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

EC Tax Law

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
Overview

Primary EC Law (Fundamental Freedoms)

Primacy of EC Law

Secondary EC Law (Directives)

Implementation

Domestic Tax Law

Double Taxation Conventions

Lex Specialis

“Stencil”

Primacy of EC Law (Art 307 EC)
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

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

Unlimited Tax Liability in MS A

Economic Activity in MS A

MS A

Economic Activity in MS B

Limited Tax Liability in MS B

Pair of Comparison from the Perspective of the Source State („Inbound“-Situation)
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*)
Graph 1: Number of (pending) direct tax cases before the ECJ as of 1 January 2010
Graph 2: Success rate – Taxpayers 76%, Member States 24%
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


Pre-Draft of a Multilateral Tax Treaty (11.414/XIV/68-D)
Körperschaftsteuer und Einkommensteuer in den Europäischen Gemeinschaften (1971) (van den Tempel Report)

Communication from the Commission Action Programme for Taxation, COM(75)391 final


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

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

Guidelines on Company Taxation, SEC(90)601 final


Communication from the Commission on Tax Measures to be Adopted by the Community in Connection with the Liberalization of Capital Movements, COM(89)60 final

- Commission Communication subsequent to the conclusions of the Ruding Committee indicating guidelines on company taxation linked to the further development of the internal market, SEC(92)1118 final

Opinion of the Economic and Social Committee on Fiscal competition and its impact on company competitiveness, ECO/067

Communication from the Commission on Dividend taxation of individuals in the Internal Market, COM(2003)810 final


Communication from the Commission The Contribution of Taxation and Customs Policies to the Lisbon Strategy, COM(2005)532 final


Communication from the Commission Co-ordinating Member States' direct tax systems in the Internal Market, COM(2006)823 final
- Communication from the Commission Exit taxation and the need for co-ordination of Member States' tax policies, COM(2006)825 final
- Communication from the Commission on the work of the EU Joint Transfer Pricing Forum in the field of dispute avoidance and resolution procedures and on Guidelines for Advance Pricing Agreements within the EU, COM(2007)71 final.
- 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.

Proposal for a CCCTB?
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
Pair of Comparison from the Perspective of the Residence State ("Outbound"-Situation)

Economic Activity in MS A

Unlimited Tax Liability in MS A

MS A

Economic Activity in MS B

Limited Tax Liability in MS B

MS B

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

Economic Activity in MS B
Disparities

- Different Tax Rates, Tax Bases \(\rightarrow\) 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 \(\rightarrow\) Double Burden as Disparity?

- What about “Consistency”?
Disparities

“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
  – 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

Inbound Situations
Inbound Situations – Subjective Ability to Pay


![Diagram showing economic activity and problems related to subjective ability to pay.](image)
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?*

![Diagram showing treaty exemption, pro-rata denial, and limited tax liability in DE, FR, and UK, with salary splitting and complete denial of benefits.]
Inbound Situations – Objective Ability to Pay

Inbound Situations – Objective Ability to Pay

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

Inbound Situations – Objective Ability to Pay
Inbound Situations – Objective Ability to Pay


![Diagram of Inbound Situations with 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?*

![Diagram of head office and subsidiary with tax rates and withholding details.]
Outbound Situations

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

Economic Activity in MS A

Unlimited Tax Liability in MS A

MS A

Economic Activity in MS B

MS B

Limited Tax Liability in MS B

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

Economic Activity in MS B
Outbound Situations

- Holdings in Foreign Companies

Problems
- Wealth Tax Exemption only for Domestic Shares (Baars)
- Dividend Exemption only for Domestic Dividends (Verkooijen)
- Taxation only of Sales of Shares in Foreign Companies (De Baeck)
- Tax Free Amount only for Shares in Domestic Companies (Weidert und Paulus)
- Different Thresholds for Taxability of Sales (Gronfelt)
- No Beneficial Rate for Foreign Dividends (Lenz)
- No Imputation Credit for Foreign Dividends (Manninen, Meilicke)
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

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

Justifications

Justifications

Justifications

• “Macro-Coherence” and Exit Taxation
Justifications

Justifications

Justifications

Justifications

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

![Diagram of Head Office, Subsidiary, PE, and Tax Calculations]

- 5% Withholding
- 30% CIT + 3.5% W/H (70%·5%) = 33.5% (until 30 June 1996)
- Tax Rate @ 42%
- Unlimited Tax Liability
Recent Issues – Tax Base Fragmentation

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

- Treaty Exemption of Foreign-Source Income
- Pro-Rata Denial of Personal and Family Benefits

- Limited Tax Liability in DE, FR and UK
- “Salery Splitting”
- Complete Denial of Personal and Family Benefits
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
• **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)

  – 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.)
• **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 \(\rightarrow\) “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 \(\rightarrow\) “**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.
• **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

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

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

<table>
<thead>
<tr>
<th>No</th>
<th>Yes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Freedom of Capital Movement and Freedom of Establishment are both applicable (e.g., Holböck; Burda).</td>
<td>Exclusive application of the Freedom of Establishment, no protection in third-country situations (e.g., Cadbury Schweppes; Lasertec; Stahlwerk Ergste Westig).</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>No</th>
<th>Yes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Freedom of Capital Movement applies (also to direct investments that are not controlling shareholdings) (e.g., FII Group Litigation; Orange European Smallcup Fund).</td>
<td>Exclusive application of the Freedom of Establishment, no protection in third-country situations (Burda, KBC Bank; but see: Glaxo Wellcome).</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>No</th>
<th>Yes</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Comparability of situations, justifications?</strong> (See, e.g., FII Group Litigation, A)?</td>
<td>“Grandfathered” (e.g., FII Group Litigation; Orange European Smallcup Fund).</td>
</tr>
</tbody>
</table>
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 (Fli 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) 2nd Situation EC directly applicable in direct tax cases? → ✔
  – Is Art 56(1) 2nd 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) 2nd 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-county 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*)
• 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.”
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

Diagram:
- Parent Company
- Head Office
- Subsidiary
- PE

MS A
- Unlimited Tax Liability in MS A

MS B
- Limited Tax Liability with PE-Income in MS B

Pair of Comparison („Inbound“-Situation)
Triangular Situations


```
Saint-Gobain

Organschaft

DE

DE

AT

IT

CH

US

FR

DE

MS

DS

- Denial of Treaty Exemption for Dividends from US and CH
- No Indirect Credit for Dividends from AT and IT
```
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
- Personal Scope of a DTC \(\Rightarrow\) 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 \(\Rightarrow\) 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
- \(\Rightarrow\) 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**


<table>
<thead>
<tr>
<th></th>
<th>Dutch Company</th>
<th>German Company</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Dividend</strong></td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>+ <strong>Credit</strong></td>
<td>5.5</td>
<td>—</td>
</tr>
<tr>
<td><strong>DTC-Refund</strong></td>
<td>0.27</td>
<td>—</td>
</tr>
<tr>
<td><strong>Net</strong></td>
<td><strong>100.27</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Limitation on Benefits-Clauses

Diagram:

- **DE**
- **NL**
- **UK**
Distributive Rules

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


```

Dividend

SE

NO

<table>
<thead>
<tr>
<th></th>
<th>Domestic Dividend</th>
<th>Outbound Dividend</th>
</tr>
</thead>
<tbody>
<tr>
<td>CIT Base</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>/. CIT (28%)</td>
<td>(28)</td>
<td>(28)</td>
</tr>
<tr>
<td>= Dividend</td>
<td>72</td>
<td>72</td>
</tr>
<tr>
<td>= Income Tax Base</td>
<td>72</td>
<td>72</td>
</tr>
<tr>
<td>/. Income Tax (28% or 15%)</td>
<td>(20,16)</td>
<td>(10,8)</td>
</tr>
<tr>
<td>+ Credit (100%)</td>
<td>20,16</td>
<td>—</td>
</tr>
<tr>
<td>= Income Tax in NO</td>
<td>0</td>
<td>10,8</td>
</tr>
<tr>
<td>= Total Burden</td>
<td>28</td>
<td>38,8</td>
</tr>
<tr>
<td>= Net Dividend</td>
<td>72</td>
<td>61,2</td>
</tr>
</tbody>
</table>
```
## Cross-Border Compensation


<table>
<thead>
<tr>
<th></th>
<th>Domestic Distribution in Norway</th>
<th>Norway as the Source State – Outbound Dividend</th>
<th>Domestic Distribution in the Residence State</th>
</tr>
</thead>
<tbody>
<tr>
<td>CIT Base</td>
<td>100</td>
<td>100 (No Credit)</td>
<td>100 (Credit)</td>
</tr>
<tr>
<td>CIT (28%)</td>
<td>(28)</td>
<td>(28) (No Credit)</td>
<td>(28) (Credit)</td>
</tr>
<tr>
<td>Dividend</td>
<td>72</td>
<td>72 (No Credit)</td>
<td>72 (Credit)</td>
</tr>
<tr>
<td>IT Base in Norway</td>
<td>72</td>
<td>72 (No Credit)</td>
<td>—</td>
</tr>
<tr>
<td>IT (28%) or Withholding Tax (15%) in Norway</td>
<td>(20.16)</td>
<td>(10.8) (No Credit)</td>
<td>—</td>
</tr>
<tr>
<td>Tax Credit (100%)</td>
<td>20.16</td>
<td>—</td>
<td>10.8</td>
</tr>
<tr>
<td>IT in Norway</td>
<td>0</td>
<td>10.8</td>
<td>0</td>
</tr>
<tr>
<td>IT Base in Shareholder’s Residence State</td>
<td>—</td>
<td>72 (No Credit)</td>
<td>72 (Credit)</td>
</tr>
<tr>
<td>Tentative IT in Shareholder’s Residence State (25%)</td>
<td>—</td>
<td>(18) (No Credit)</td>
<td>(18) (Credit)</td>
</tr>
<tr>
<td>Credit for Norwegian Withholding Tax</td>
<td>—</td>
<td>10.8 (No Credit)</td>
<td>0 (Credit)</td>
</tr>
<tr>
<td>IT in Shareholder’s Residence State</td>
<td>—</td>
<td>7.2 (No Credit)</td>
<td>18 (Credit)</td>
</tr>
<tr>
<td>Overall Tax Burden</td>
<td>28</td>
<td>46 (No Credit)</td>
<td>46 (Credit)</td>
</tr>
<tr>
<td>Net Dividend</td>
<td>72</td>
<td>54 (No Credit)</td>
<td>54 (Credit)</td>
</tr>
</tbody>
</table>
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

<table>
<thead>
<tr>
<th></th>
<th>Domestic Distribution in France</th>
<th>Distribution to a Dutch Corporate Shareholder</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Situation 1: 25% CIT in the Netherlands</td>
</tr>
<tr>
<td>Dividend</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>= CIT Base in France</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>./ French Withholding Tax</td>
<td>—</td>
<td>(5)</td>
</tr>
<tr>
<td>= CIT in France</td>
<td>0</td>
<td>5</td>
</tr>
<tr>
<td>CIT Base in the Netherlands</td>
<td>—</td>
<td>100</td>
</tr>
<tr>
<td>./ CIT in the Netherlands</td>
<td>—</td>
<td>(25)</td>
</tr>
<tr>
<td>+ Credit for French Withholding Tax</td>
<td>—</td>
<td>5</td>
</tr>
<tr>
<td>= Overall Tax Burden</td>
<td>—</td>
<td>25</td>
</tr>
<tr>
<td>= Hypothetical Burden in Case of a Domestic Distribution in the Netherlands</td>
<td>—</td>
<td>25</td>
</tr>
</tbody>
</table>
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

Methods to Avoid Double Taxation

- **Exemption Method – Core Issues**

  ![Diagram]

  - 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 –
  - 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?*

```
<table>
<thead>
<tr>
<th></th>
<th>German PE</th>
<th>Belgian PE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>DTC</td>
<td>Switch-Over</td>
</tr>
<tr>
<td></td>
<td>Exemption</td>
<td>to Credit</td>
</tr>
<tr>
<td>Belgian Tax Base</td>
<td>—</td>
<td>100</td>
</tr>
<tr>
<td>CIT in BE (e.g., 10%)</td>
<td>—</td>
<td>(10)</td>
</tr>
<tr>
<td>German Tax Base</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>Tax in DE (25%)</td>
<td>(25)</td>
<td>(0)</td>
</tr>
<tr>
<td>+ Credit for Belgian Tax</td>
<td>—</td>
<td>10</td>
</tr>
<tr>
<td>= Tax Burden in DE</td>
<td>25</td>
<td>0</td>
</tr>
<tr>
<td>= Overall Tax Burden</td>
<td>25</td>
<td>10</td>
</tr>
</tbody>
</table>
```

Switch-Over from Treaty Exemption to the Credit Method if the Foreign Permanent Establishment has Passive Income and is Lowly Taxed
• **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


<table>
<thead>
<tr>
<th></th>
<th>UK Individual</th>
<th>UK-Company</th>
<th>NL-Company</th>
<th>DE-Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>+ Credit</td>
<td>11,1</td>
<td>—</td>
<td>5,5</td>
<td>—</td>
</tr>
<tr>
<td>= DTC Refund</td>
<td>—</td>
<td>—</td>
<td>0,27</td>
<td>—</td>
</tr>
<tr>
<td>= Net</td>
<td>100 + 11,1</td>
<td>100</td>
<td>100,27</td>
<td>100</td>
</tr>
</tbody>
</table>
Horizontal Discrimination

• *Outbound*-Most-Favored Nation Treatment

Possible Examples
- DTC-Activity Clauses (→ C-298/05, Columbus Container Services)
- Different methods of DTC relief
- Tax Sparing Credits
- Switch-over on the basis of domestic law

Advantage/benefit under DTC or domestic law

“Normal” taxation
Horizontal Discrimination

Horizonal Discrimination

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

<table>
<thead>
<tr>
<th></th>
<th>Classical</th>
<th>Schedular System</th>
<th>Full Imputation</th>
<th>Exemption</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Tax Rate</td>
<td>Tax Base</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Corporate Tax Rate 33,3%</td>
<td>33.3</td>
<td>33.3</td>
<td>33.3</td>
<td>33.3</td>
</tr>
<tr>
<td>Dividend (1 / 2)</td>
<td>66.7</td>
<td>66.7</td>
<td>66.7</td>
<td>66.7</td>
</tr>
<tr>
<td>Income Tax Base</td>
<td>66.7</td>
<td>66.7</td>
<td>33.35</td>
<td>100</td>
</tr>
<tr>
<td>Income Tax Rate (50% of 4.)</td>
<td>33.35</td>
<td>—</td>
<td>16.7</td>
<td>50</td>
</tr>
<tr>
<td>Full Imputation (2)</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>33.3</td>
</tr>
<tr>
<td>Remaining Income Tax (5 / 6)</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>16.7</td>
</tr>
<tr>
<td>Schedular Tax (25% of 4)</td>
<td>—</td>
<td>16.7</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Net Dividend (3 / 5, 7, 8)</td>
<td>33.35</td>
<td>50</td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td>Overall Tax Burden</td>
<td>66.65%</td>
<td>50%</td>
<td>50%</td>
<td>50%</td>
</tr>
</tbody>
</table>
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


<table>
<thead>
<tr>
<th></th>
<th>AT</th>
<th>MS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate Tax Base</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>\ (Corporate Tax (34%))</td>
<td>(34)</td>
<td>(34)</td>
</tr>
<tr>
<td>= Dividend</td>
<td>66</td>
<td>66</td>
</tr>
<tr>
<td>= Income Tax Base</td>
<td>66</td>
<td>66</td>
</tr>
<tr>
<td>\ (Income Tax (25%/50%))</td>
<td>(16.5)</td>
<td>(33)</td>
</tr>
<tr>
<td>= Income Tax in AT</td>
<td>16.5</td>
<td>33</td>
</tr>
<tr>
<td>= Overall Burden</td>
<td>50.5</td>
<td>67</td>
</tr>
<tr>
<td>= Net</td>
<td>49.5</td>
<td>33</td>
</tr>
</tbody>
</table>
Inbound Dividends


![Diagram showing dividend flow between FI and SE with a table illustrating calculations of Corporate Tax Base, Income Tax Base, and final net amount.]
Inbound Dividends


<table>
<thead>
<tr>
<th>UK Dividend</th>
<th>MS Dividend</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate Tax Base (Subsidiary)</td>
<td>100</td>
</tr>
<tr>
<td>Corporate Tax Base (Subsidiary) (35% or 10%)</td>
<td>(35)</td>
</tr>
<tr>
<td>= Gross Dividend</td>
<td>65</td>
</tr>
<tr>
<td>Withholding Tax (e.g., 10%)</td>
<td>—</td>
</tr>
<tr>
<td>Corporate Tax Base (Parent)</td>
<td>65</td>
</tr>
<tr>
<td>Corporate Tax (Subsidiary) (35%)</td>
<td>(0)</td>
</tr>
<tr>
<td>Credit</td>
<td>—</td>
</tr>
<tr>
<td>= Tax in UK</td>
<td>35</td>
</tr>
<tr>
<td>= Overall Burden</td>
<td>35</td>
</tr>
<tr>
<td>= Net Dividend</td>
<td>65</td>
</tr>
</tbody>
</table>
Outbound Dividends


<table>
<thead>
<tr>
<th></th>
<th>Domestic Dividend</th>
<th>Outbound Dividend</th>
</tr>
</thead>
<tbody>
<tr>
<td>CIT Base</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>/ \ CIT (28%)</td>
<td>(28)</td>
<td>(28)</td>
</tr>
<tr>
<td>= Dividend</td>
<td>72</td>
<td>72</td>
</tr>
<tr>
<td>= Income Tax Base</td>
<td>72</td>
<td>72</td>
</tr>
<tr>
<td>/ \ Income Tax (28% or 15%)</td>
<td>(20,16)</td>
<td>(10,8)</td>
</tr>
<tr>
<td>+ Credit (100%)</td>
<td>20,16</td>
<td>—</td>
</tr>
<tr>
<td>= Income Tax in NO</td>
<td>0</td>
<td>10,8</td>
</tr>
<tr>
<td>= Total Burden</td>
<td>28</td>
<td>38,8</td>
</tr>
<tr>
<td>= Net Dividend</td>
<td>72</td>
<td>61,2</td>
</tr>
</tbody>
</table>
Outbound Dividends

Outbound Dividends


<table>
<thead>
<tr>
<th></th>
<th>UK Individual</th>
<th>UK-Company</th>
<th>NL-Company</th>
<th>DE-Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>+ Credit</td>
<td>11,1</td>
<td>—</td>
<td>5,5</td>
<td>—</td>
</tr>
<tr>
<td>= DTC Refund</td>
<td>—</td>
<td>—</td>
<td>0,27</td>
<td>—</td>
</tr>
<tr>
<td>= Net</td>
<td>100 + 11,1</td>
<td>100</td>
<td>100,27</td>
<td>100</td>
</tr>
</tbody>
</table>

Diagram: Dividend flow from UK to NL and then DE.
### Summary

<table>
<thead>
<tr>
<th>Shareholder's Residence State</th>
<th>Classical System</th>
<th>Schedular System</th>
<th>Full Imputation System</th>
<th>Exemption System</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Same treatment as for domestic dividends (A)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Same treatment as for domestic dividends (Verkooijen, Lenz)</td>
<td>Credit for foreign corporate tax (Manninen, Meilicke, FII Group Litigation)</td>
<td>However, a Member State may decide to grant an indirect foreign tax credit instead (FII Group Litigation – But: Haribo and Salinen)</td>
</tr>
<tr>
<td>Source State = Company’s Residence State</td>
<td>Taxation of Non-Resident Shareholder</td>
<td></td>
<td>Same treatment as for resident shareholders (Avoir Fiscal, Saint-Gobain, Fokus Bank, ACT Group Litigation), Only to the extent to cancel domestic economic double taxation (ACT Group Litigation), “Neutralization”? (Denkavit, Amurta)</td>
<td>Same treatment as for resident shareholders (Saint-Gobain, Denkavit, Amurta, Commission v. Netherlands, Aberdeen, Gaz de France), “Neutralization”? (Denkavit, Amurta)</td>
</tr>
<tr>
<td>Taxation of Company’s Profits</td>
<td></td>
<td></td>
<td>Not affected by fundamental freedoms (ACT Group Litigation)</td>
<td></td>
</tr>
</tbody>
</table>
Part III-5
Anti-Avoidance Provisions
Anti-Avoidance

• **Domestic Measures and ECJ Case Law**
  – **Switch Over** \(\rightarrow\) ECJ, 6 December 2007, C-298/05, *Columbus Container Services* [2007] ECR I-10451
  – **Treaty Shopping**
    • **GAARs**
    • **Limitation on Benefits** \(\rightarrow\) 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

Switch Over Clauses

- **Anti-Avoidance: Switch-Over** — ECJ, 6 December 2007, C-298/05, *Columbus Container Services* [2007] ECR I-10451
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*
• **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**
  – Codification in 2009?


Act concerning the conditions of accession of the Kingdom of Norway, the Republic of Austria, the Republic of Finland and the Kingdom of Sweden and the adjustments to the Treaties on which the European Union is founded, Annex I, XI.B.I, [1994] OJ C 241, p. 196.

Act concerning the conditions of accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic and the adjustments to the Treaties on which the European Union is founded — Appendix II, 9, [2003] OJ L 236, p. 555.
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
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
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
• **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*
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
Art 1 — Each Member State shall apply this Directive

- to distributions of profits received by companies of that State which come from their subsidiaries of other Member States
- to distributions of profits by companies of that State to companies of other Member States of which they are subsidiaries
- to distributions of profits received by permanent establishments situated in that State of companies of other Member States which come from their subsidiaries of a Member State other than that where the permanent establishment is situated
- to distributions of profits by companies of that State to permanent establishments situated in another Member State of companies of the same Member State of which they are subsidiaries
Scope of Application

- **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
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.
Minimum Holding Requirement → Art 3(1)

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

Minimum Holding Period → Art 3(2)

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

• **Two Options for Member States**
  – Exemption at the Parent Level → Art 4(1) 1st intend
    • 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 equitable 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
• **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.

<table>
<thead>
<tr>
<th>Exemption</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>CIT in MS S (30%)</td>
<td>30</td>
</tr>
<tr>
<td>Income in MS P</td>
<td>70</td>
</tr>
<tr>
<td>Tentative CIT in MS P (40%)</td>
<td>28</td>
</tr>
<tr>
<td>Exemption (70 @ 40%)</td>
<td>28</td>
</tr>
<tr>
<td>Credit (Min(30;100@40%))</td>
<td>—</td>
</tr>
<tr>
<td>CIT in MS P</td>
<td>0</td>
</tr>
<tr>
<td>Overall CIT</td>
<td>30</td>
</tr>
</tbody>
</table>
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.”

---

<table>
<thead>
<tr>
<th>MS S: Exemption</th>
<th>MS S: Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic</td>
<td>Directive</td>
</tr>
</tbody>
</table>

<p>| | | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>CIT in <strong>MS SS</strong> (20%)</td>
<td>20</td>
<td>20</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>Income in <strong>MS S</strong></td>
<td>80</td>
<td>80</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Tentative CIT in <strong>MS S</strong> (30%)</td>
<td>24</td>
<td>24</td>
<td>30</td>
<td>30</td>
</tr>
<tr>
<td>Credit (Min(20;100@30%))</td>
<td>—</td>
<td>—</td>
<td>(20)</td>
<td>(20)</td>
</tr>
<tr>
<td>Exemption</td>
<td>(24)</td>
<td>(24)</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>CIT in <strong>MS S</strong></td>
<td>0</td>
<td>0</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Income in <strong>MS P</strong></td>
<td>80</td>
<td>100</td>
<td>80</td>
<td>100</td>
</tr>
<tr>
<td>Tentative CIT in <strong>MS P</strong> (40%)</td>
<td>32</td>
<td>40</td>
<td>36</td>
<td>40</td>
</tr>
<tr>
<td>Credit (Min(CIT;Income@40%))</td>
<td>0</td>
<td>20</td>
<td>10</td>
<td>30</td>
</tr>
<tr>
<td>CIT in <strong>MS P</strong></td>
<td>32</td>
<td>20</td>
<td>26</td>
<td>10</td>
</tr>
<tr>
<td>Overall CIT</td>
<td>52</td>
<td>40</td>
<td>56</td>
<td>40</td>
</tr>
</tbody>
</table>
• **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

Economic 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
• 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 conguaglio in Italy, ACT in the UK, and Ausschüttungsbelastung in Germany

• 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?
Art 7(2)

“\textit{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.}”


\begin{align*}
\text{Dividend} & = 13,045,629.60 \\
\text{Half Tax Credit} & = 2,174,271.60 \\
\text{Tax Base} & = 15,219,901.20 \\
\text{Tax Rate} & = 5\% \\
\text{UK Tax} & = 760,995.06 \\
\text{Payment to Océ NV} & = 1,413,275.54
\end{align*}

\begin{align*}
\text{Payment of ACT of £} & 4,348,543.2 \\
\text{Océ UK} & (UK) \\
\text{Dividend of £} & 13,045,629.60 \\
\text{Océ NV} & (Netherlands)
\end{align*}
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**
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.


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
• Exemption from source-taxation of
  – interest payments \(\rightarrow\) Art 2(a)
  – royalty payments \(\rightarrow\) 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” \(\rightarrow\) Art 1(2)), whether by deduction at source or by assessment, provided that the beneficial owner of the interest or royalties \(\rightarrow\) Art 1(4) and (5)) is
  – a company of another Member State \(\rightarrow\) Art 1(4) \(\rightarrow\) Art 3(a))
  – or a permanent establishment situated in another Member State of a company of a Member State \(\rightarrow\) Art 1(5) and (8) \(\rightarrow\) 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” \(\rightarrow\) Art 1(2) and (3))
• **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)
• 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
• 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
• **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**
  – Codification in 2009
### Timeline

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>Act concerning the conditions of accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic and the adjustments to the Treaties on which the European Union is founded – Appendix II, 9, [2003] OJ L 236, p. 555.</td>
</tr>
</tbody>
</table>
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
**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) to 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)
• **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)
• **Partial Division** \(\rightarrow\) **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 \(\rightarrow\) Art 4, 10
    - Carry-over of provisions or reserves \(\rightarrow\) 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 \(\rightarrow\) Art 8(2)
• **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
• **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)
• **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”.

![Diagram showing the ownership structure and percentages of shares between companies A and B.]

171
• **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

<table>
<thead>
<tr>
<th>Event</th>
<th>Company Level</th>
<th>Shareholder Level</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Assets</td>
<td>Losses</td>
</tr>
</tbody>
</table>
| **Merger**
Art 2(a)                                | Art 4(1) | Art 6 | Art 5 | Art 8(1) |
| **Division**
Art 2(b)                                | Art 4(1) | Art 6 | Art 5 | Art 8(1) |
| **Partial Division**
Art 2(ba)                                 | Art 4(1) | Art 6 | Art 5 | Art 8(2) |
| **Transfer of Assets**
Art 2(c)                                    | Art 9 → Art 4(1) | Art 9 → Art 6 | Art 9 → Art 5 | — |
| **Exchange of Shares**
Art 2(d)                                    | — | — | — | Art 8(1) |
| **Transfer of the Registered Office**
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?
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.”
• 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: „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%?

  – Art 3 of the “old” Parent-Subsidiary-Directive: „minimum holding of 20 % [15%, 10%]“
  – Art 7(2) of the “new” Merger 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“
**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
New Rules on Transparent (Hybrid) Entities
- Basic Rules $\rightarrow$ Art 4(2), 8(3)
- Opt-outs for Member States $\rightarrow$ 10a

Company Level $\rightarrow$ 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.”
• **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.”
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?