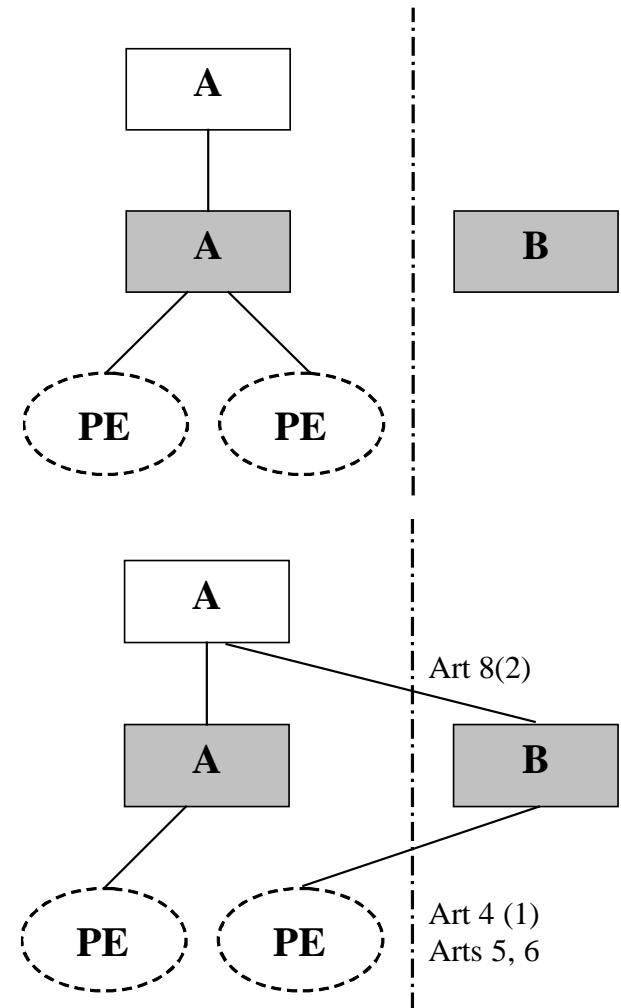
# Scope of Application

- **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

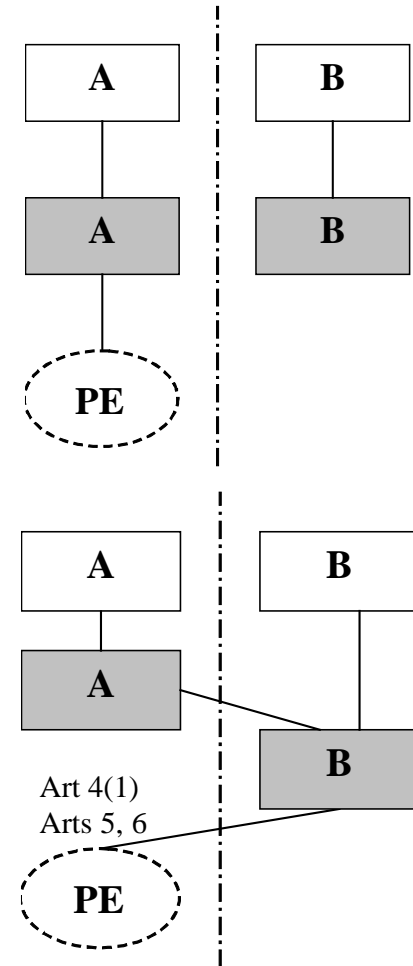
- **Partial Division** → Art 2(ba)
  - Transfer by the “transferring company” (A), without being dissolved, of one or more branches of activity, to one or more existing or new “receiving companies” (B), leaving at least one branch of activity in the “transferring company” (A), in exchange for the pro-rata 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)





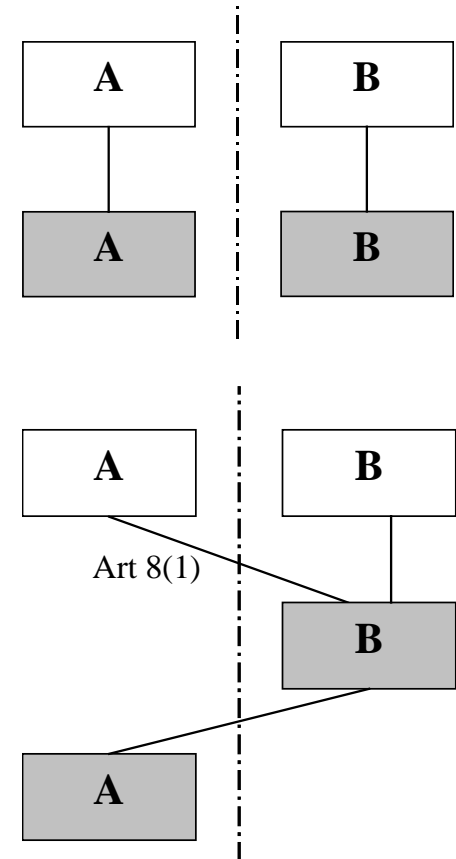
# Scope of Application

- **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



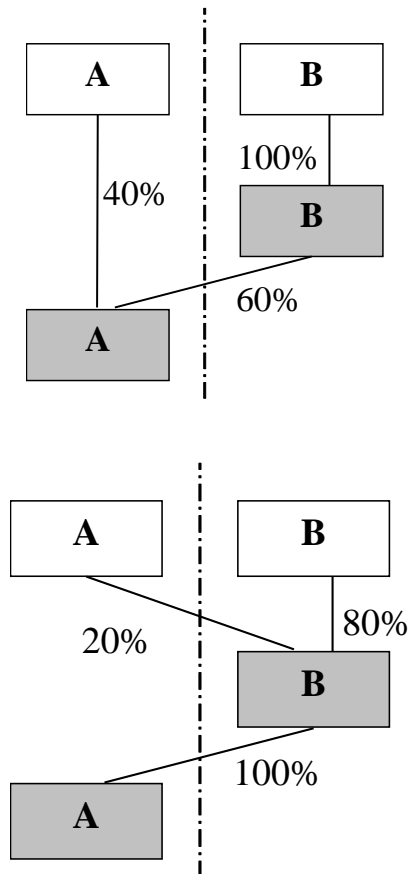
# Scope of Application

- **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)



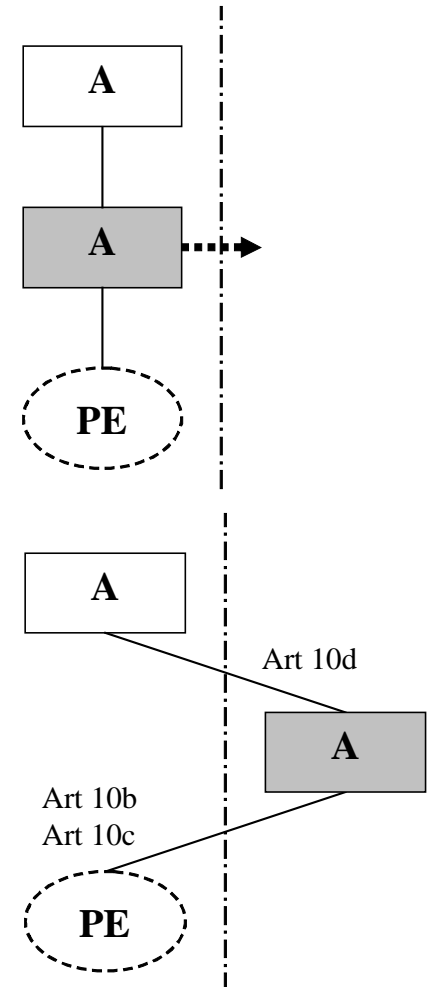
# Scope of Application

- **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)
  - 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

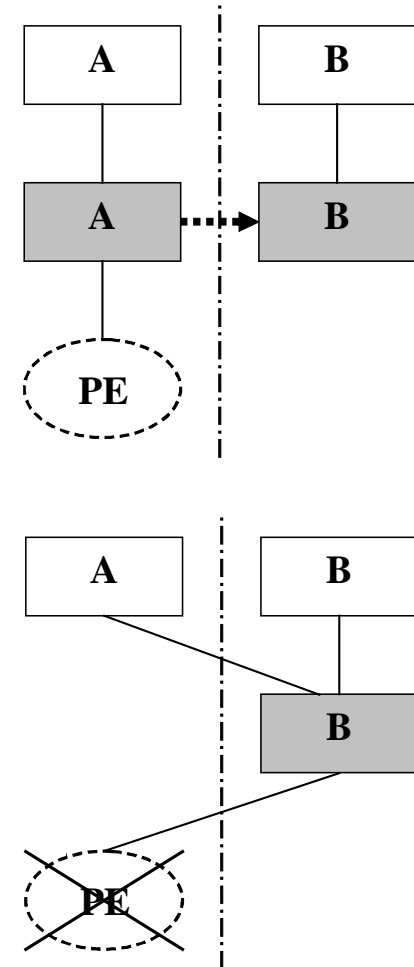
- Art 3 → For the purposes of the Directive, “company from a Member State” shall mean any company which:
  - takes one of the **legal forms** listed in the Annex to the Directive → Art 3(a)
  - according to the tax laws of a Member State is considered to be **resident in that State for tax purposes** *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





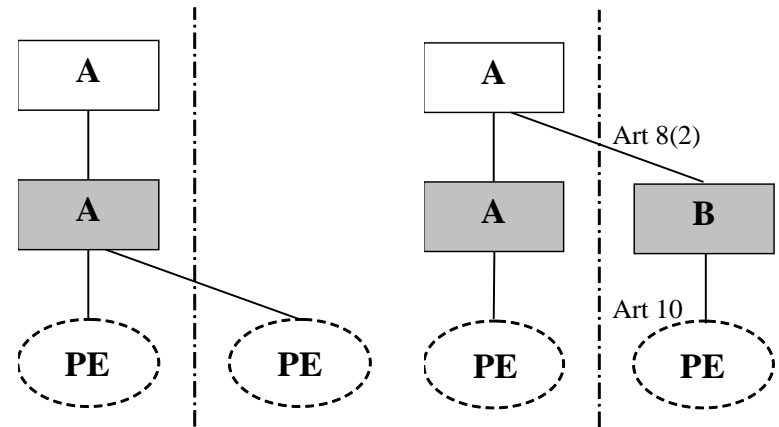
# Permanent Establishments

- **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

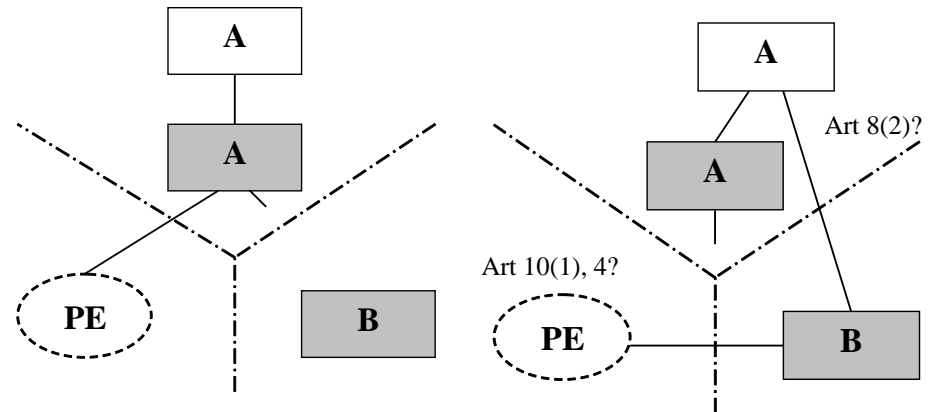
- “Incorporation” of Foreign Permanent Establishment?

- 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**



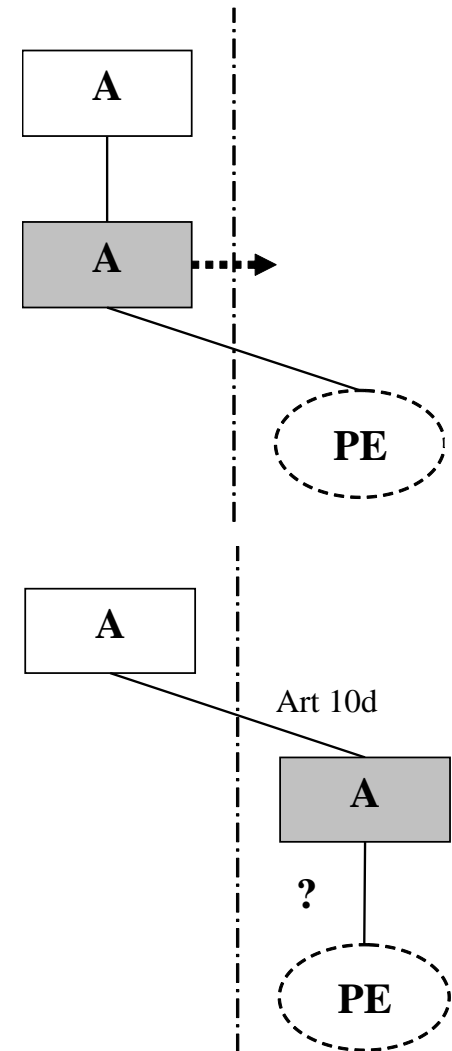
- “Split-off” of a Permanent Establishment in a Third Member State?

- 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.”



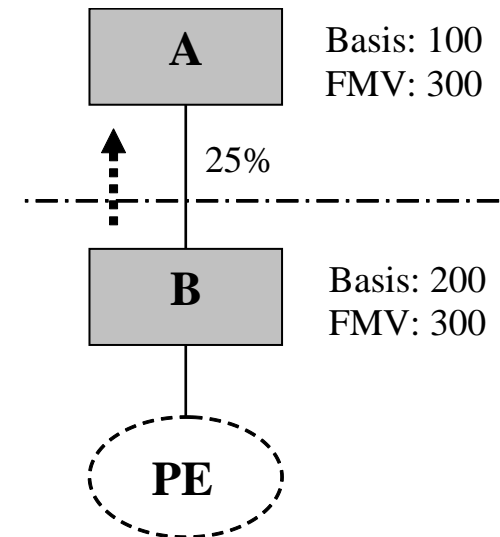
# Permanent Establishments

- **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.*”



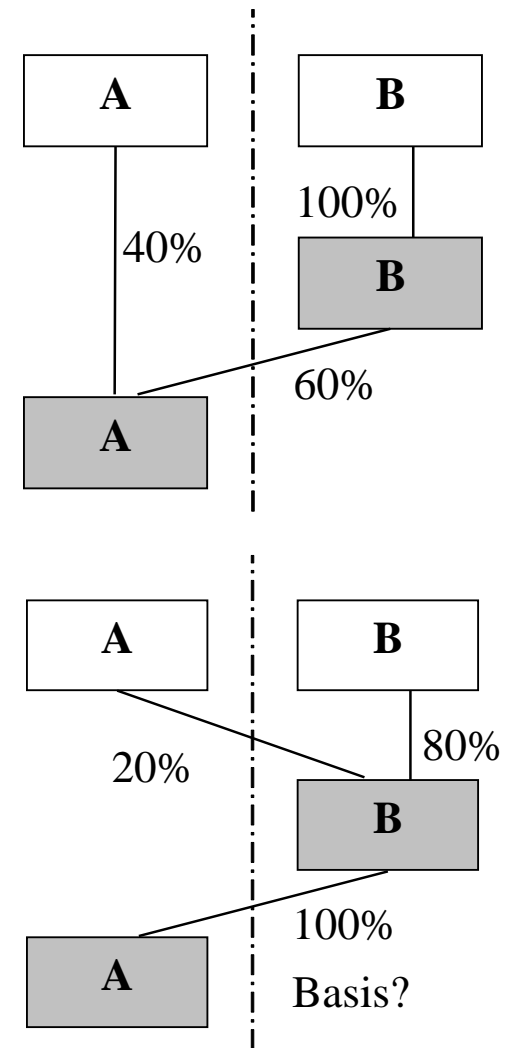
# “Confusio” Gains

- **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“



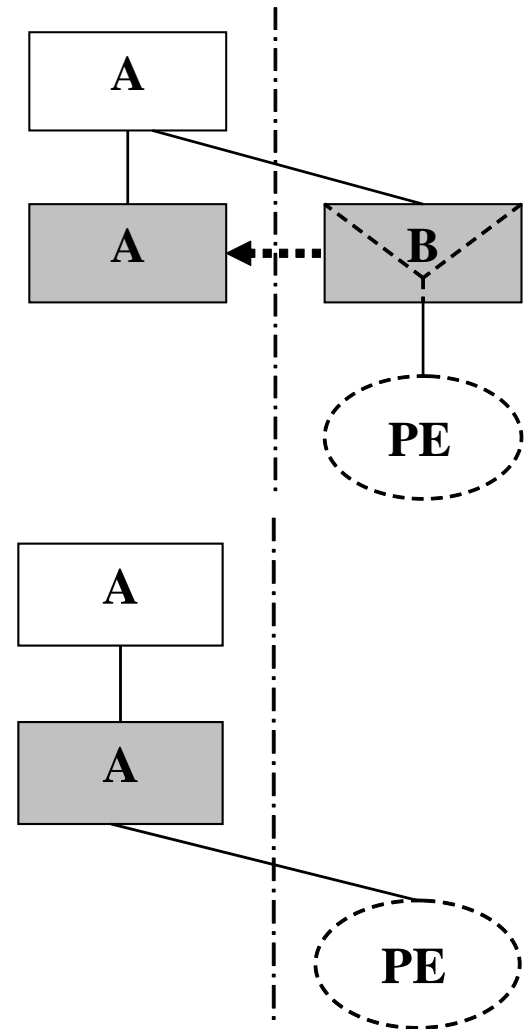
# Double Taxation

- **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



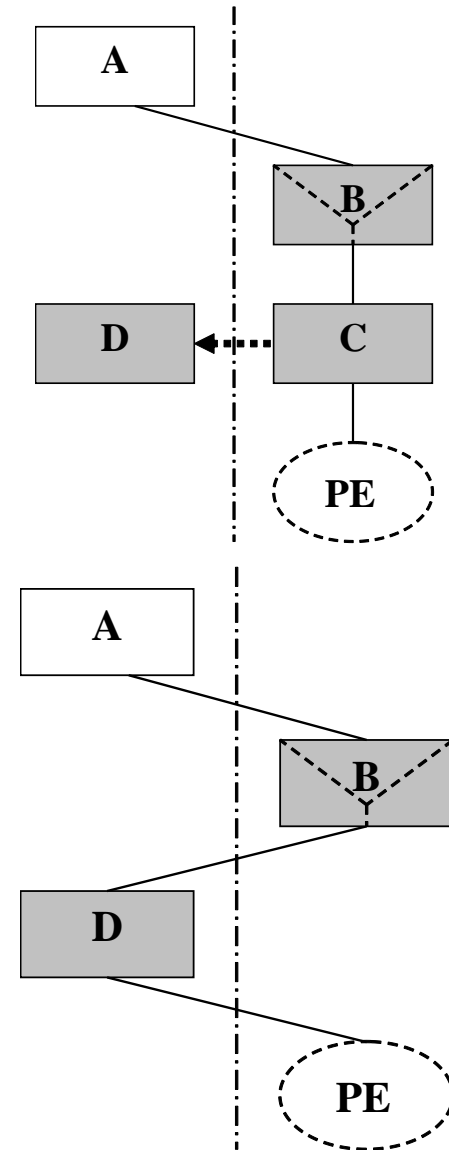
# Hybrid Entities

- **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.***”



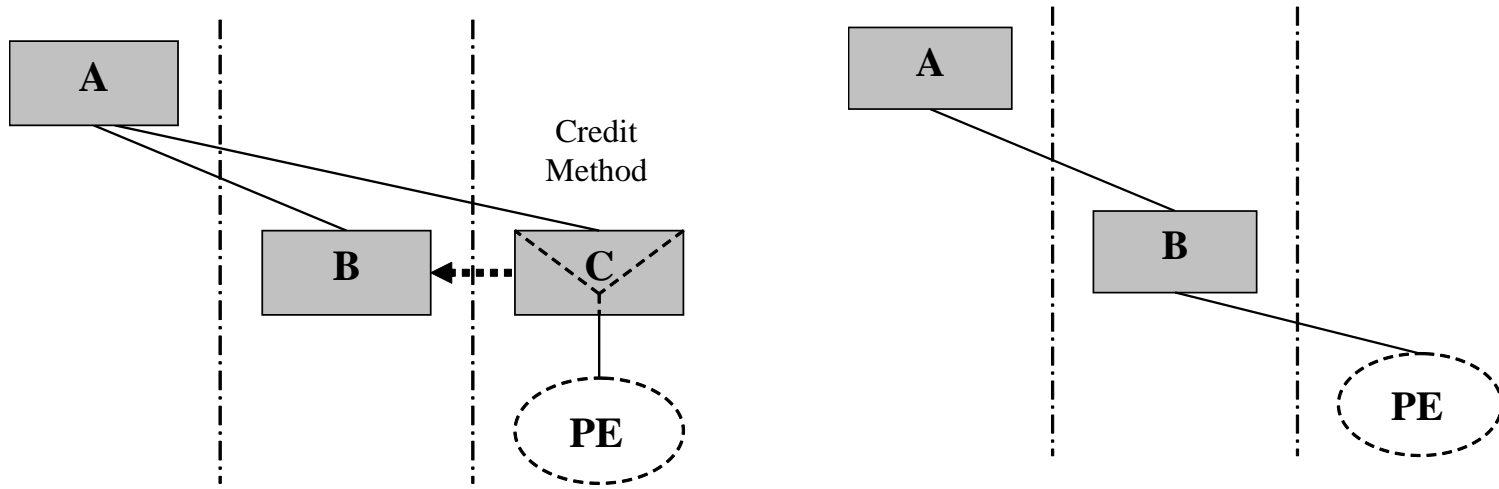
# Hybrid Entities

- **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

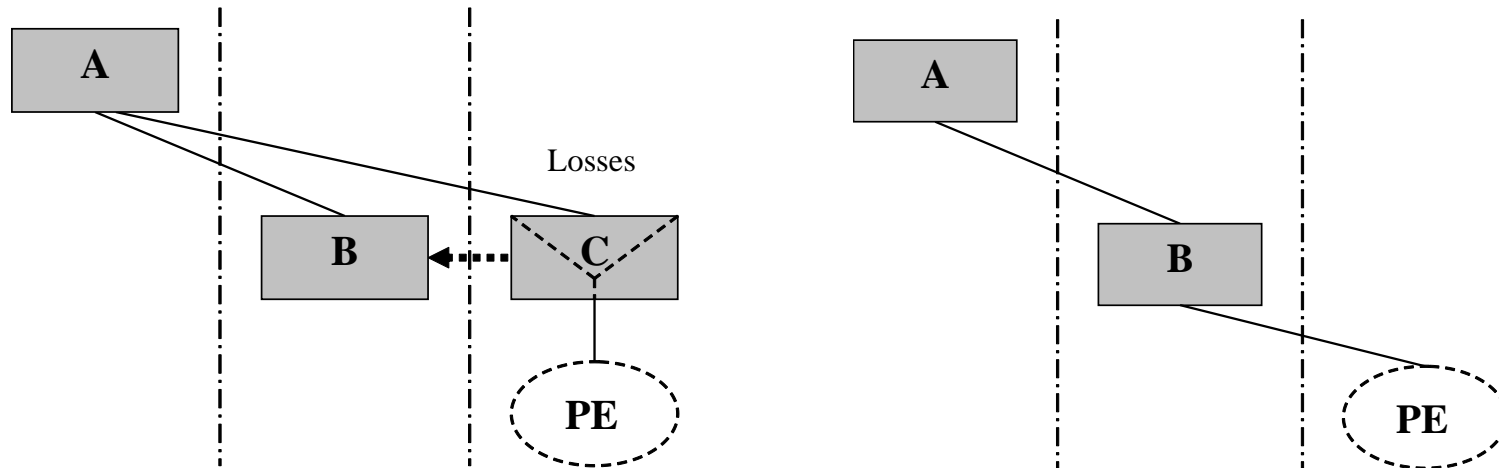


- Art 4(2) prohibits State A to tax hidden reserves in the PE's assets
- Art 8(1) prohibits State A to tax the allotment of B shares to company A
- Art 10(2) does not apply as the hybrid is a company within the meaning of the Directive (and not a permanent establishment of company A)
- But: **Art 10a(1) 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

# Thank You!

– Questions?

