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EU Tax Law

Fundamental Freedoms and Secondary EC Tax Law

Mo	11. 4. 2011	12:00-15:15	BA 9911	
Mi	13. 4. 2011	8:30-11:45	MT226/1	
Fr	15. 4. 2011	8:30-11:45	HS 6	
Fr	*5. 5. 2011*	*15:30-16:15*	*HS 3*	*Exam*

Overview

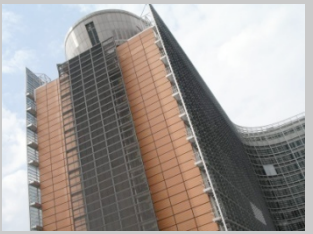
- **Introduction**
- **European Tax Policy: Summary**
- **The Fundamental Freedoms**
  - Dogmatic Foundations
  - Third Country Situations
  - Cross-Border Dividends
- **Secondary EU Tax Law**
  - Parent Subsidiary Directive
  - Interest and Royalties Directive
  - Merger Directive

Reading

- **Cases!**
- **Directives!**
  - Parent Subsidiary Directive
  - Interest and Royalties Directive
  - Merger Directive
- **Reader (German)**
  - *Kofler*, p. 17-37
  - *Cordewener*, p. 38-65
- www.steuerrecht.jku.at (English materials)
  - *Lyal (18 pages)*
  - *Van Thiel (50 pages)*
  - *Wattel (16 pages)*

- Further Reading
  - *Lang* (ed.) Introduction European Tax Law (2008/2010)

Part I
Introduction



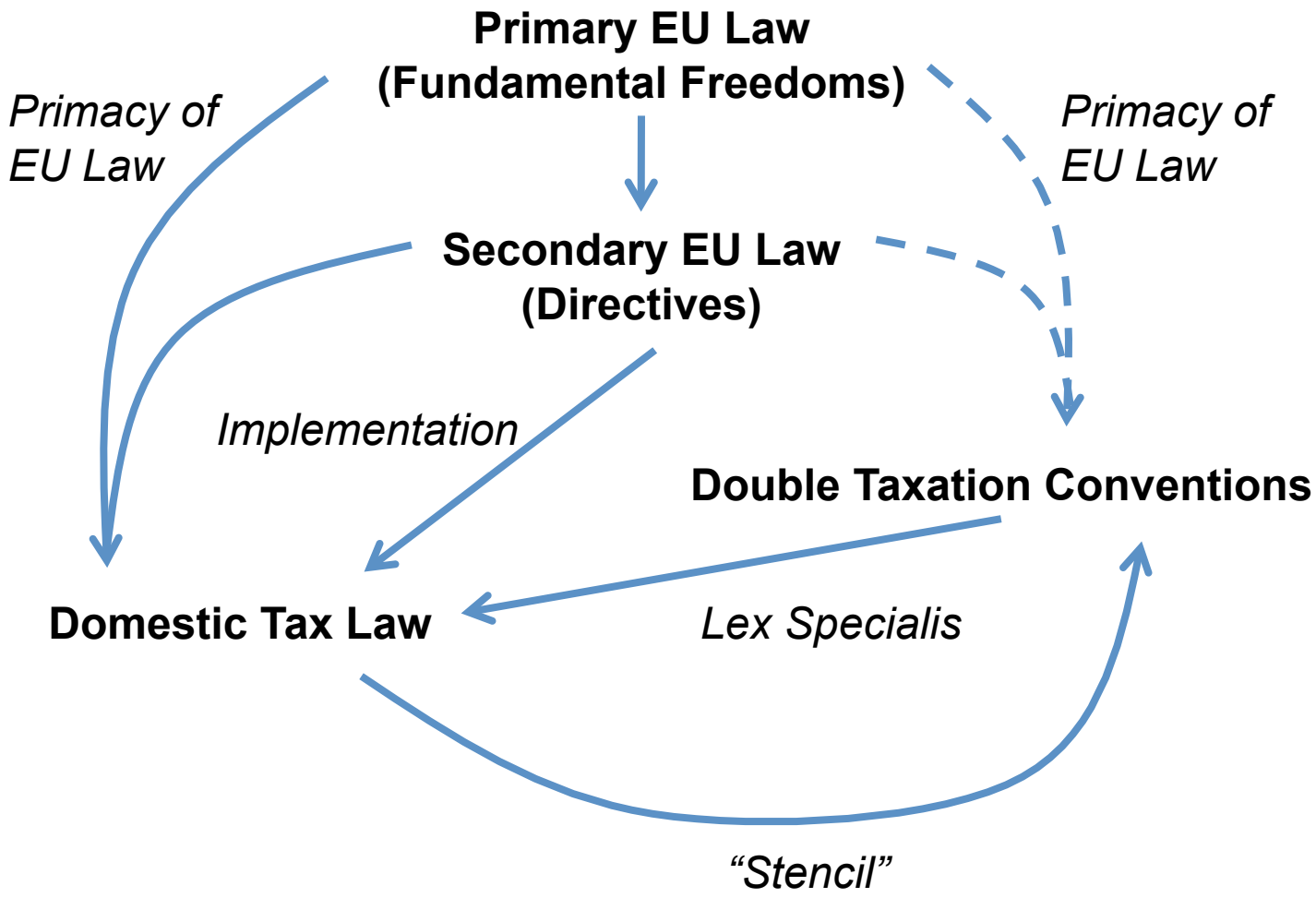
European Commission

Council

European Parliament

Court of Justice

Overview


Primary EU Law
(Fundamental Freedoms)
Primacy of
EU Law
Primacy of
EU Law
Secondary EU Law
(Directives)
Implementation
Double Taxation Conventions
Domestic Tax Law
Lex Specialis
"Stencil"

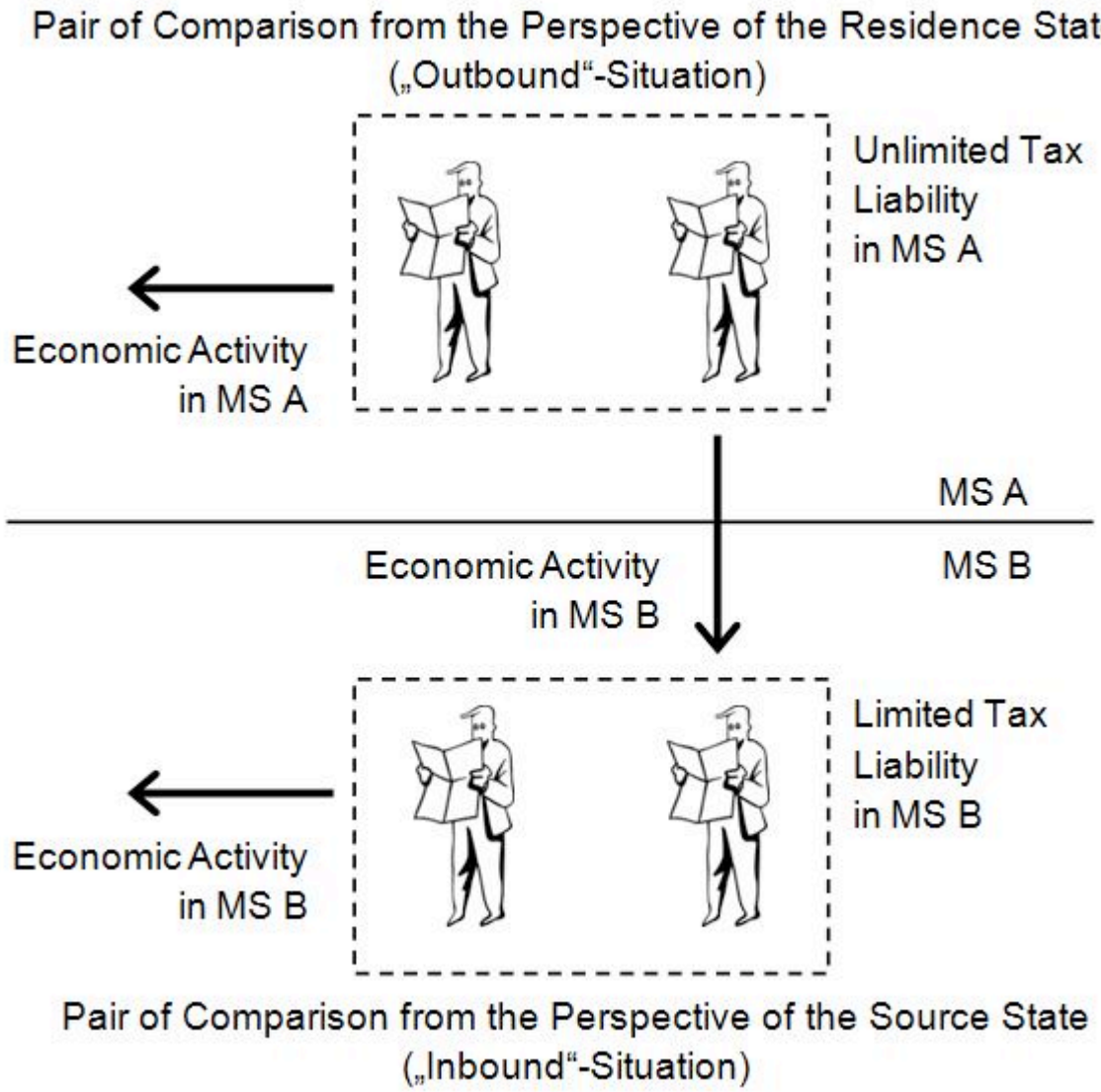
Overview

- **EU competence in tax matters**
  - **Indirect Taxation** → Customs Union (Art 28 TFEU), prohibition of custom duties (Art 30 TFEU), and prohibition of direct and indirect discrimination against foreign products (Art 110 TFEU); harmonisation under **Art 113 TFEU**
  - **Direct Taxation** → No harmonisation programme, but **Art 115 TFEU**: internal market provision
- **EC Law and Direct Taxation**
  - **Fundamental Freedoms**
    - Free Movement of Workers (Art 45 TFEU — *Art 28 EEA*)
    - Freedom of Establishment (Art 49 TFEU — *Art 31 EEA*)
    - Freedom to Provide Services (Art 56 TFEU — *Art 36 EEA*)
    - Free Movement of Capital (Art 63 TFEU — *Art 40 EEA*) — Under EU 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
    - *CCCTB? (Proposal published March 2011)*

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 – procedural issues of EU law application in practice**
    - 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? (denied in *Cadbury Schweppes, Columbus Container Services*)

Part II
European Tax Policy: Summary

European Tax Policy

- **Directives**
  - Parent-Subsidiary-Directive
  - Merger Directive
  - Interest-Royalties-Directive
  - Savings Directive
  - Directives on Mutual Assistance and Recovery of Tax Claims
- **Current Tax Policy**
  - **No broad harmonization** of Member States' systems of (direct) taxation.
    - Within the boundaries of the treaty rules, Member States are free to choose the tax systems that they consider most appropriate and according to their preferences.
  - Measures adopted follow principles of **subsidiarity** and **proportionality**.
    - → Remaining tax problems may in fact require better **co-ordination** of national policies.
  - Main **priorities**:
    - Strengthening internal market by **eliminating tax obstacles** to all forms of cross-border economic activity, in addition to continuing the
    - Fight against **harmful tax competition**. → **Code of Conduct, Joint Transfer Pricing Forum, CCCTB proposal**
- Double Taxation → **Art 293 EC**? → Deleted in Treaty of Lisbon!

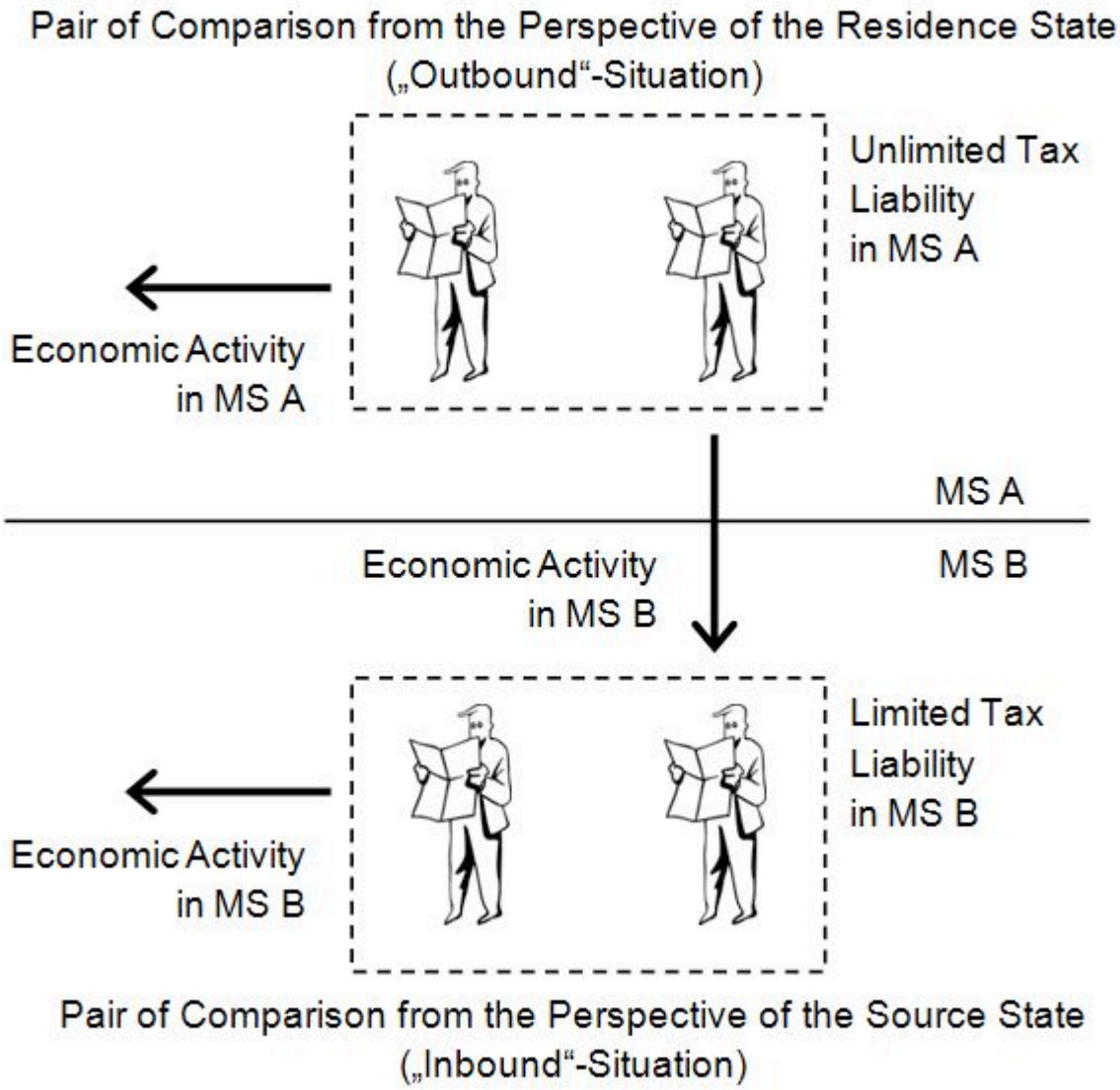
Part III
The Fundamental Freedoms

Overview

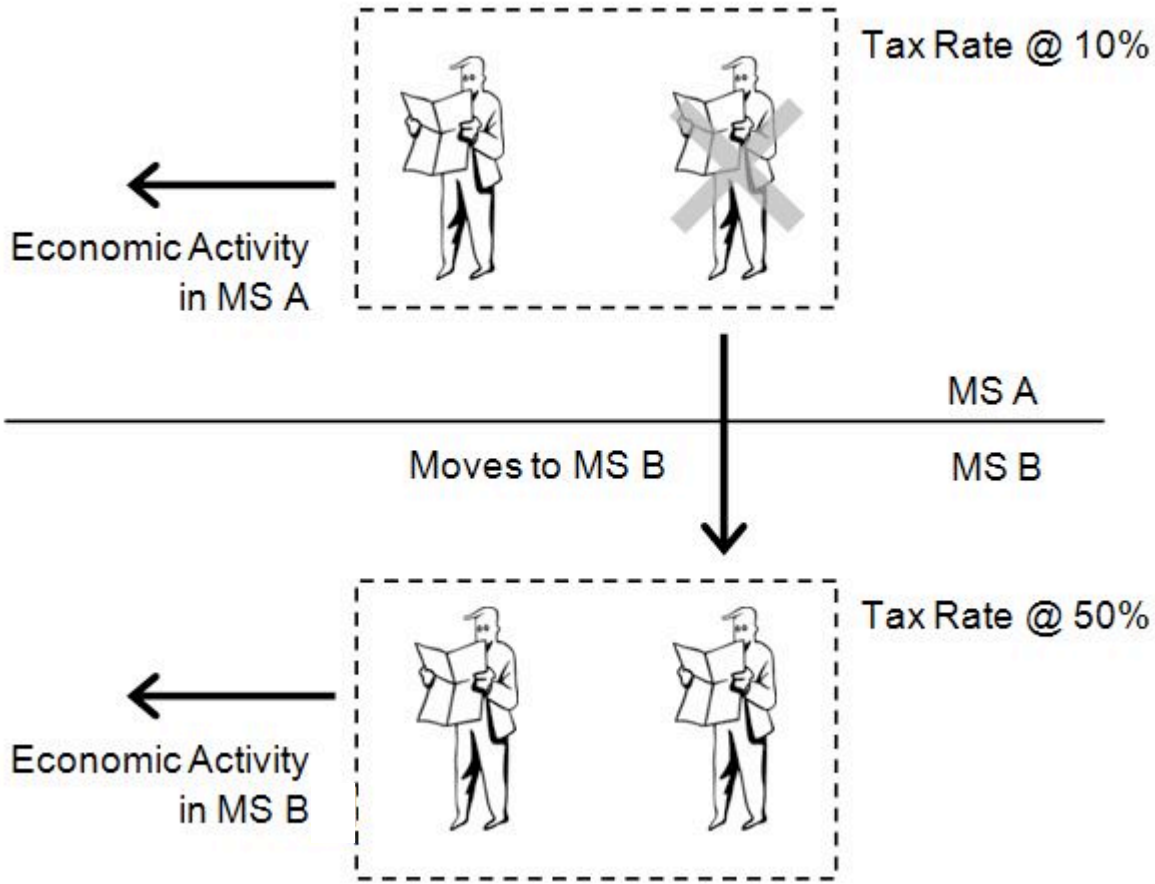
- **The Fundamental Freedoms**
  - Dogmatic Foundations
    - *Discrimination vs disparity*
    - *“Double burden” and Juridical double taxation*
    - *Inbound cases – objective/subjective ability to pay*
    - *Outbound cases*
    - *Justification*
    - *Neutrality of legal form*
    - *Tax base fragementation and “internal consistency”?*
    - *Neutralisation / cross border compensation*
  - Third Country Situations
  - Cross border dividends

Part III-1
Dogmatic Foundations

Discrimination



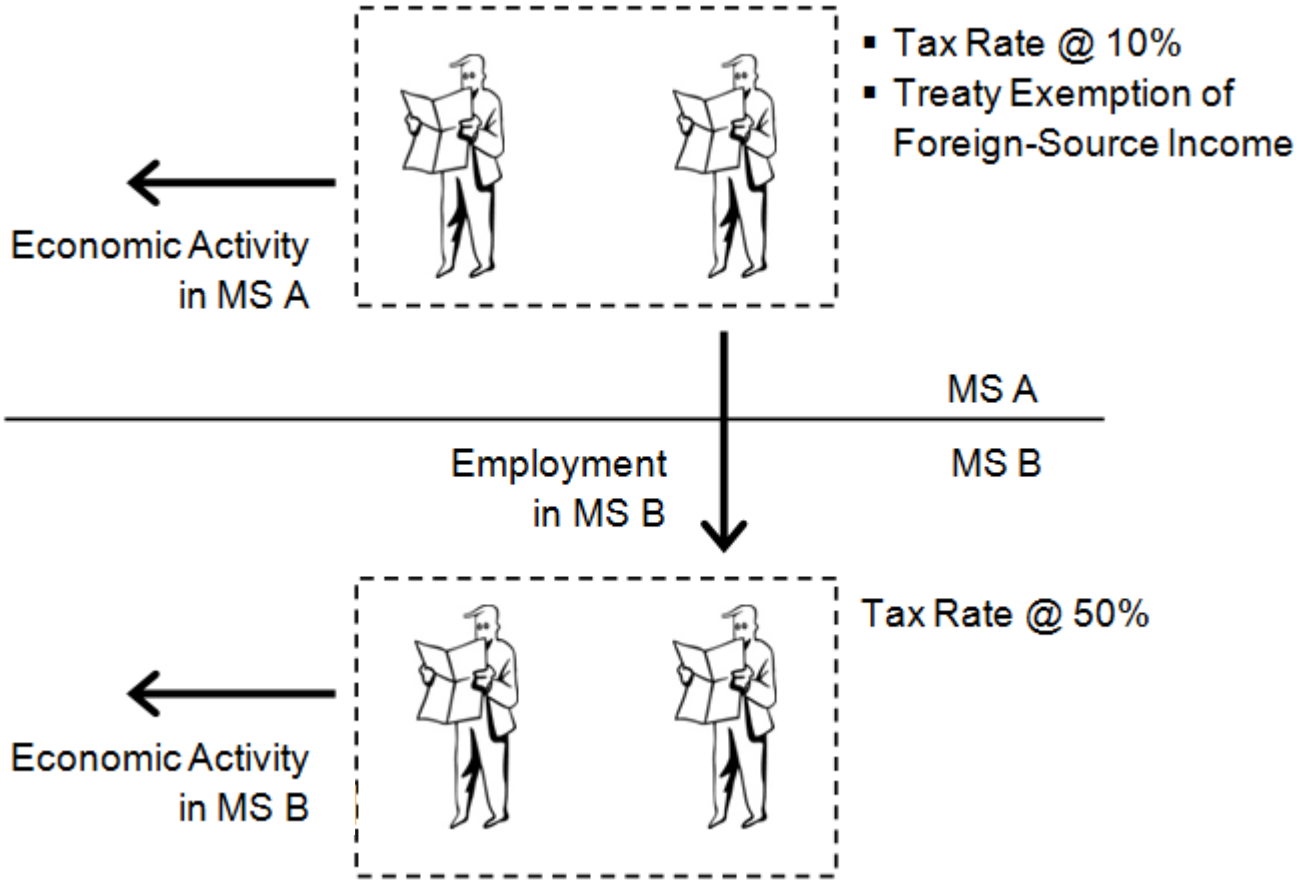
Disparities



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

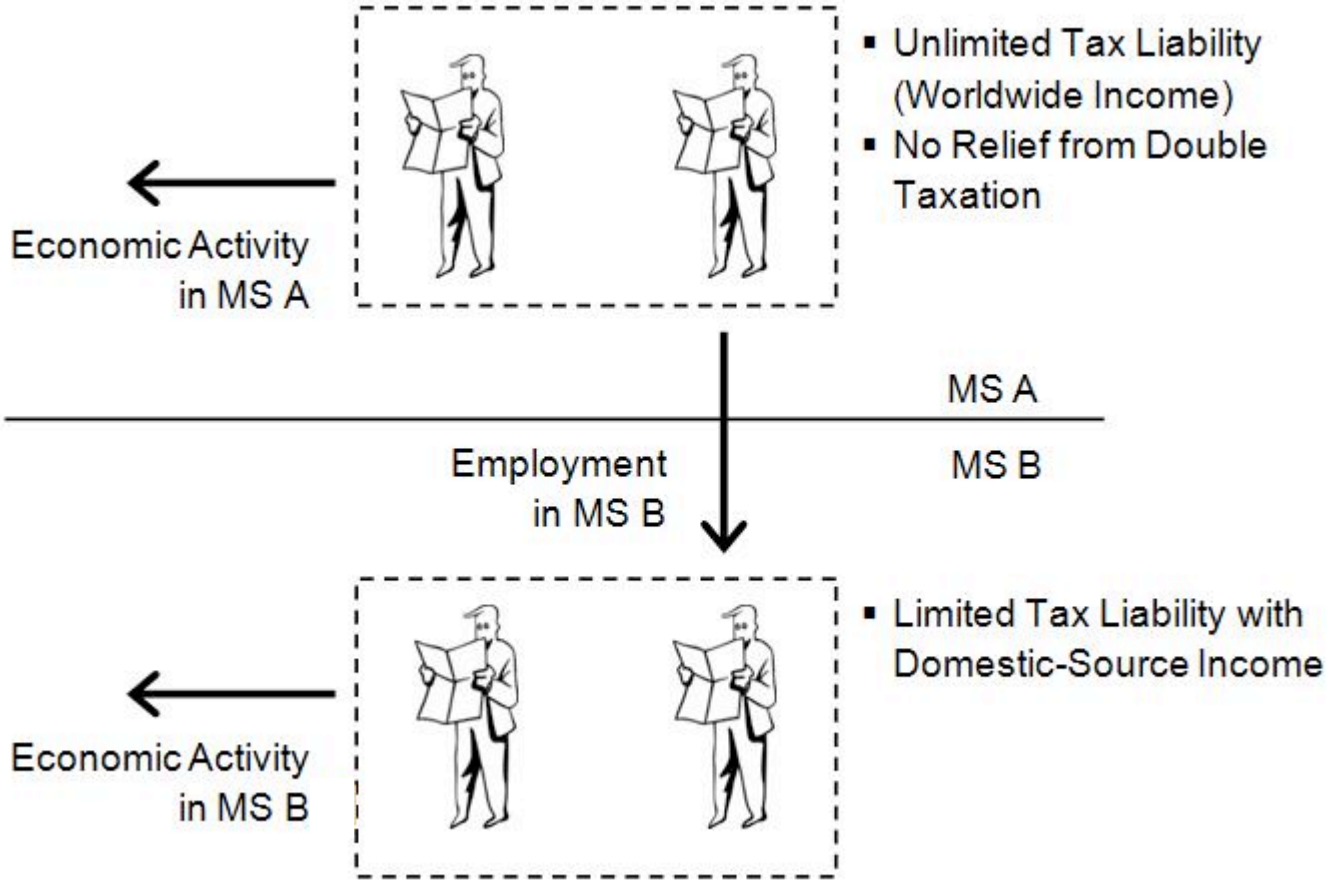
Disparities

- **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”?**



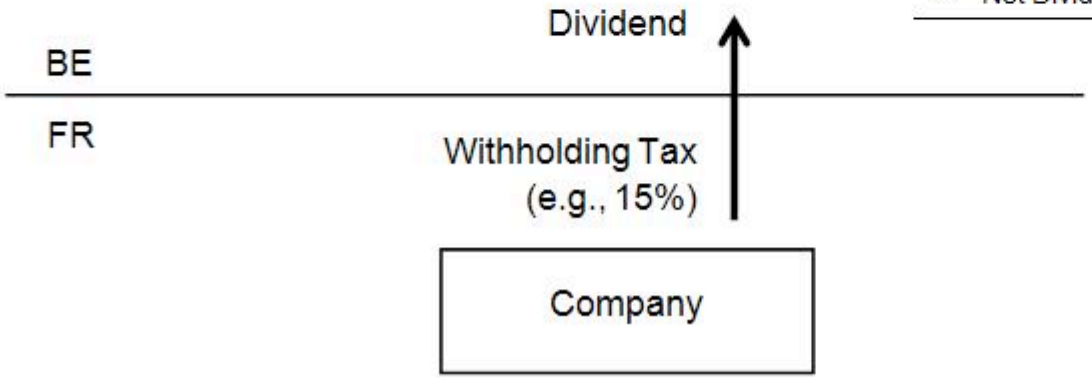
Juridical Double Taxation

- **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***, […]"
  - Deleted from end 2009 (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?

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)



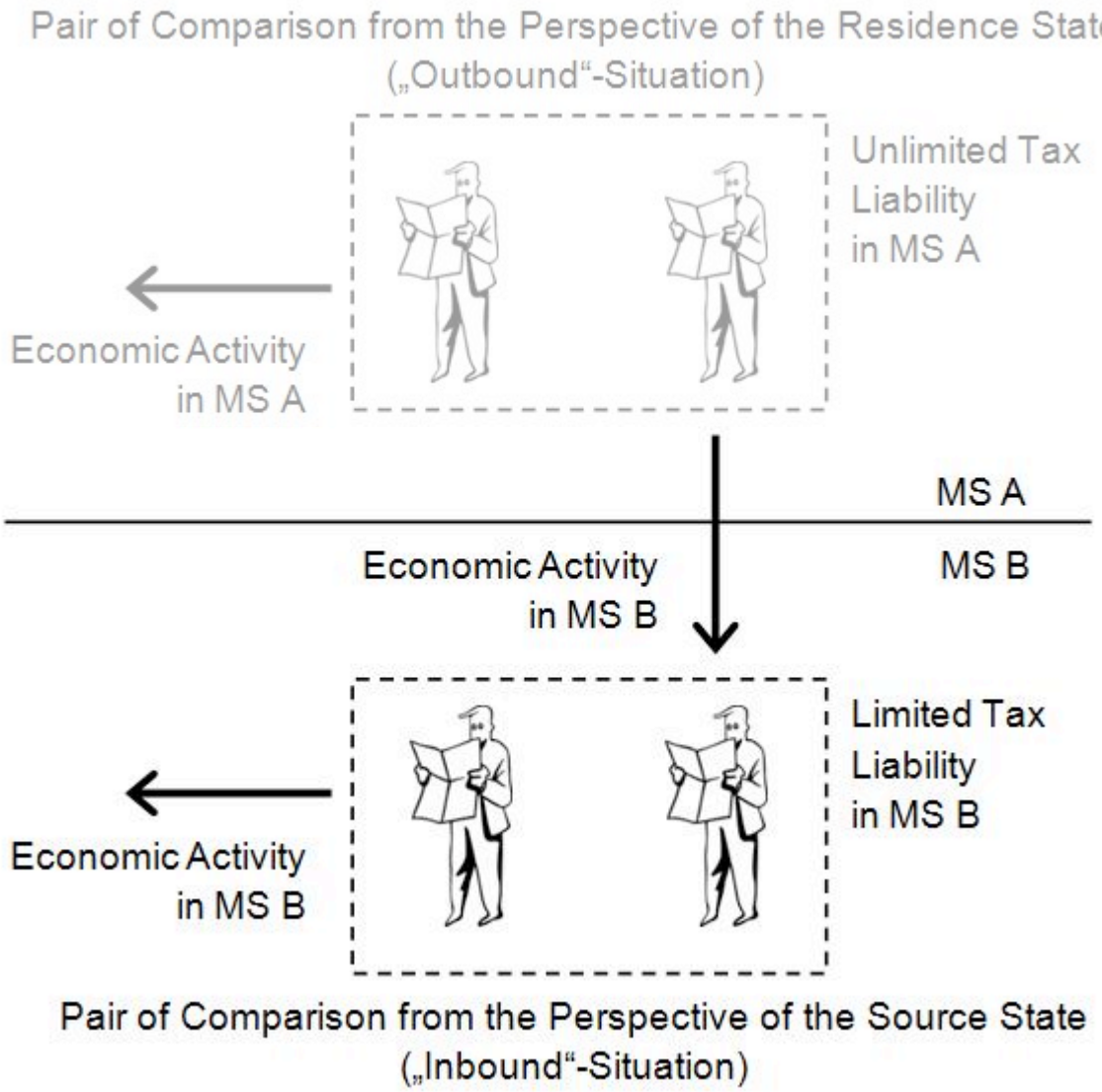
		Domestic Dividend	Inbound Dividend
	Gross Dividend	100	100
./.	Withholding Tax	—	(15)
=	Tax Base in Belgium	100	85
./.	Tax (25%)	(25)	(21,25)
./.	Credit for Foreign Withholding Tax	—	—
=	Tax in Belgium	25	21,25
=	Overall Tax	25	36,25
=	Net Dividend	75	63,75

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***
  - Withdrawn: C-307/08, ***Commission v. Belgium***

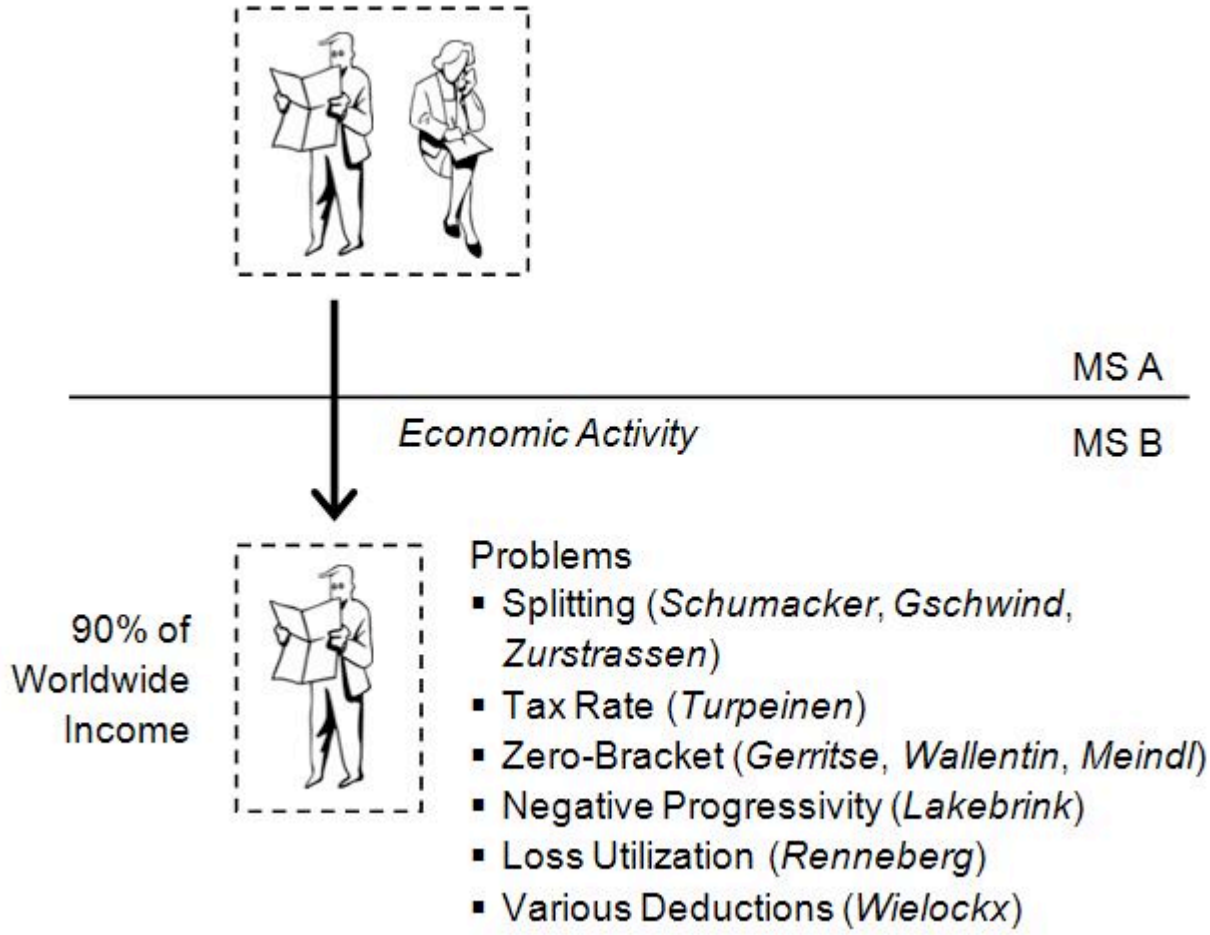
- ***Which Member State would have to Refrain from Taxation?***
  - Joint Liability of the Member States involved?
  - Identify the Infringing State → Efficiency, Equity, OECD-MC, exisiting DTC network, Treaty Override
  - Justification and (formerly) Art 293 EC
  - Procedural Issues

Inbound Situations



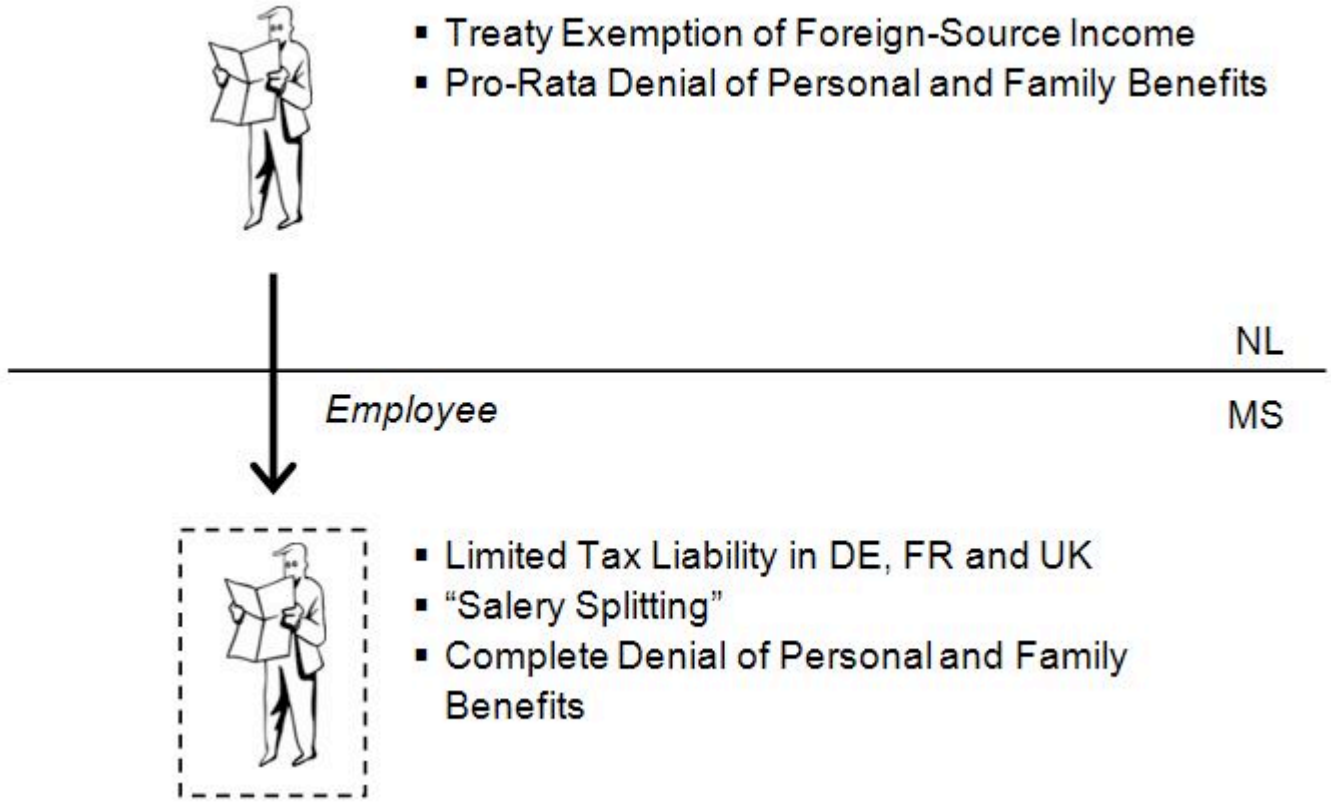
Inbound Situations – Subjective Ability to Pay

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



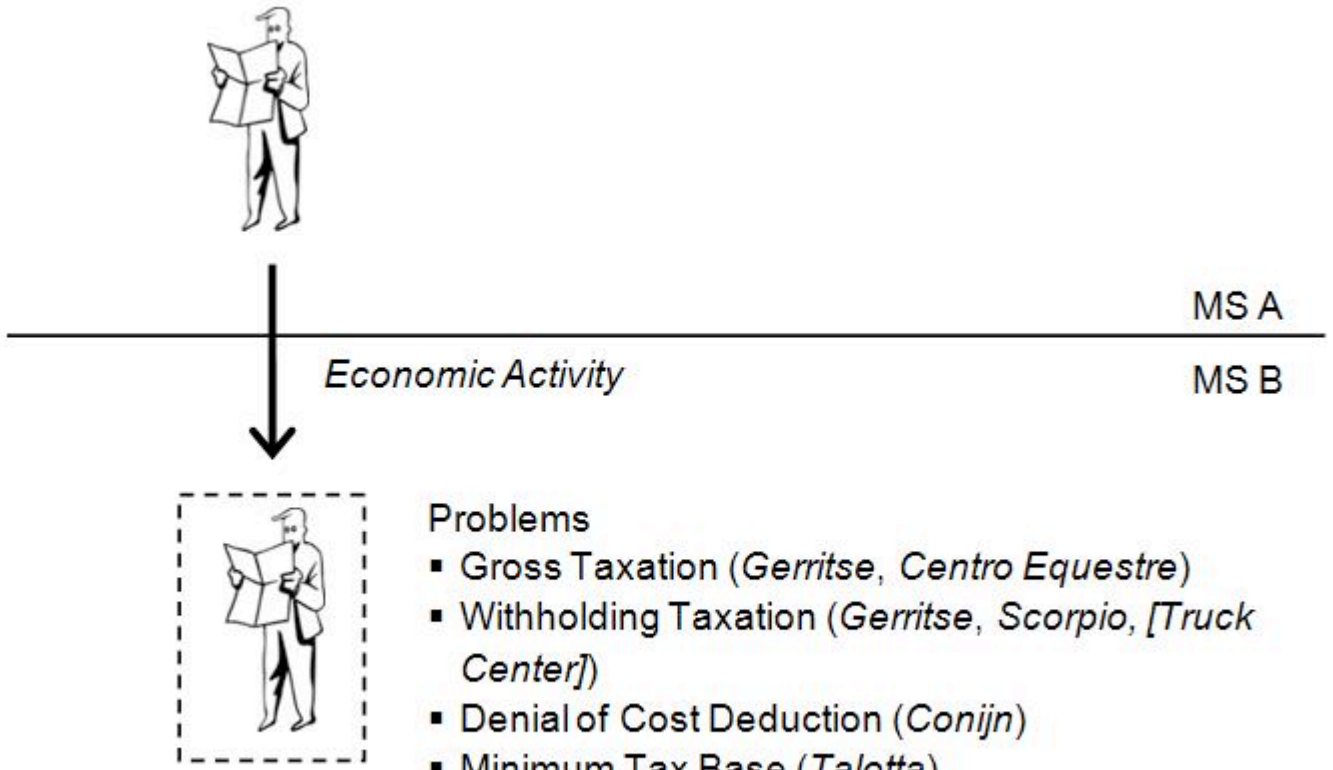
Inbound Situations – Subjective Ability to Pay

- **Personal and Family Circumstances: Subjective Ability to Pay** — ECJ, 12 December 2002, C-385/00, ***De Groot*** [2002] ECR I-11819 → ***Fractional Taxation as a solution for consistent treatment in both states? – needs coordination (DTCs?)***



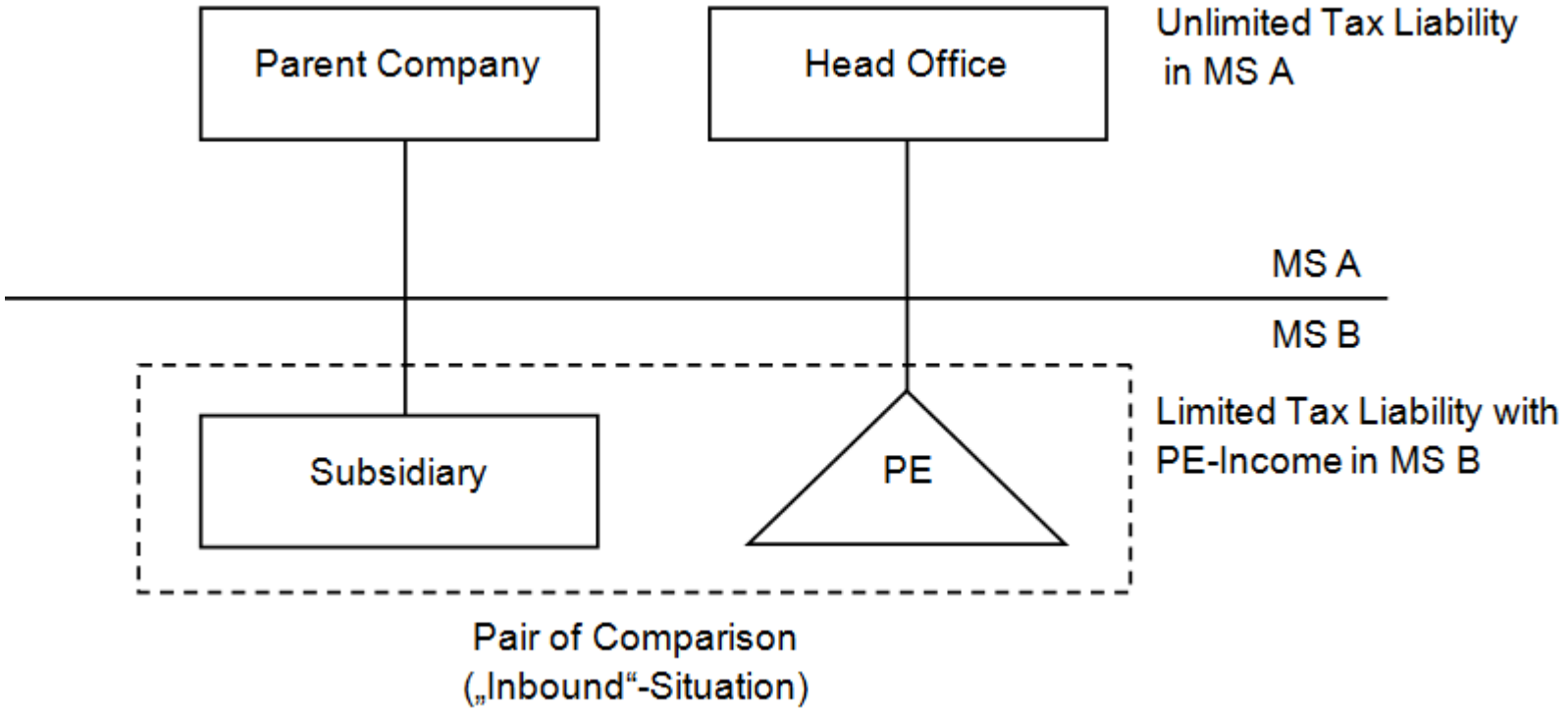
Inbound Situations – Objective Ability to Pay

- **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



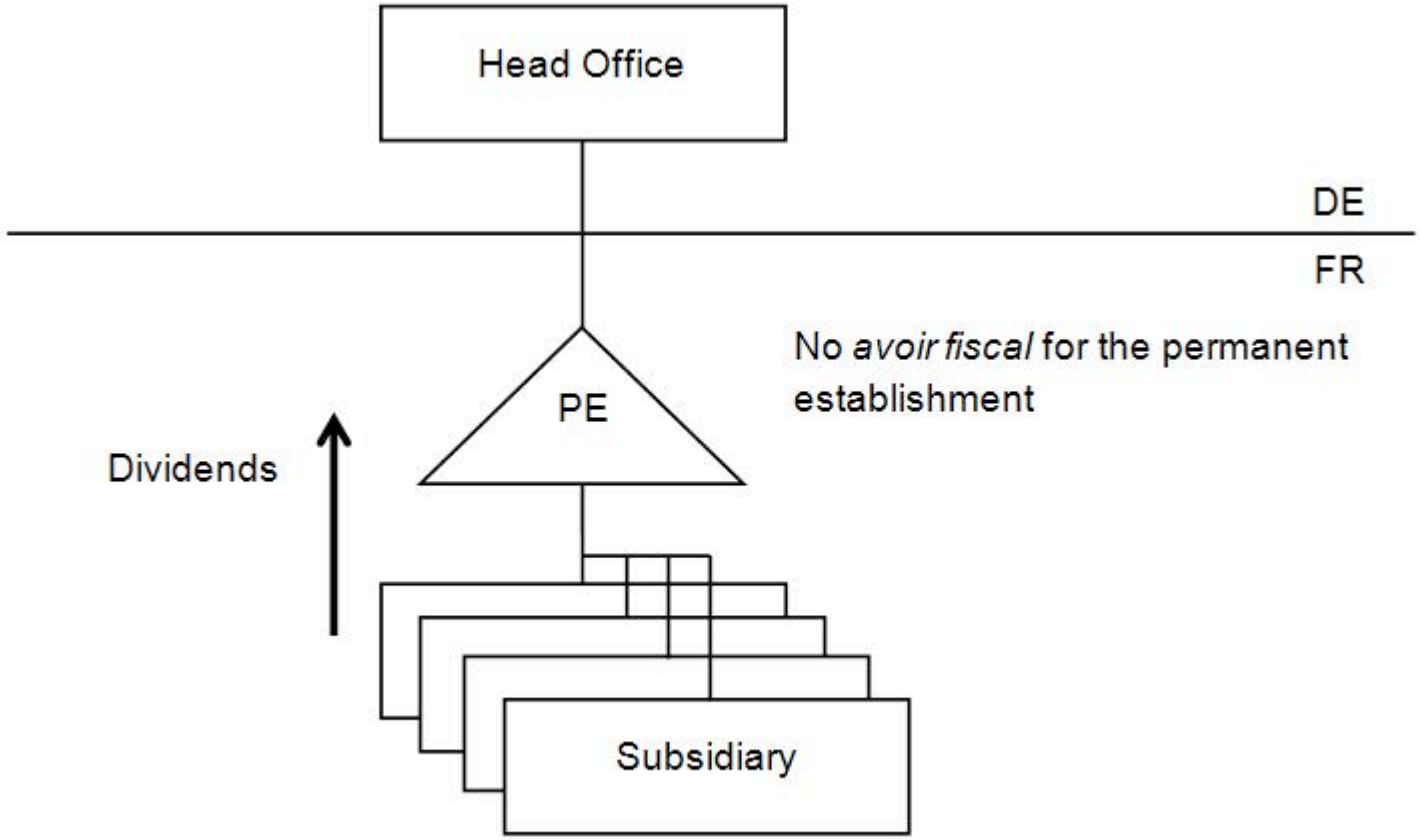
Inbound Situations – Objective Ability to Pay

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



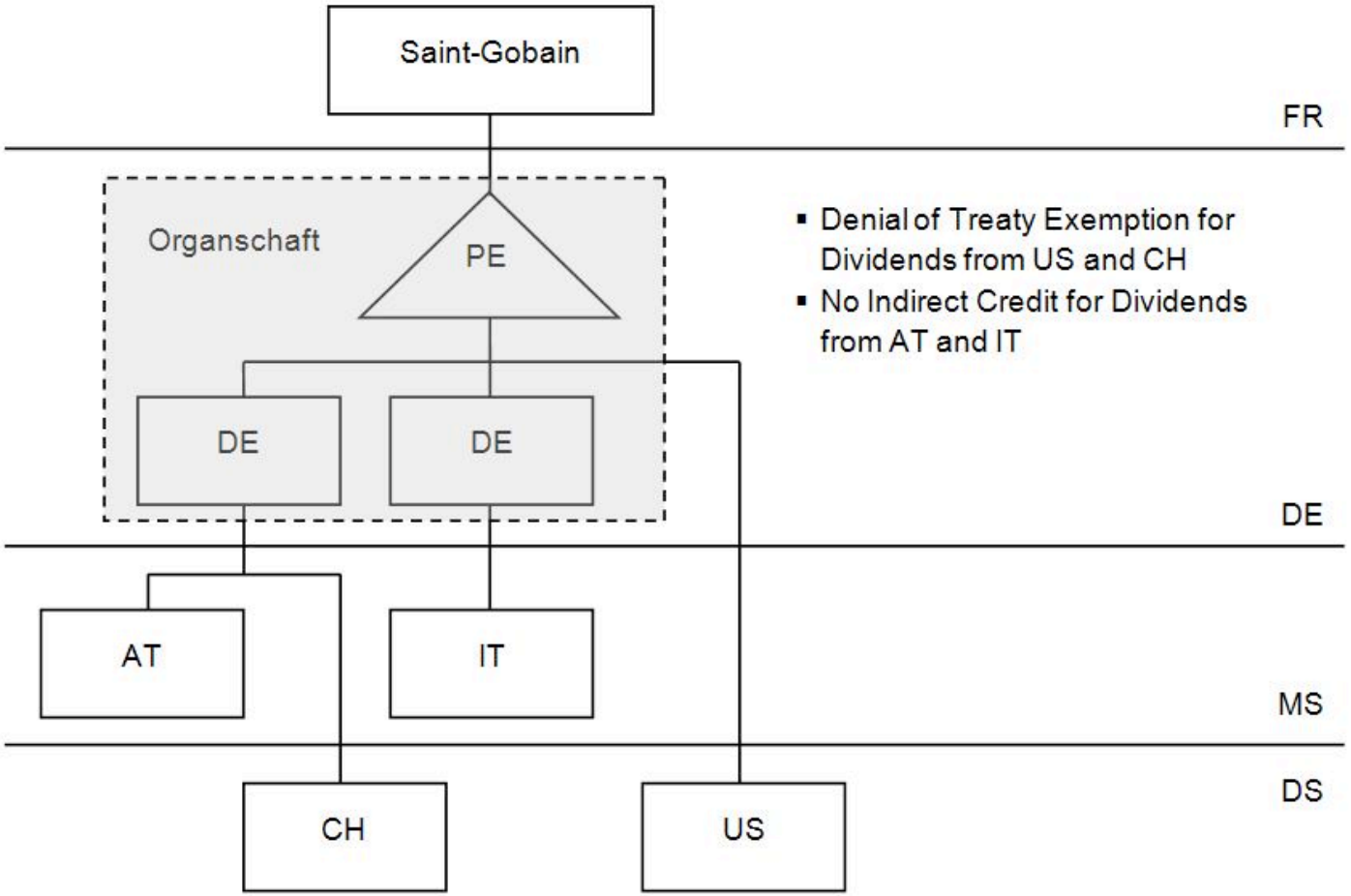
Inbound Situations – Objective Ability to Pay

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



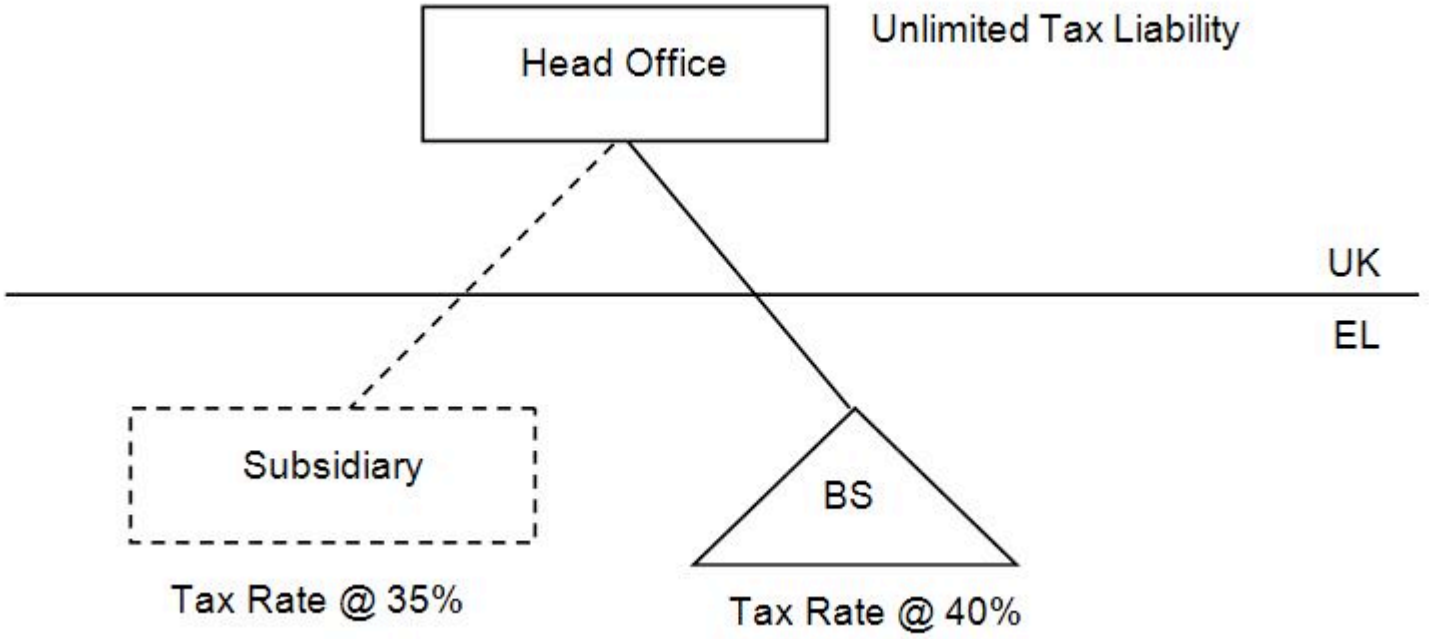
Inbound Situations – Objective Ability to Pay

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



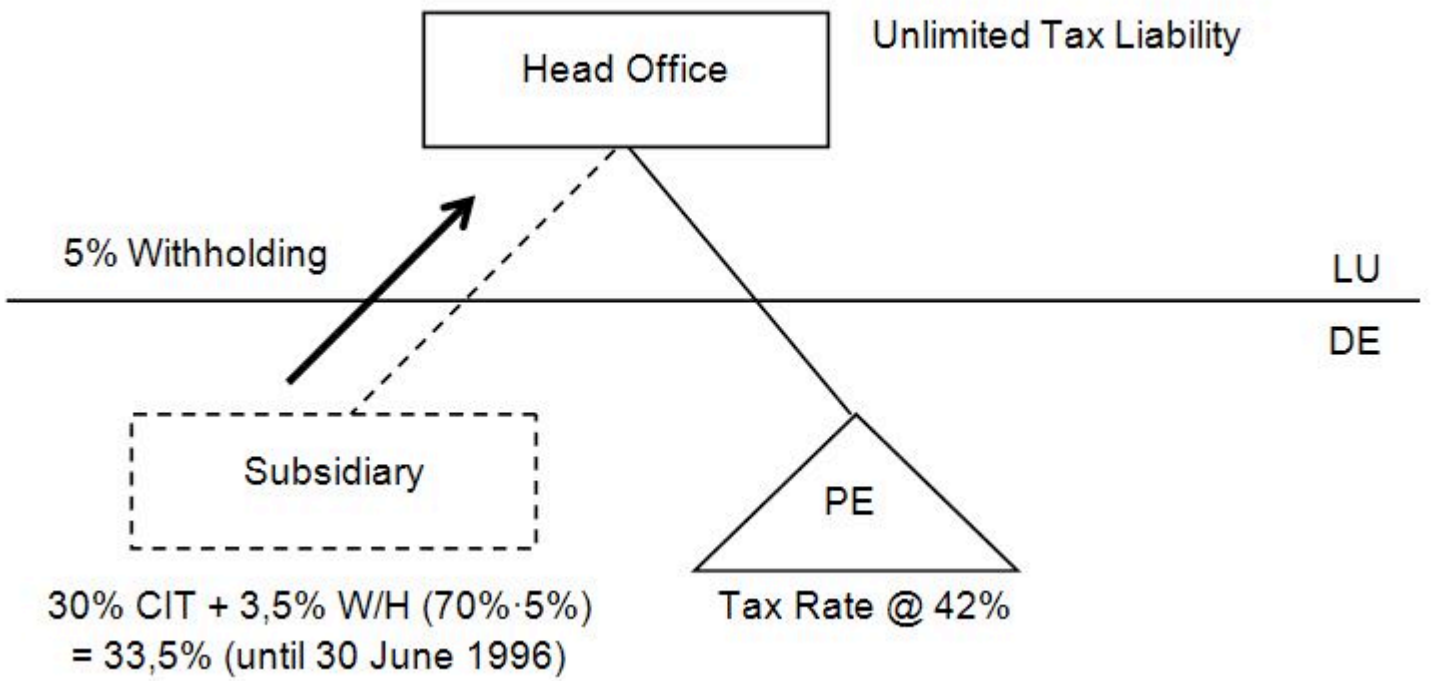
Inbound Situations – Objective Ability to Pay

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



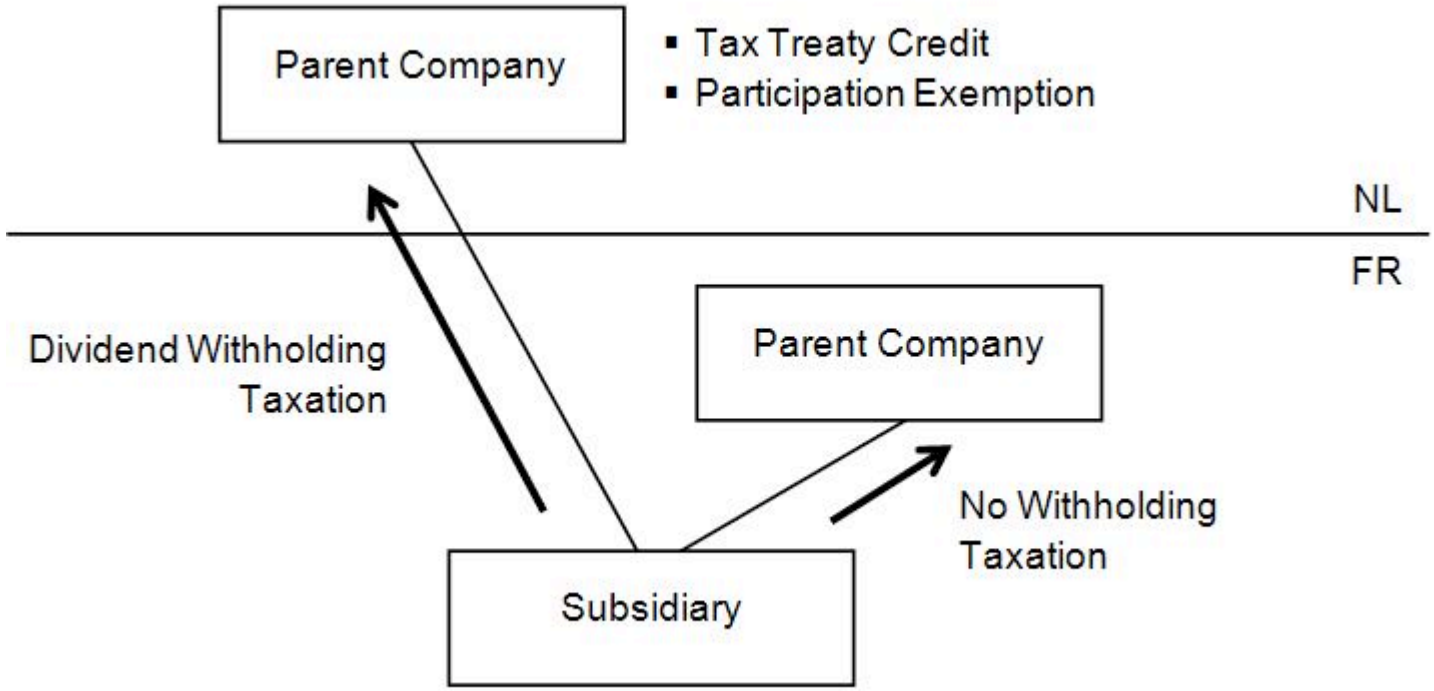
Inbound Situations – Objective Ability to Pay

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

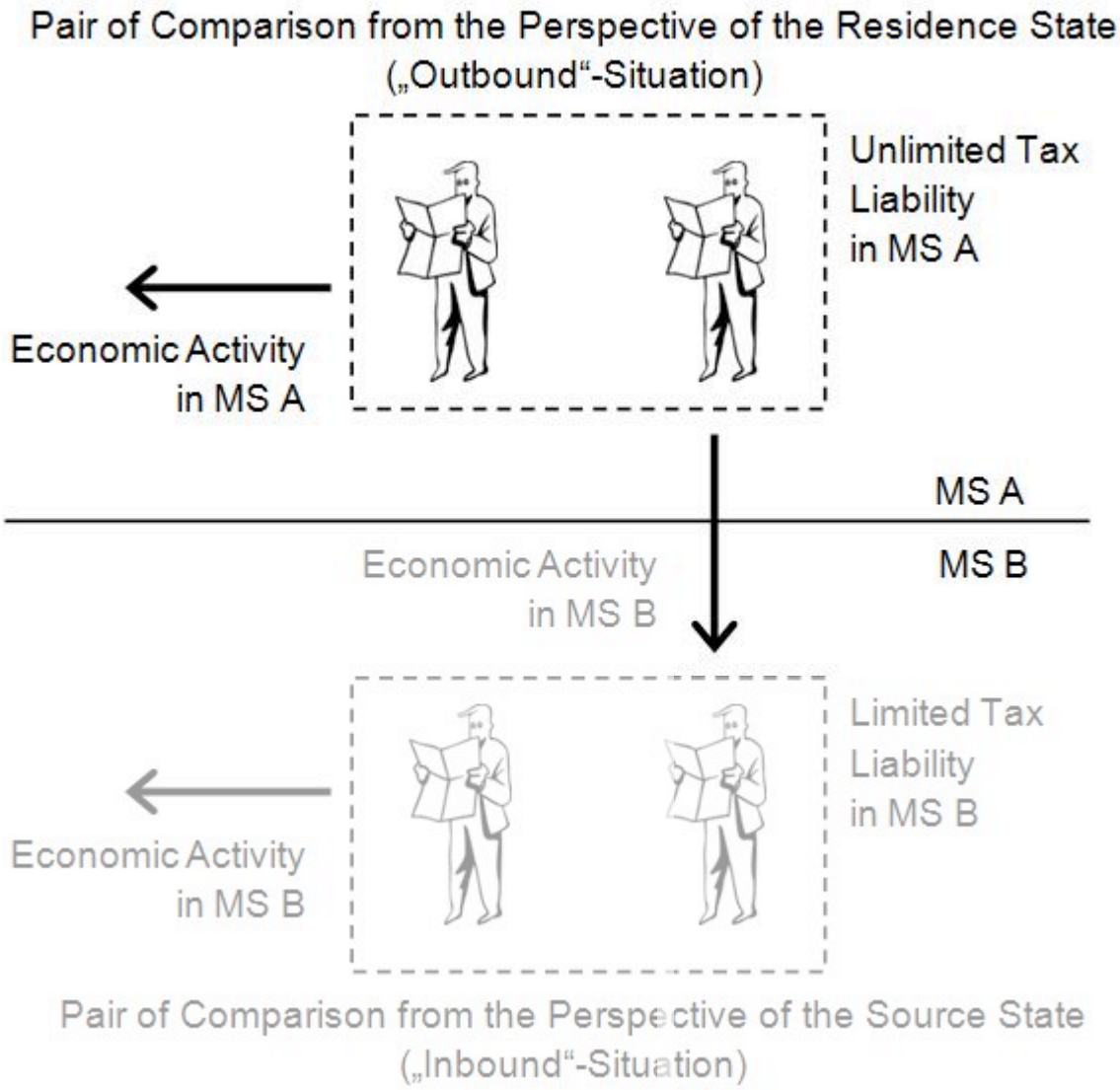


Inbound Situations – Objective Ability to Pay

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

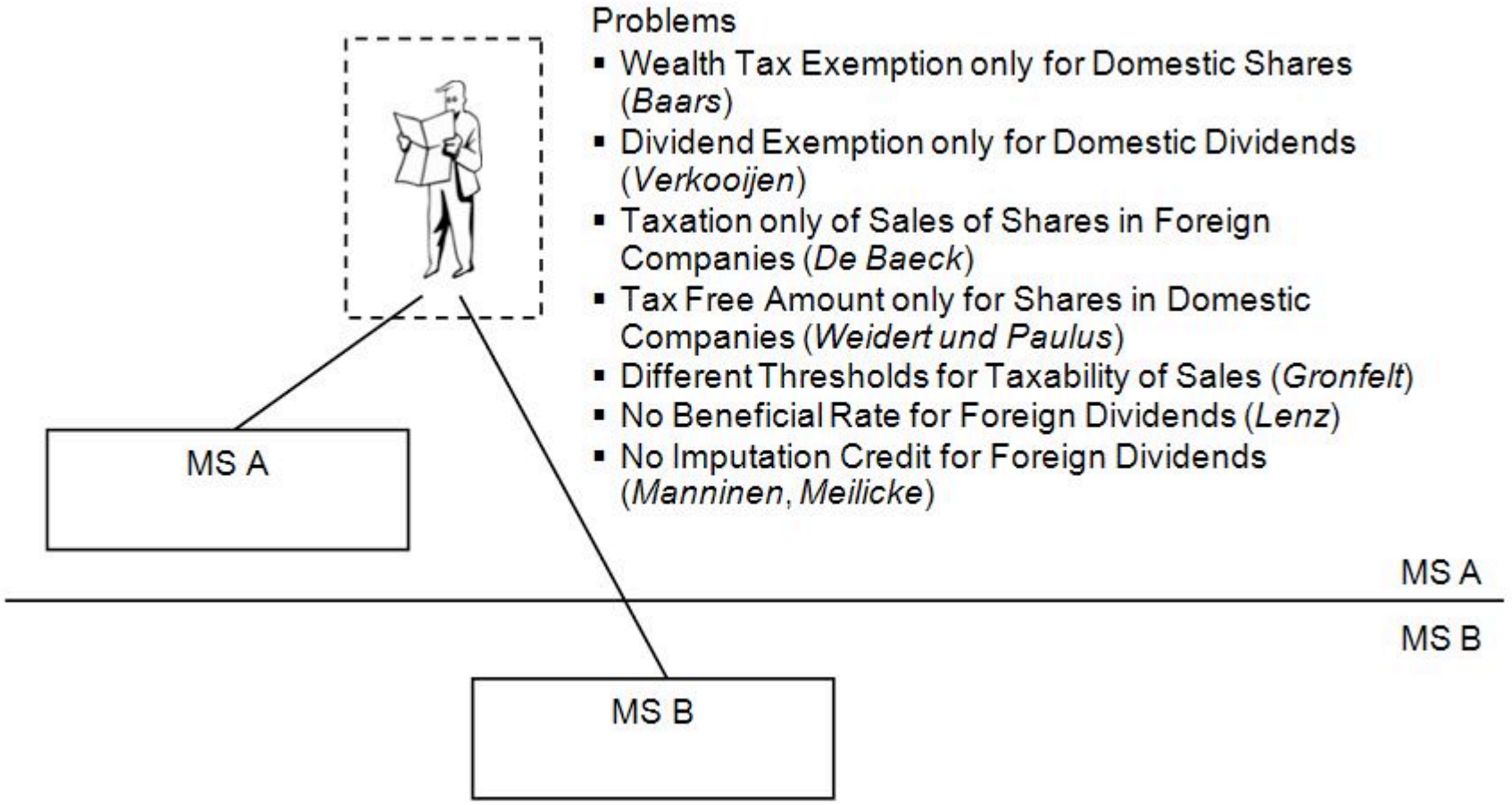


Outbound Situations



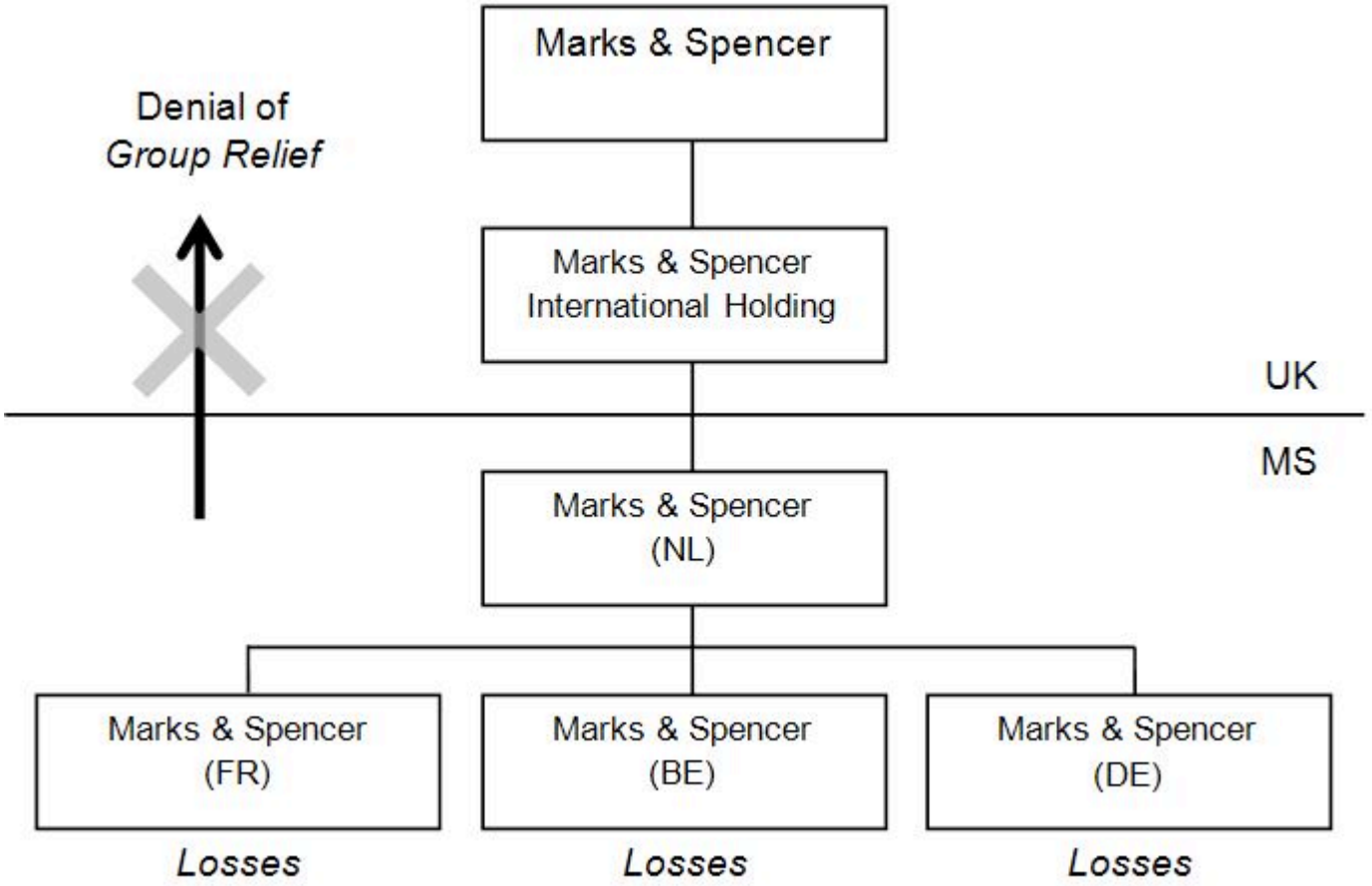
Outbound Situations

- **Holdings in Foreign Companies**



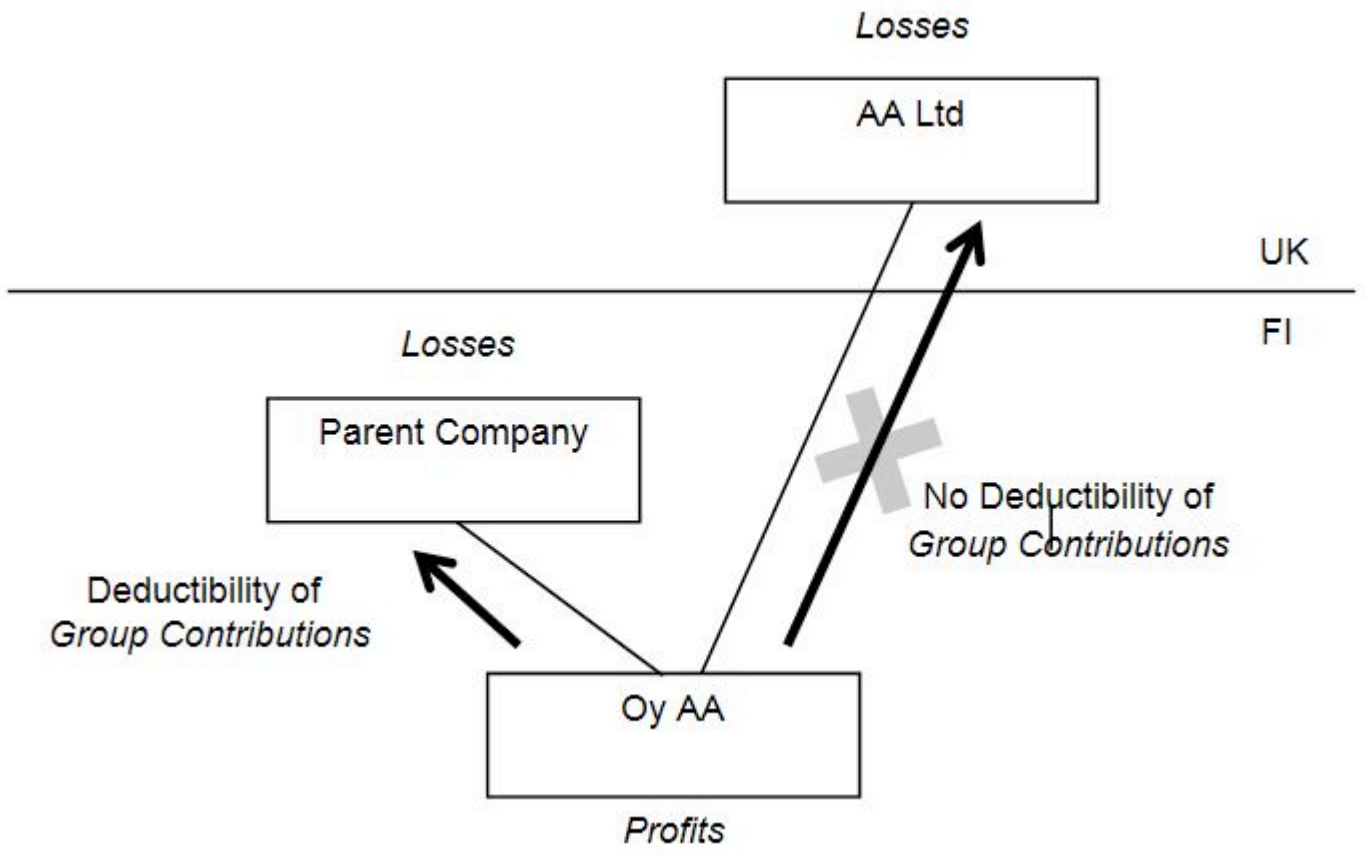
Outbound Situations

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



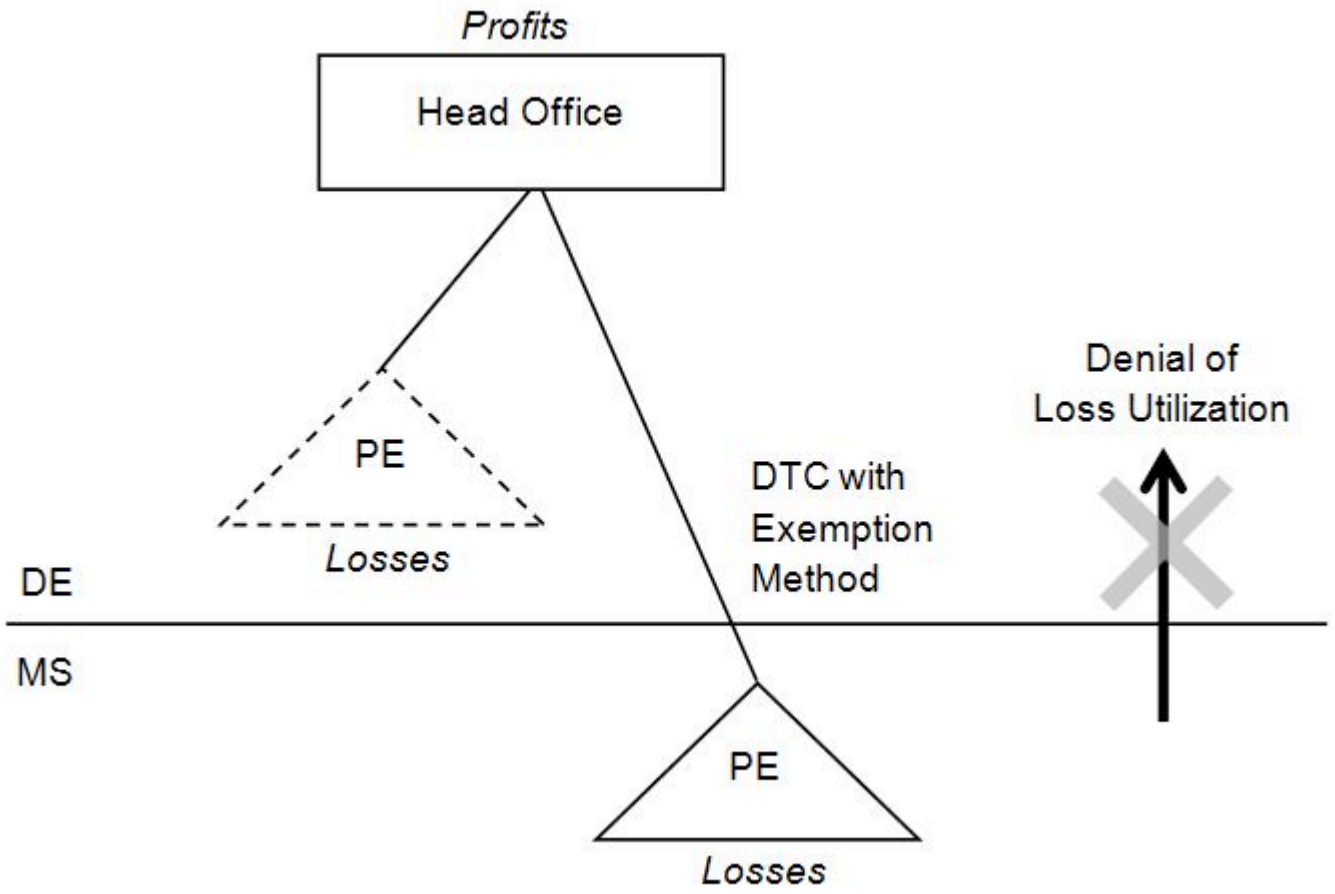
Outbound Situations

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



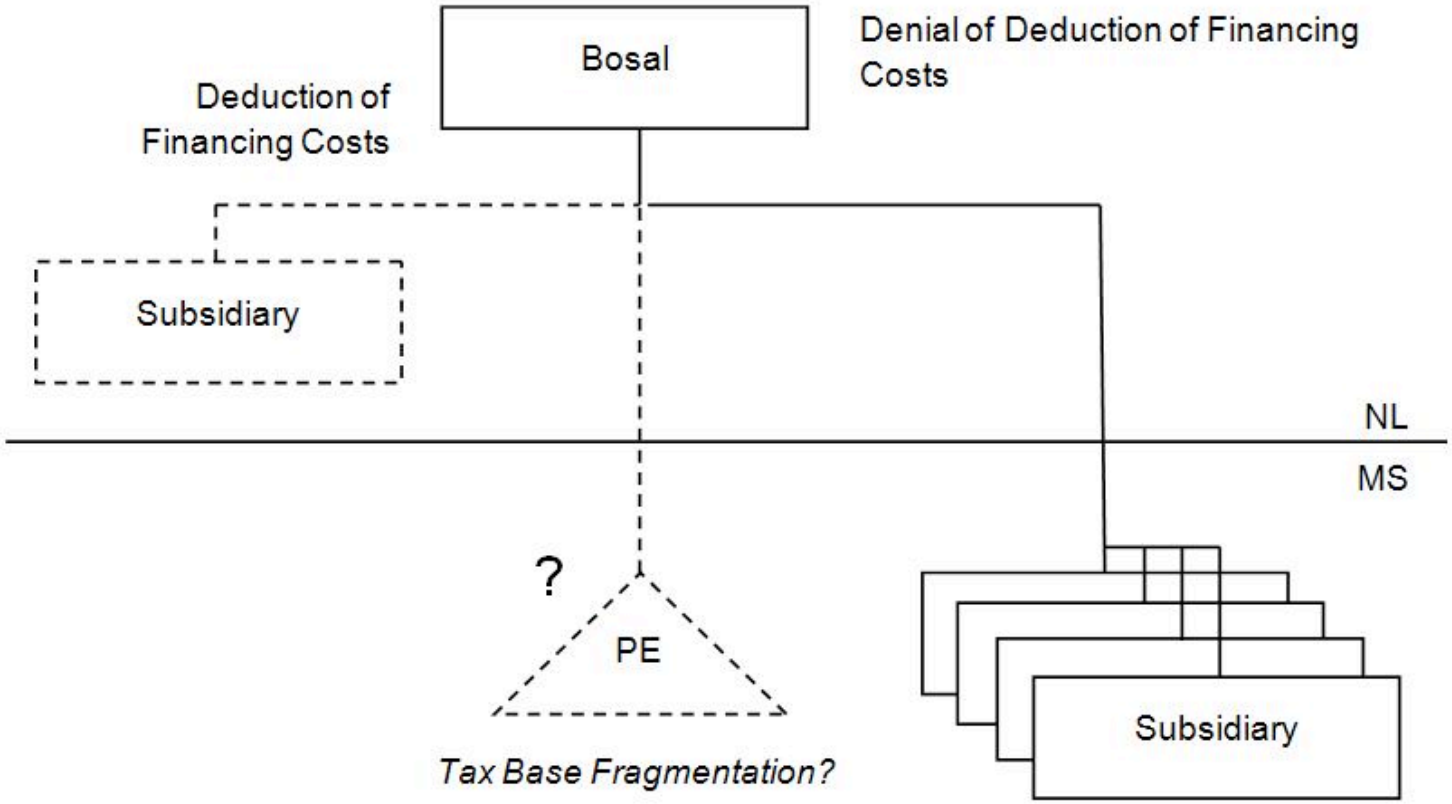
Outbound Situations

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



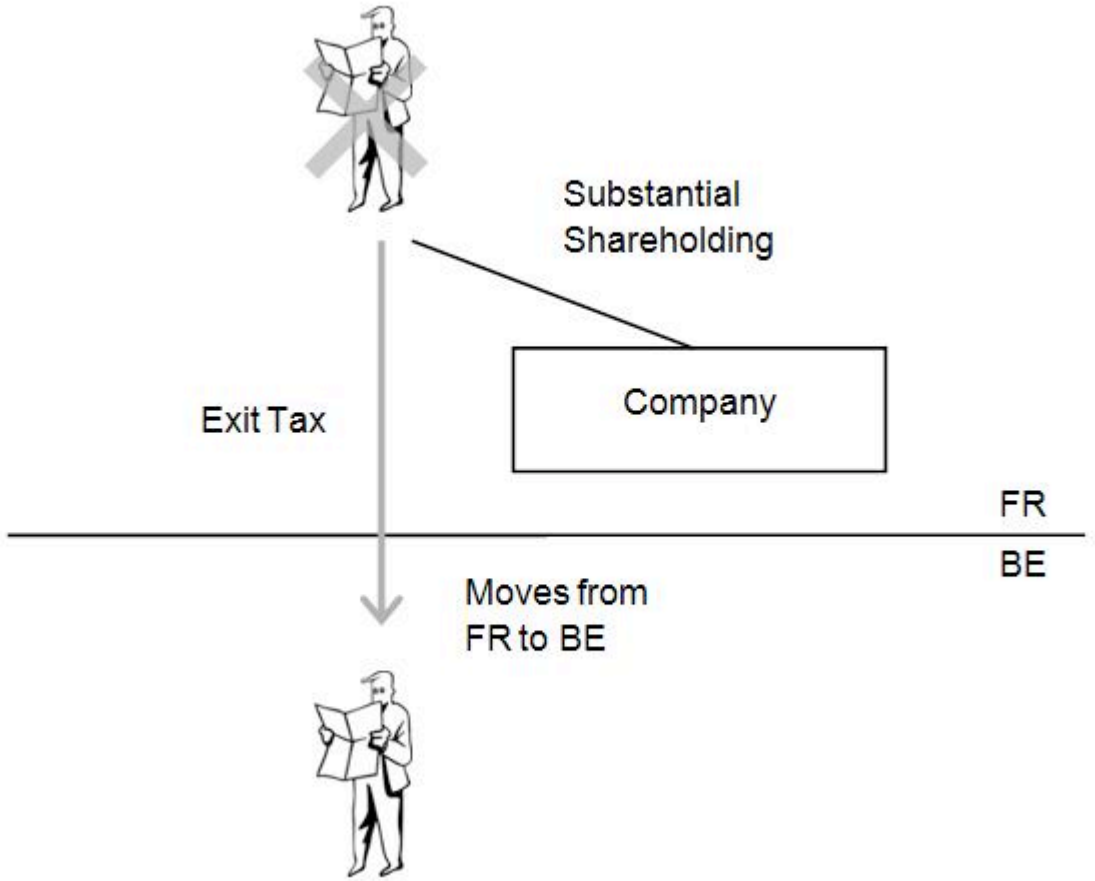
Outbound Situations

- **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: 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

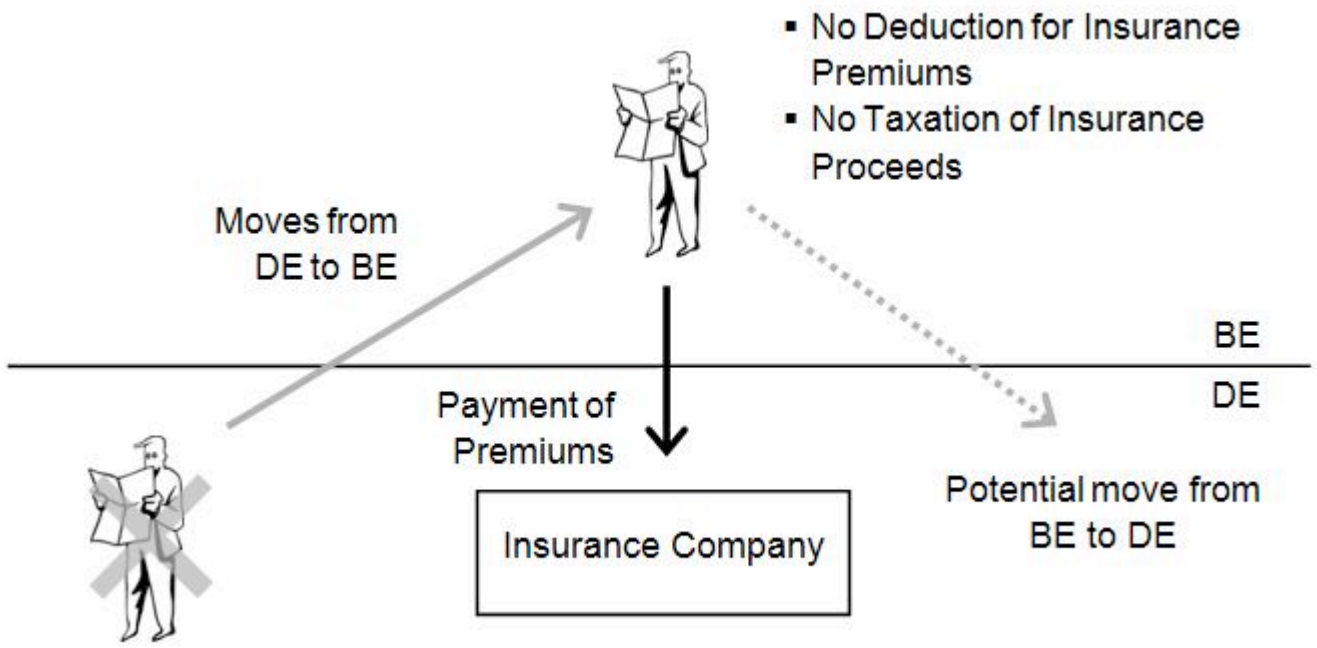


Justifications

- **Explicit: Public policy, security and health (e.g. Art 45 (3) TFEU)**
- **Implicit: "Rule of reason"**
  - Non-discriminatory
  - Overriding requirement of general interest
  - Suitable
  - Necessary
- **Coherence of the Tax System**
  - *Bachmann, Commission v. Belgium, Wielockx*
  - *Krankenheim, Papillon*
- **Anti-Avoidance**
  - *Cadbury Schweppes, Thin Cap Group Litigation*
- **Effectiveness of fiscal supervision / tax collection**
  - *Futura Participations, Scorpio*
- **Balanced allocation of taxing power**
  - *Marks & Spencer plc, Oy AA, Lidl Belgium, X Holding*

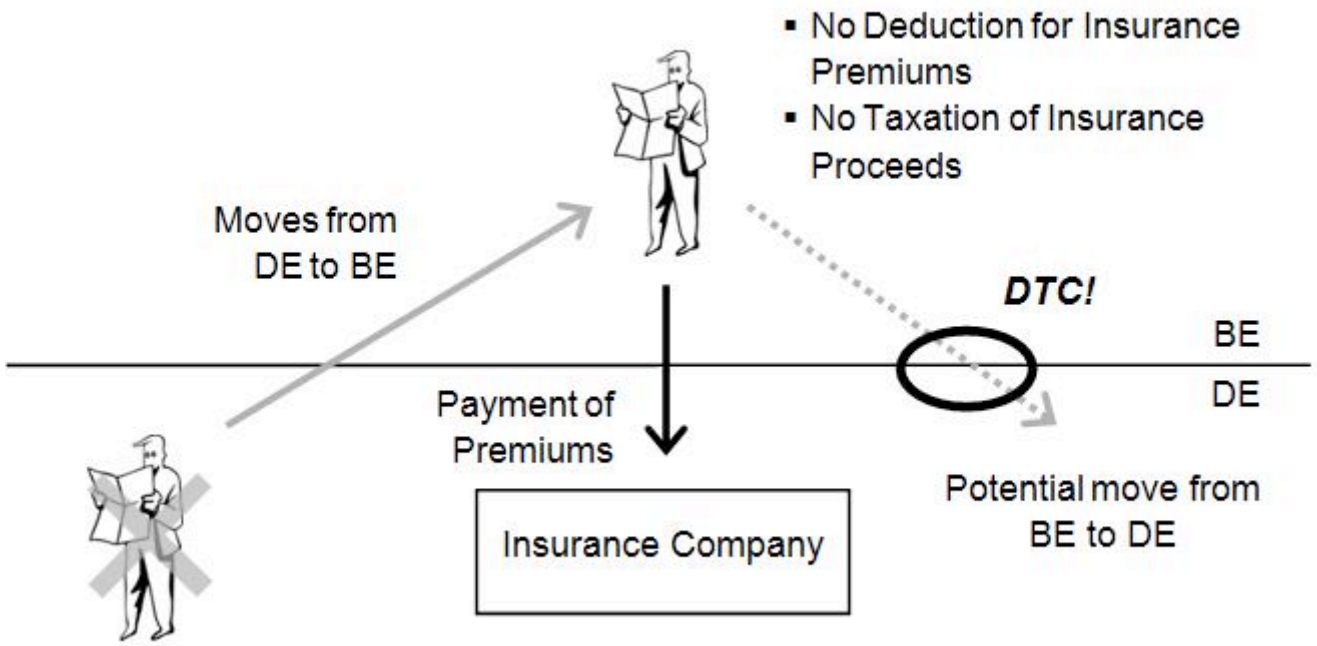
Justifications

- **Coherence of the Tax System —** ECJ, 28 January 1992, C-204/90, ***Bachmann*** [1992] ECR I-249, and ECJ 28 Januar 1992, C-300/90, ***Commission v. Belgium*** [1992] ECR I-305



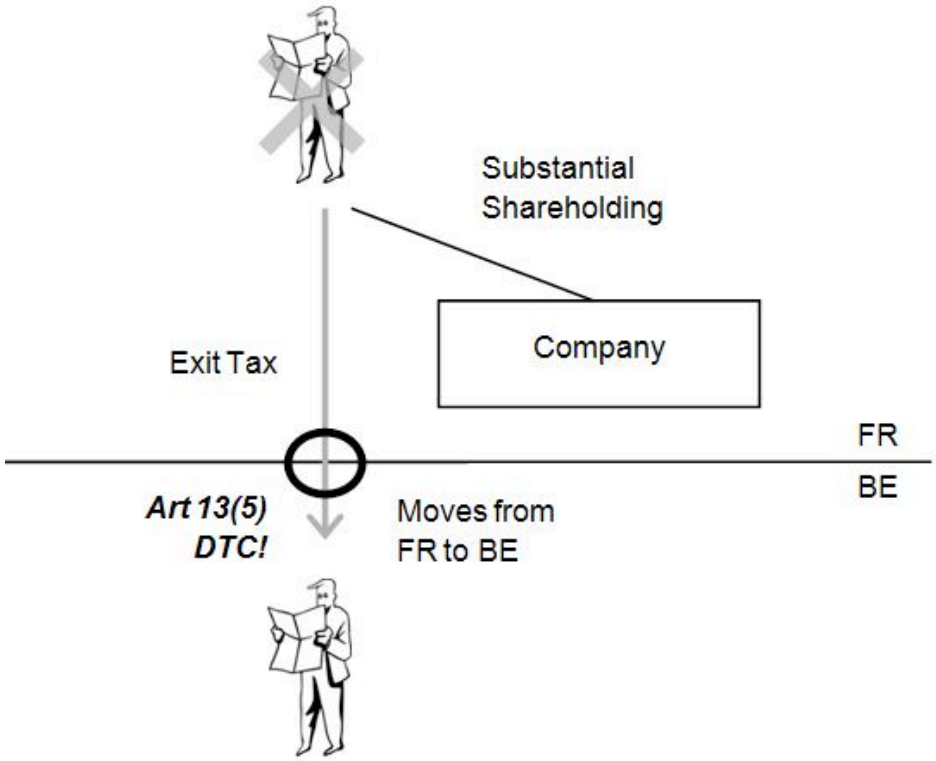
Justifications

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



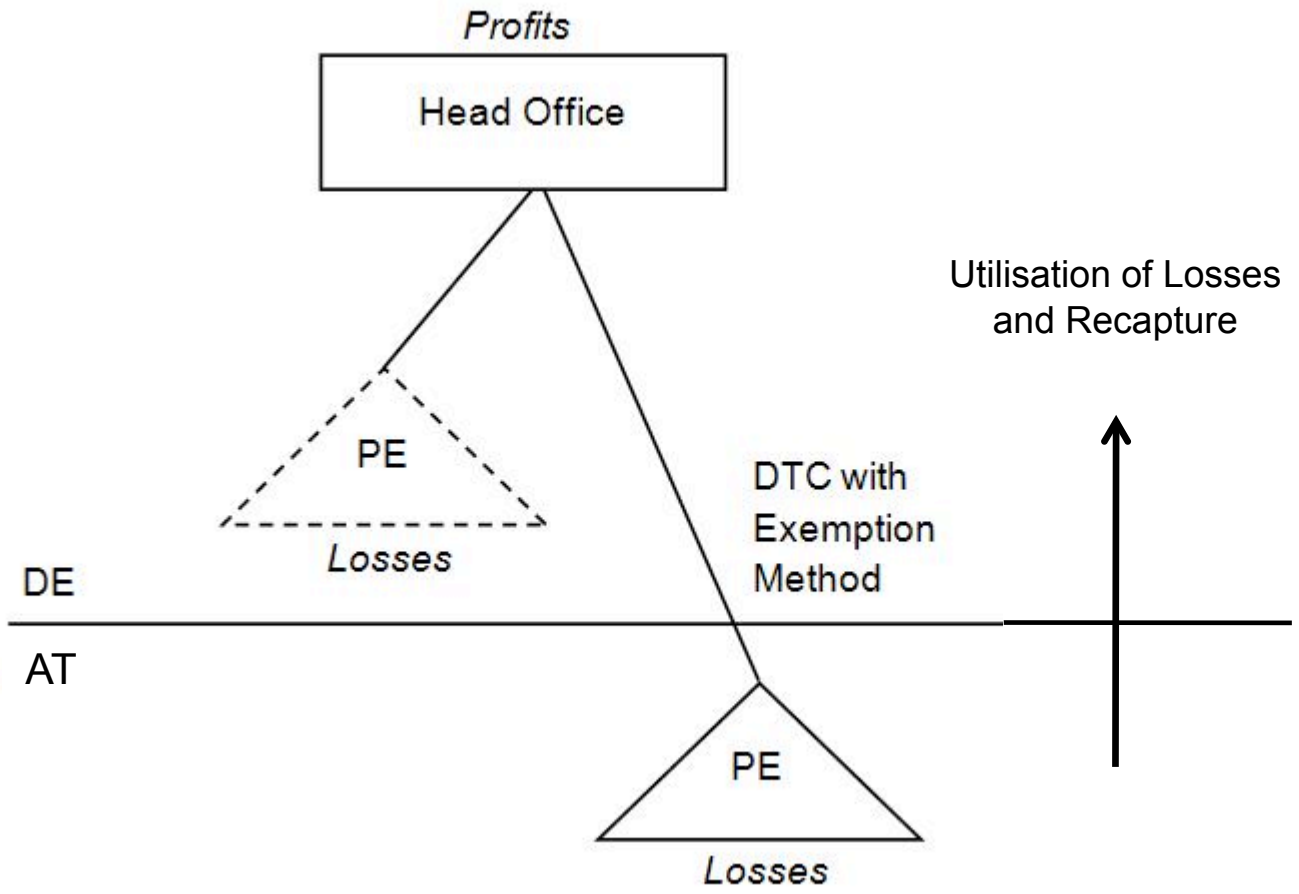
Justifications

- **"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



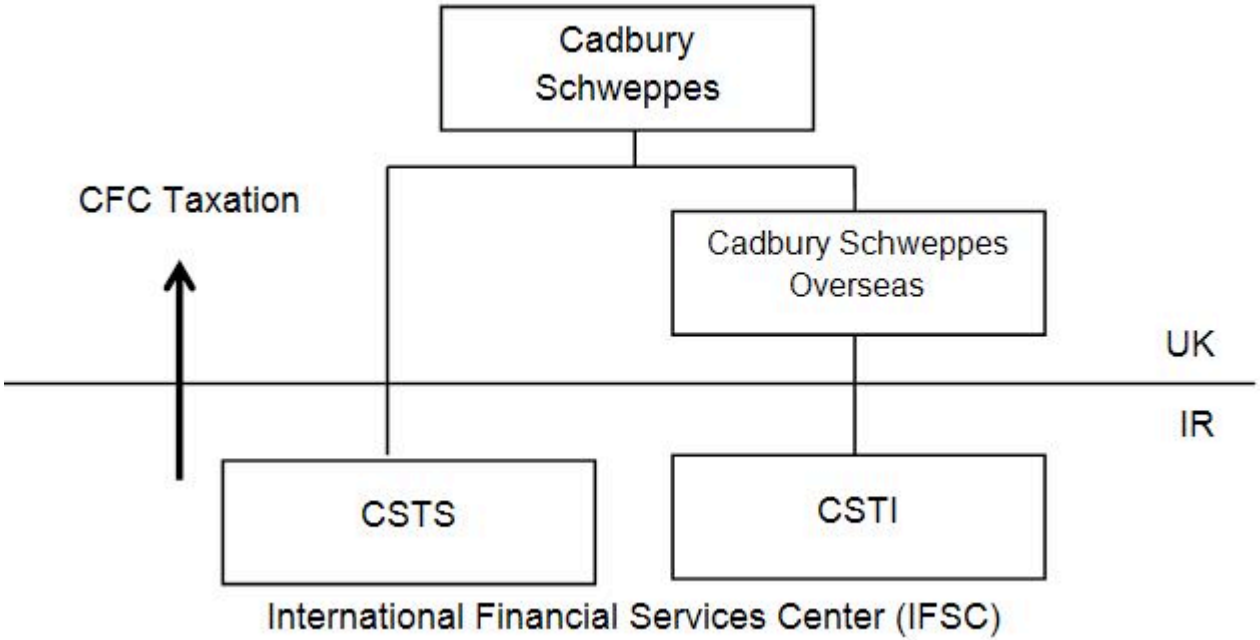
Justifications

- **Coherence of the tax system** — ECJ, 23 October 2008, C-157/07, ***Krankenheim Ruhesitz am Wannsee Seniorenheimstatt GmbH***



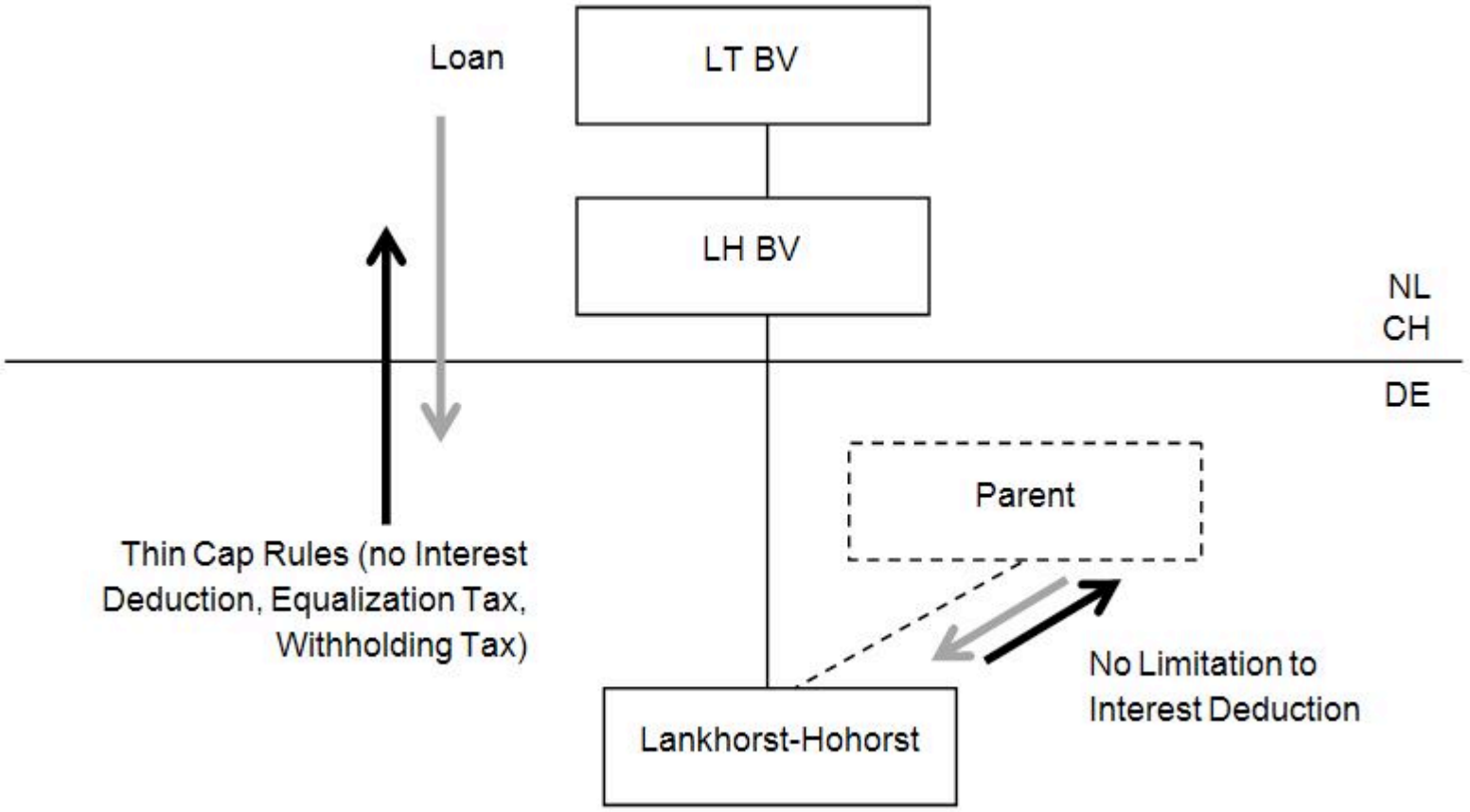
Justifications

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



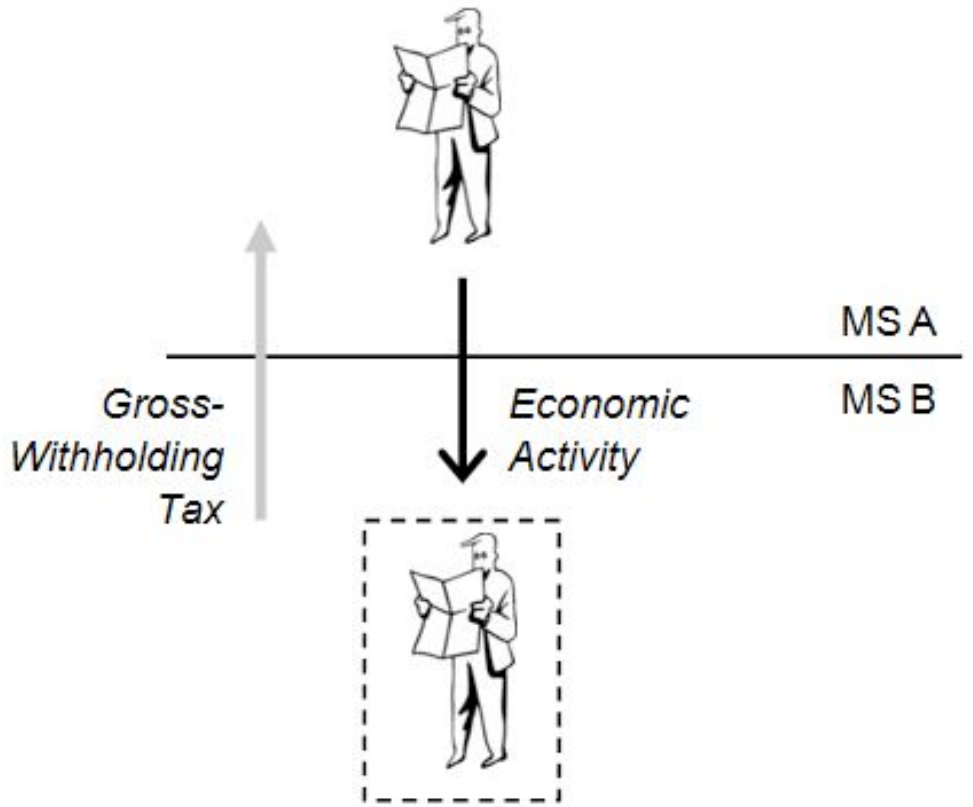
Justifications

- **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



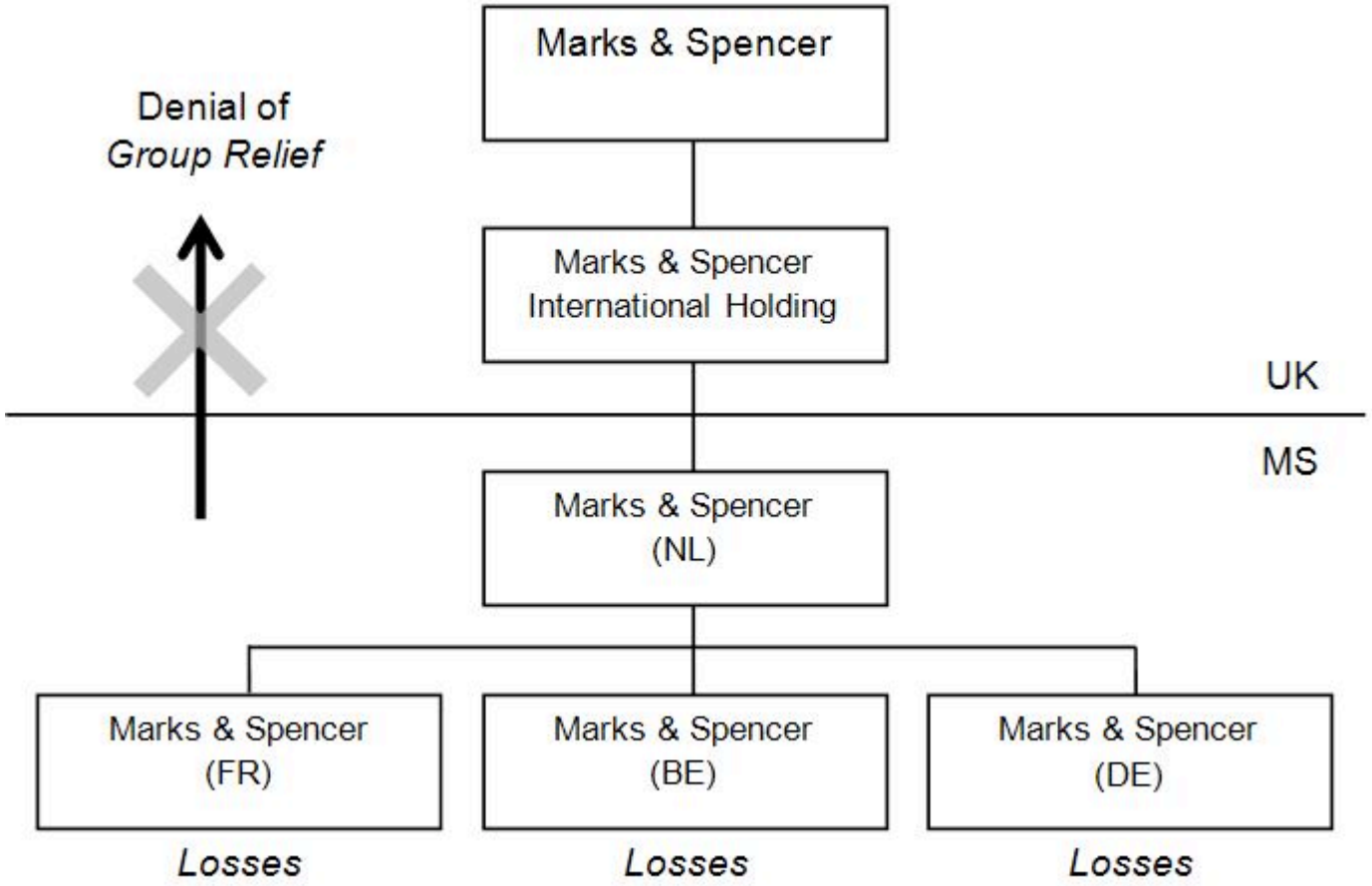
Justifications

- **Effectiveness of Fiscal Supervision/Tax Collection —** ECJ 15 May 1997, C-250/95, ***Futura Participations*** [1997] ECR I-2471; ECJ, 3 October 2006, C-290/04, ***Scorpio*** [2006] ECR I-9461 → ***Impact of Mutual Assistance and Recovery Directives?***



Justifications

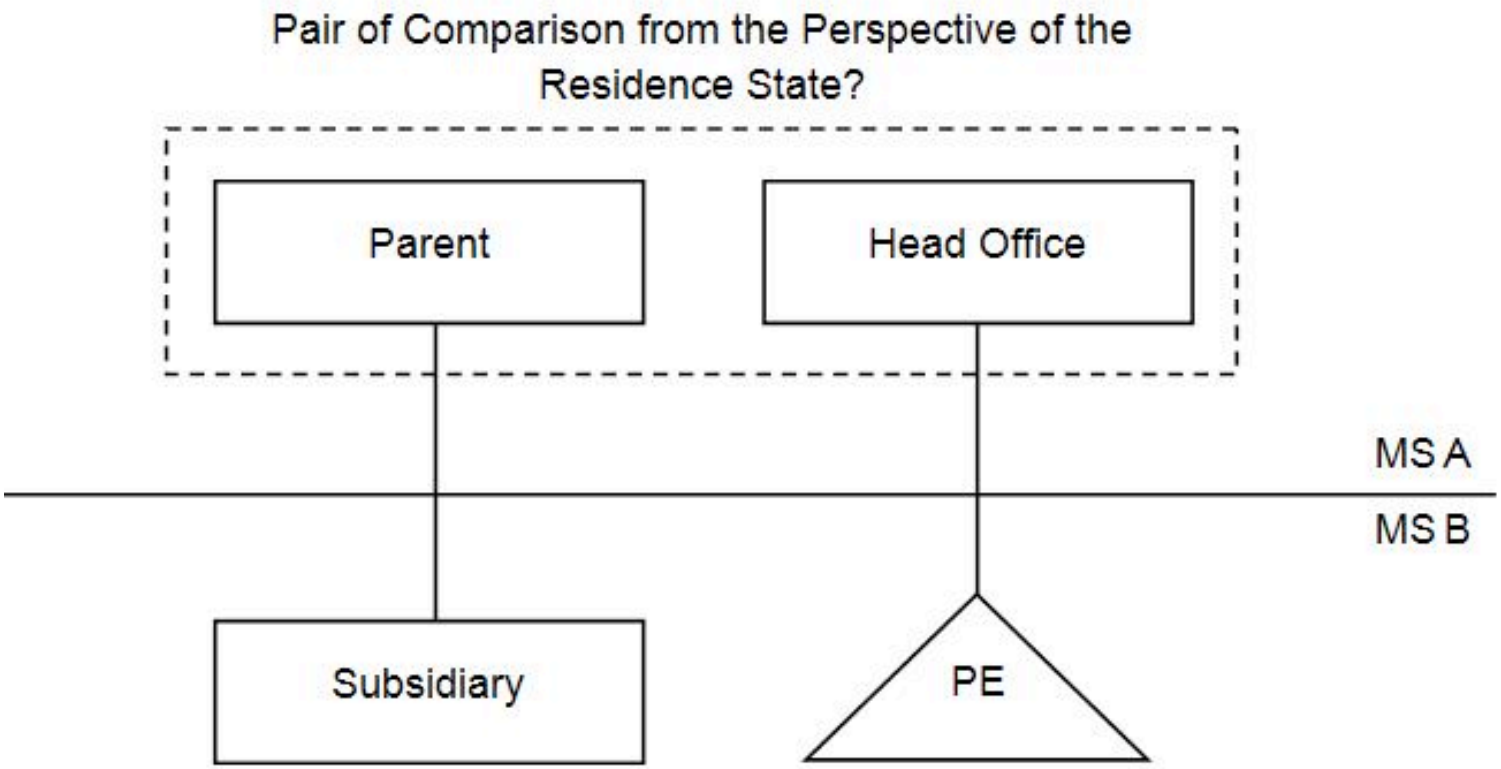
- **Balanced Allocation of Taxing Rights ("Inter-Nation Equity") —** ECJ 5 July 2005, C-376/03, ***D*** [2005] ECR I-5821; ECJ 13 December 2005, C-446/03, ***Marks & Spencer*** [2005] ECR I-10837; ECJ 21 January 2010, C-311/08, ***SGI***; ECJ 25 February 2010, C-337/08, ***X Holding***.



Recent Issues

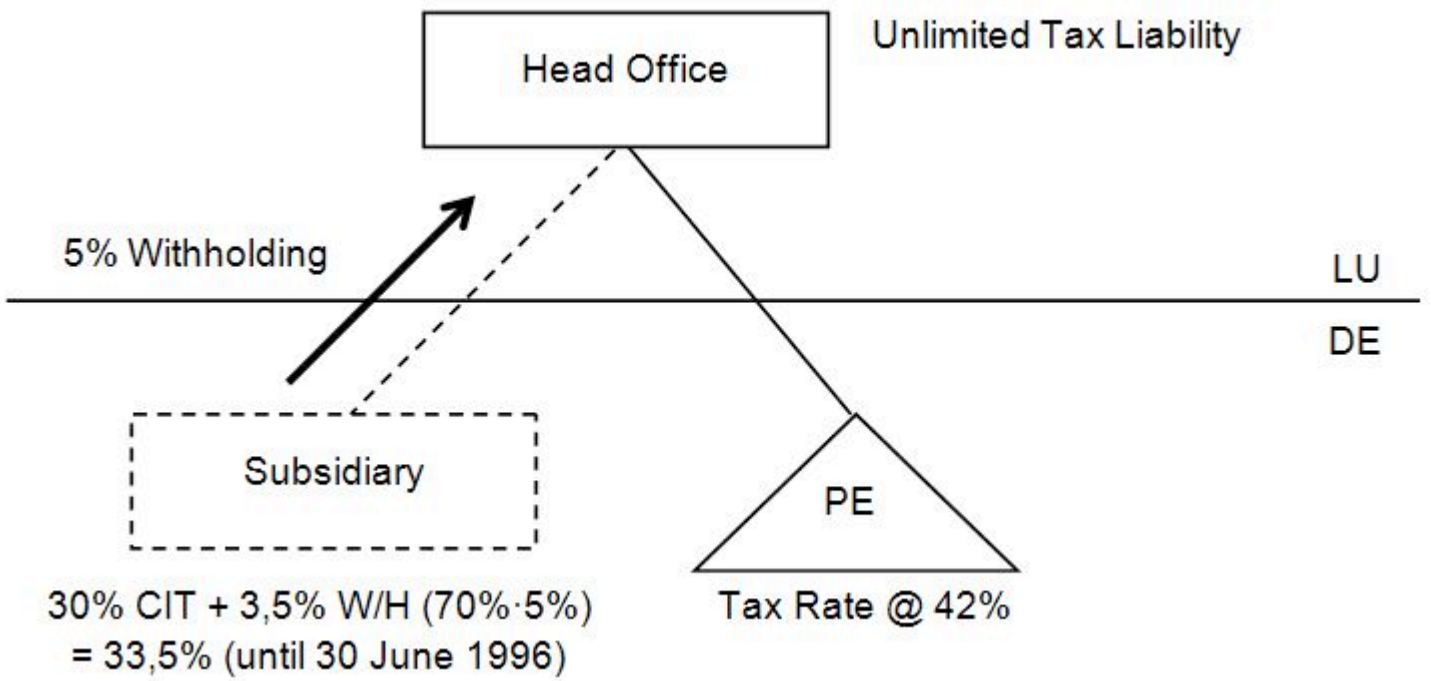
- **Horizontal Discrimination**
  - **Neutrality of the Legal Form**
- **Symmetry and Tax Base Fragmentations**
- **Internal Consistency versus Discrimination**
- **“Single Country” versus “Overall Approach”**
  - **Factual Situations and Comparability** (*Schumacker*, *Marks & Spencer*, *Manninen*)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

Recent Issues – Neutrality of Legal Form



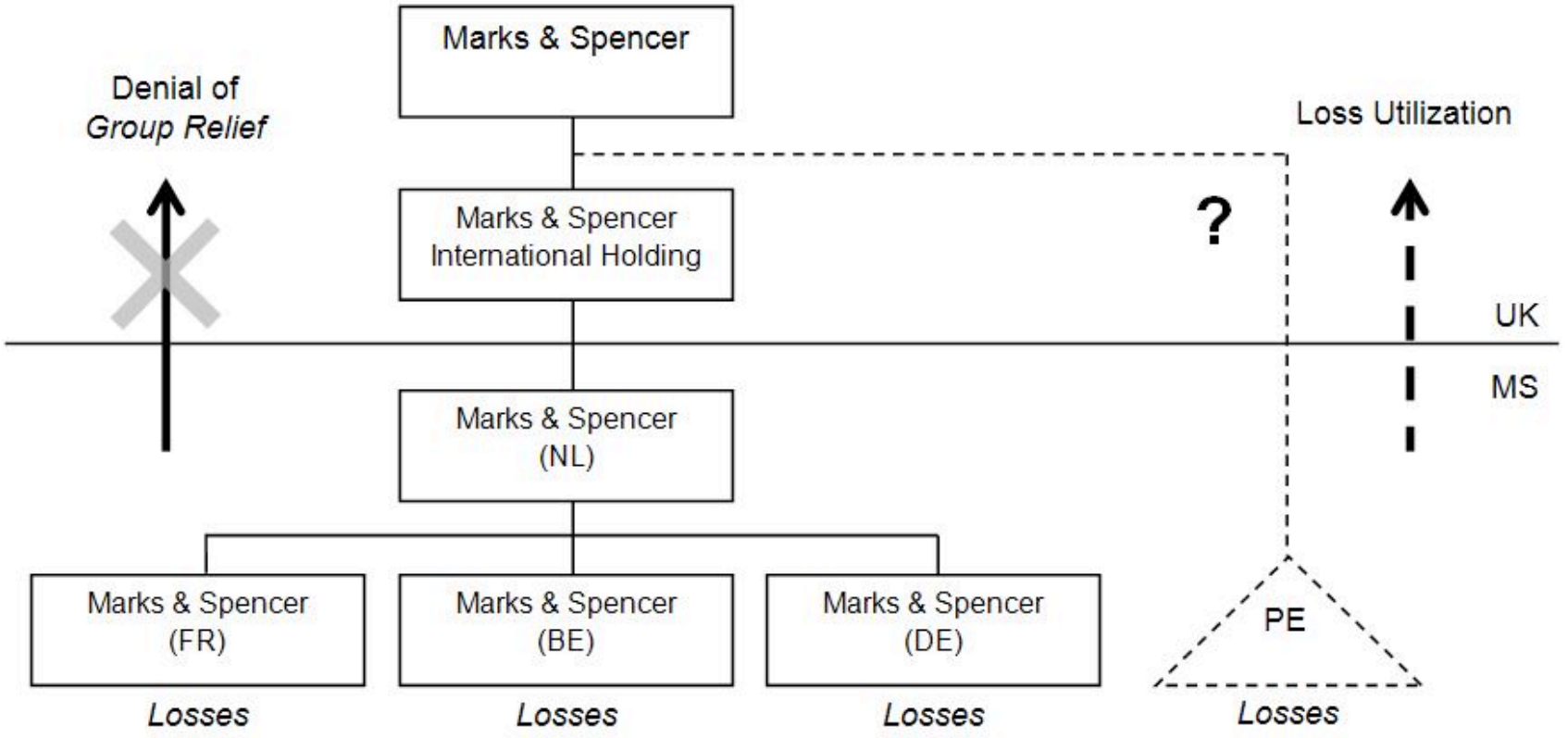
Recent Issues – Neutrality of Legal Form

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



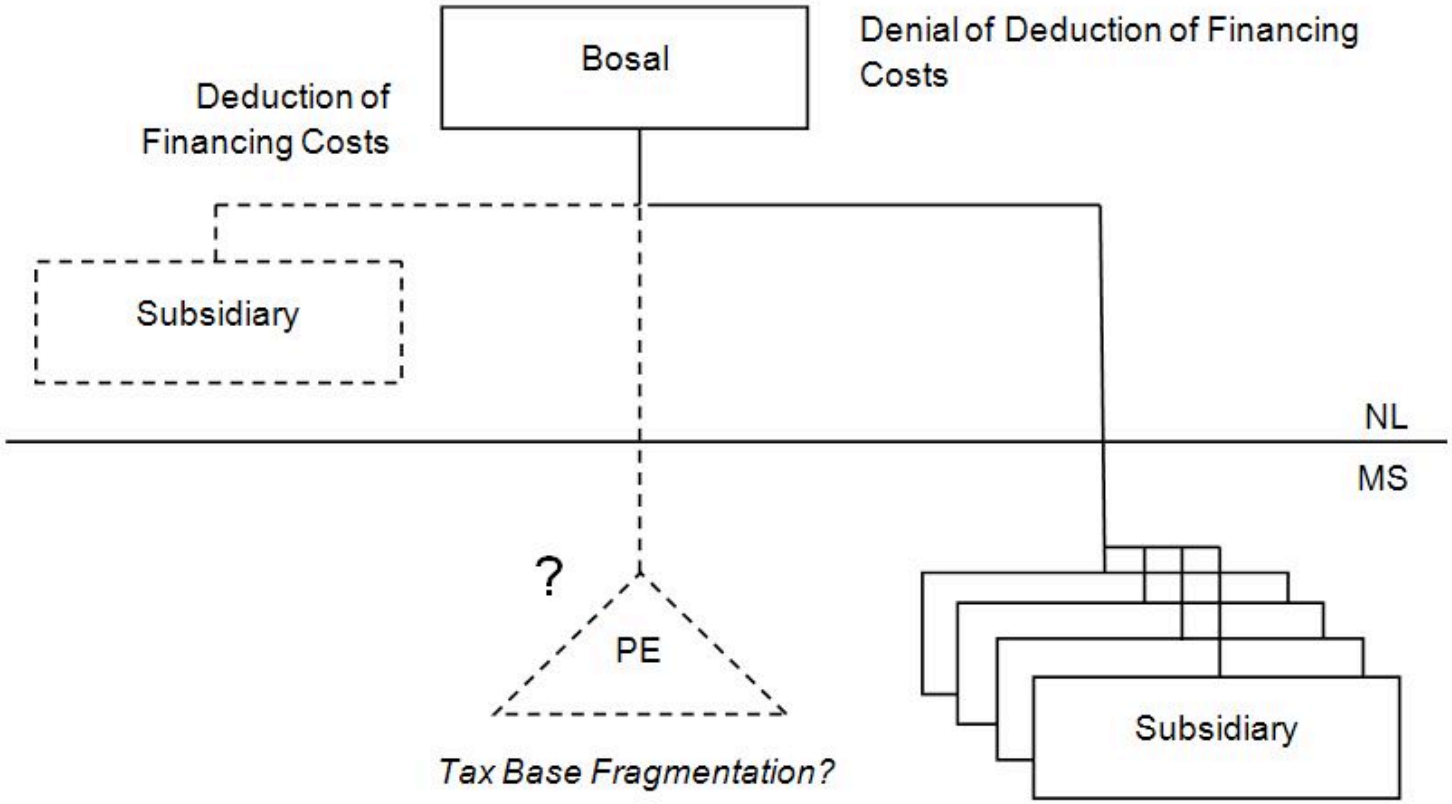
Recent Issues – Neutrality of Legal Form

- **Comparison Between Foreign PE and Foreign Subsidiary** → Rejected by ECJ, 13 December 2005, C-446/03, ***Marks & Spencer*** [2005] ECR I-10837; also ECJ 25 February 2010, C-337/08, ***X Holding*****.**



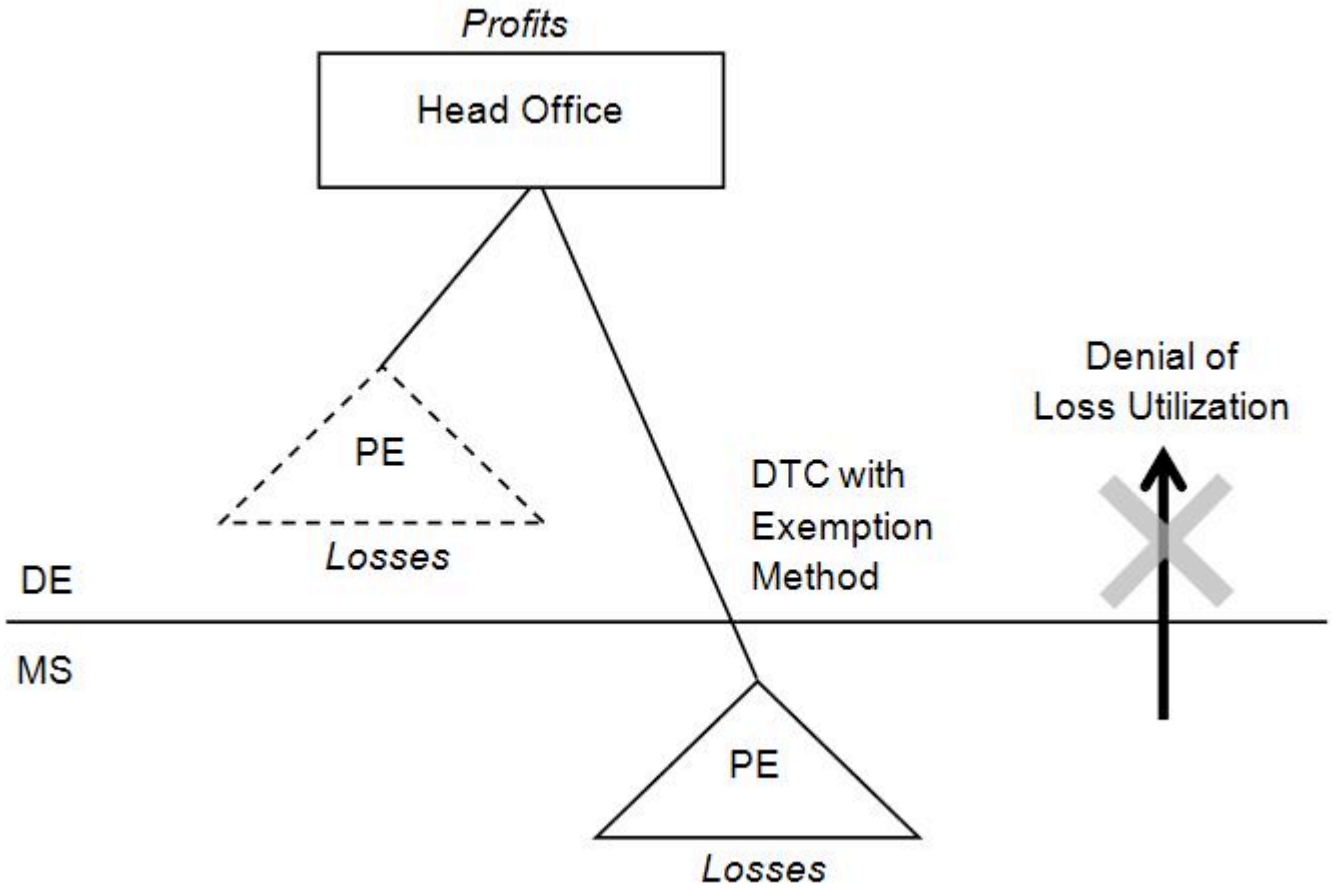
Recent Issues – Tax Base Fragmentation

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



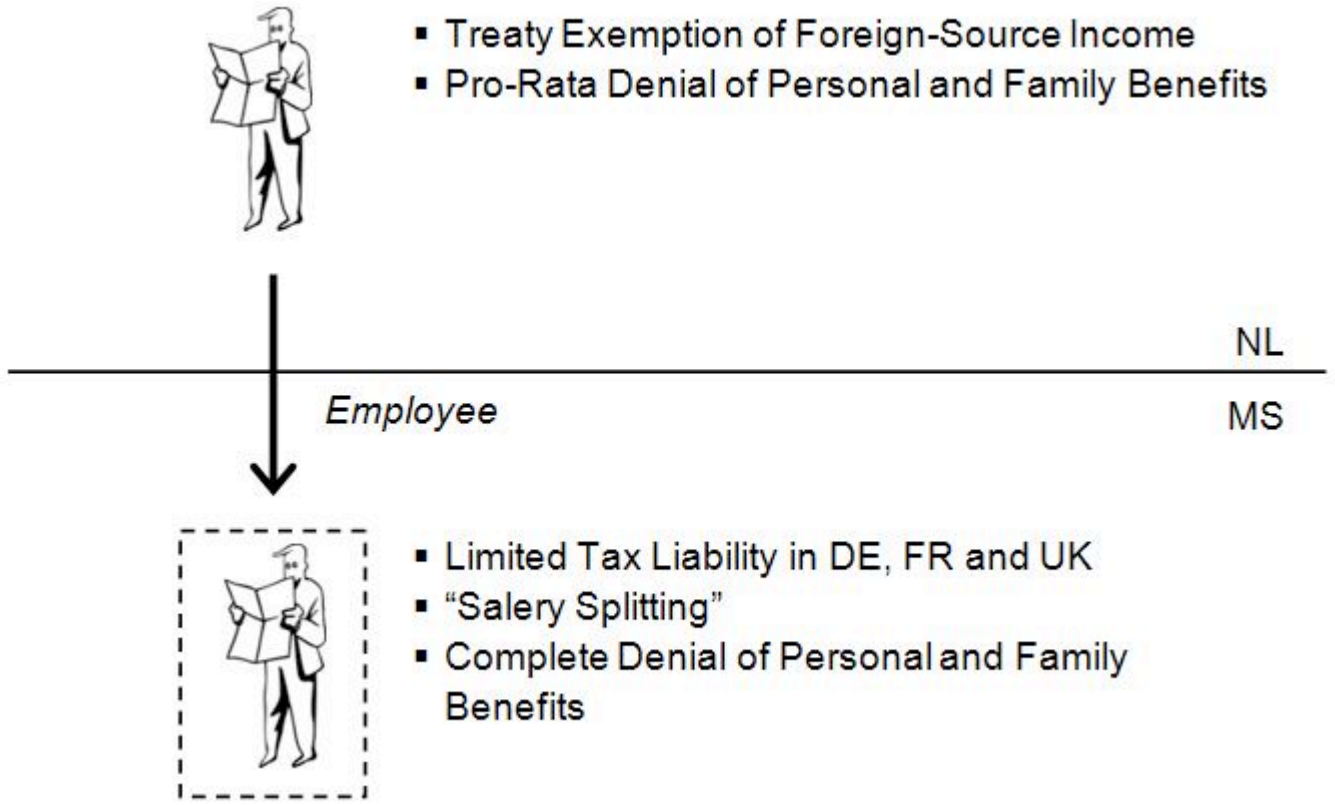
Recent Issues – Tax Base Fragmentation

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



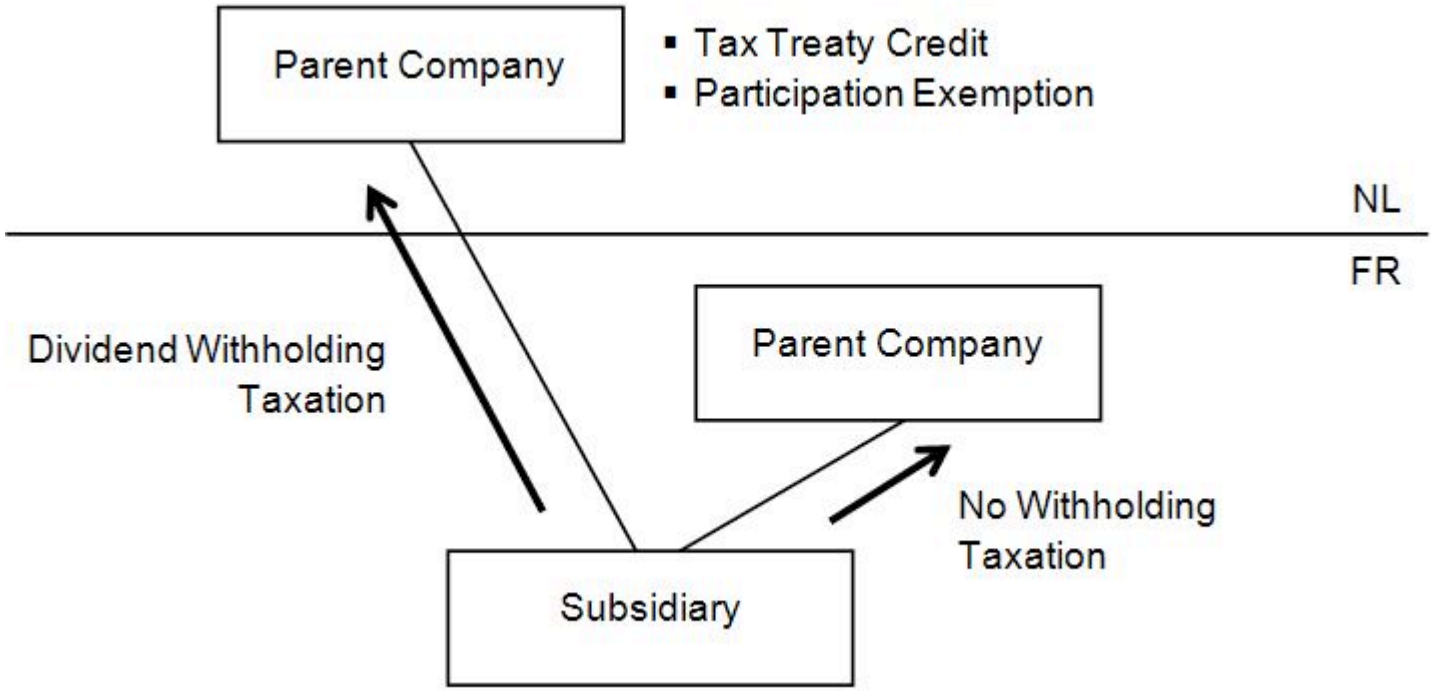
Recent Issues – Internal Consistency

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



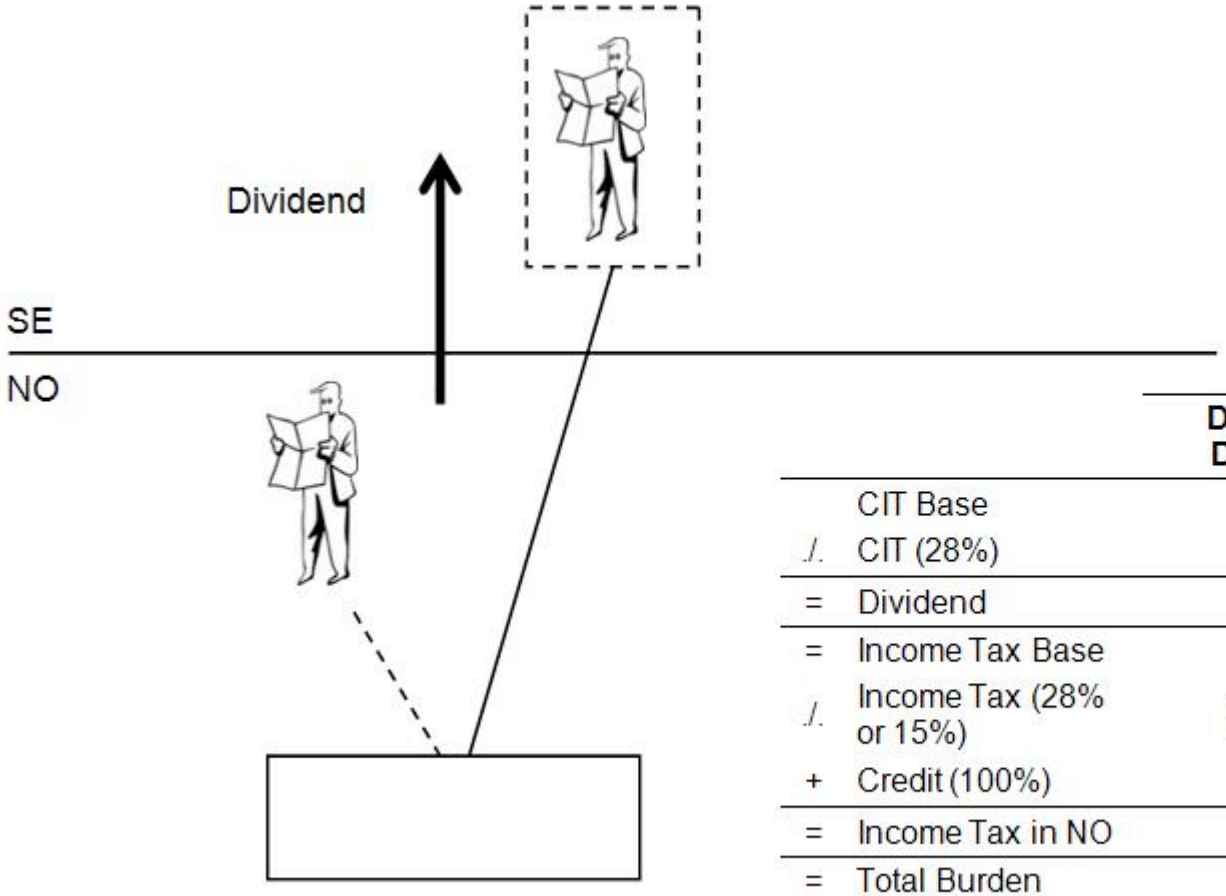
Recent Issues – “Neutralisation”

- **“Single Country” versus “Overall Approach”**
  - **Factual Situations and Comparability** (*Schumacker*, *Marks & Spencer*, *Manninen*)
  - **Cross-Border Compensation** *(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

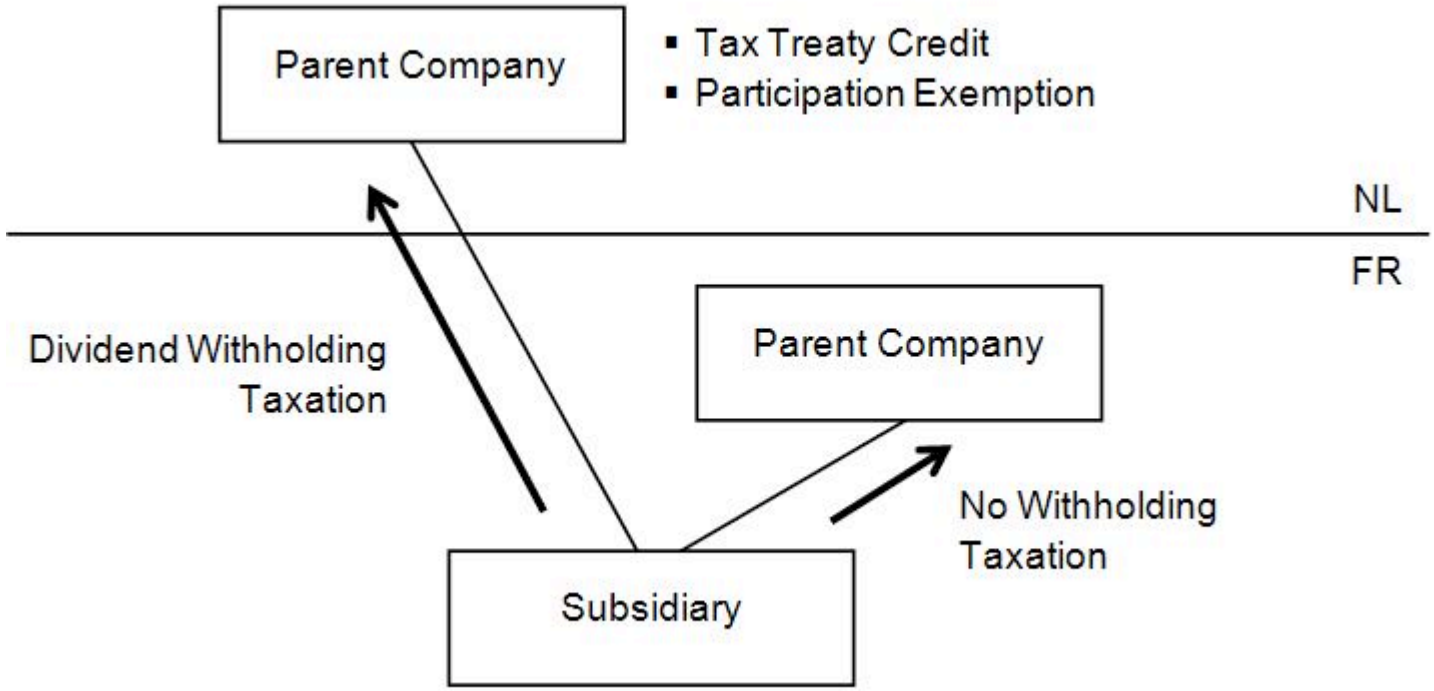
Cross-Border Compensation

- **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

			Distribution to a Dutch Corporate Shareholder	
		Domestic Distribution in France	*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
  - → Extent to which compensation can remedy discriminatory taxation remains unclear!

Part III-2

Third Country Situations

Freedom of Capital Movement

- **Art 63 (1) TFEU → "Erga Omnes Effect": includes capital flows to/from third countries**
  - "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."

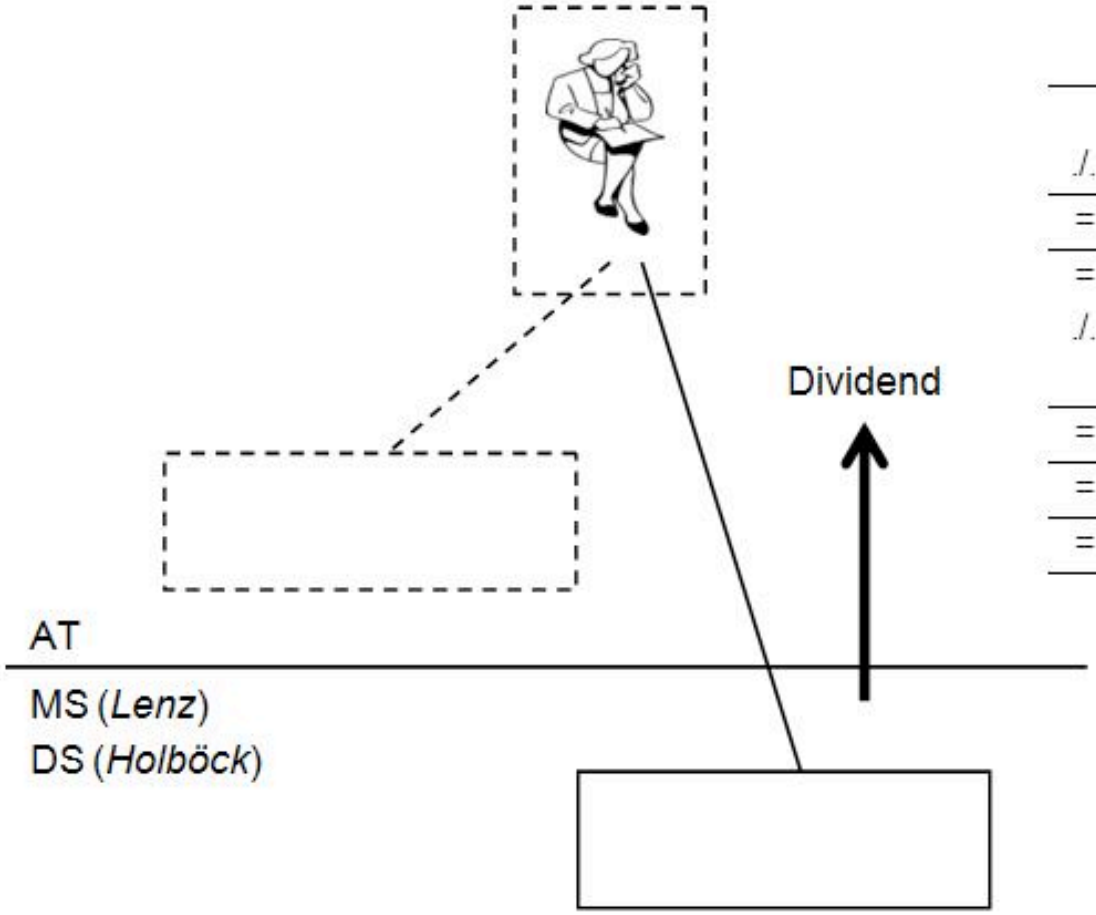
- **Art 64 (1) TFEU → "Grandfather-clause": exception for "old" restrictions**
  - "The provisions of Article 63 shall be without prejudice to the **application to third countries** of **any restrictions which exist on 31 December 1993** under national or Community law adopted in respect of the movement 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."

- **Art 65 TFEU → "Tax Justification"? General exception for tax laws?**
  - "The provisions of Article 63 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**;"

- **Art 65 (3) TFEU → "No arbitrary discrimination" – ECJ: rule of reason, proportionality!**
  - **"**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 63**."

Third Countries – Which Freedom?

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



		AT	MS
	Corporate Tax Bae	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 sharholdings)?

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 64 (1) TFEU?***

No

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

Yes

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

Yes

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

Yes

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

Art 64 TFEU - Interpretation

- **Art 64 (1) TFEU – Issues of Interpretation (*FII Group Litigation*, *Holböck*)**
  - **"*Application to third countries*"** → grandfathers in- and outbound investment
  - **"*Restrictions ... in respect of the movement of capital to or from third countries*"** → grandfathers *direct* restrictions of investments as well as subsequent capital flows (e.g. dividends).
  - **"*In respect of the movement of capital to or from third countries*"** → No specifity required.
  - **"*Direct investment*"** → Shares held enable the shareholder, "*to participate effectively in the management of that company or in its control*." (Annex I to Council Directive 88/361/EEC)
  - **Any restrictions which "*exist*" on 31 December 1993 →**
    - Deemed to have "*existed*" if subsequent amendment, but in substance identical to the previous legislation, or less restrictive.
  - **Any restrictions which exist on "*31 December 1993*" →**
    - Irrespective of date of accession of the respective Member State.
    - Recent amendment of Art. 64 (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 63(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 63(1) 2nd Situation TFEU directly applicable in direct tax cases? → ✓
  - Is Art 63(1) 2nd Situation TFEU applicable in the specific direct tax case? → ***Lasertec***, ***A and B***, ***Stahlwerk Ergste Westig***
  - Is the restriction at issue grandfathered by Art 64(1) TFEU? → ***FII Group Litigation***, ***Holböck***
  - Does Art 63 (1) 2nd Situation EC prohibit the restriction at issue?
    - Comparability Standard? → Art 63, 65(1) TFEU → ***FII Group Litigation (?)***
    - Justification Standard? → Art 65(1) TFEU→ ***FII Group Litigation (?)***, ***A***
    - Proportionality Standard? → Art 65(3) TFEU → ***A***

Third Countries – 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 (C-102/05)***
  - Taxation of inbound dividends → ***A (C-101/05)***

Part III-3

Cross-Border Dividends

Core Issues

- **Cross-Border Divivdends**

  - **Inbound Dividends**
    - Schedular Systems → *Verkooijen*, *Lenz, Kerckhaert-Morres, Holböck*, *A*
    - Imputation Systems → *Manninen*, *Meilicke*
    - Participation Privilege → *FII Group Litigation, Haribo & Salinen*

  - **Outbound Dividends and Withholding Taxation** → *Fokus Bank*, *Denkavit Internationaal*, *ACT Group Litigation*, *Amurta*

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:

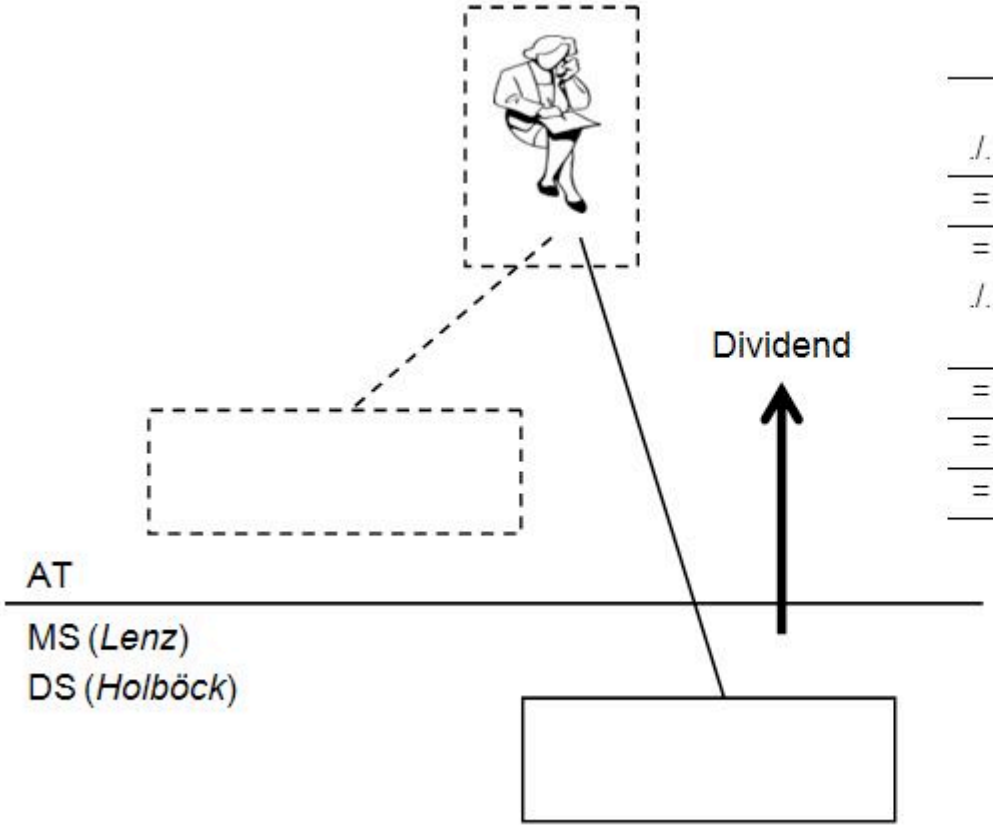
		Classical	Schedular System		Full Imputation	Exemption
			Tax Rate	Tax Base		
1	Income	100	100	100	100	100
2	Corporate Tax Rate 33,3%	33.3	33.3	33.3	33.3	33.3
3	Dividend (1 ./. 2)	66.7	66.7	66.7	66.7	66.7
4	Income Tax Base	66.7	66.7	33.35	100	0
5	Income Tax Rate (50% of 4.)	33.35	—	16.7	50	—
6	Full Imputation (2)	—	—	—	33.3	—
7	Remaining Income Tax (5 ./. 6)	—	—	—	16.7	—
8	Schedular Tax (25% of 4)	—	16.7	—	—	—
9	Net Dividend (3 ./. 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) levies a withholding tax (e.g., 25%), i.e., a tax on the foreign shareholder, and the Residence State of the shareholder levies 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

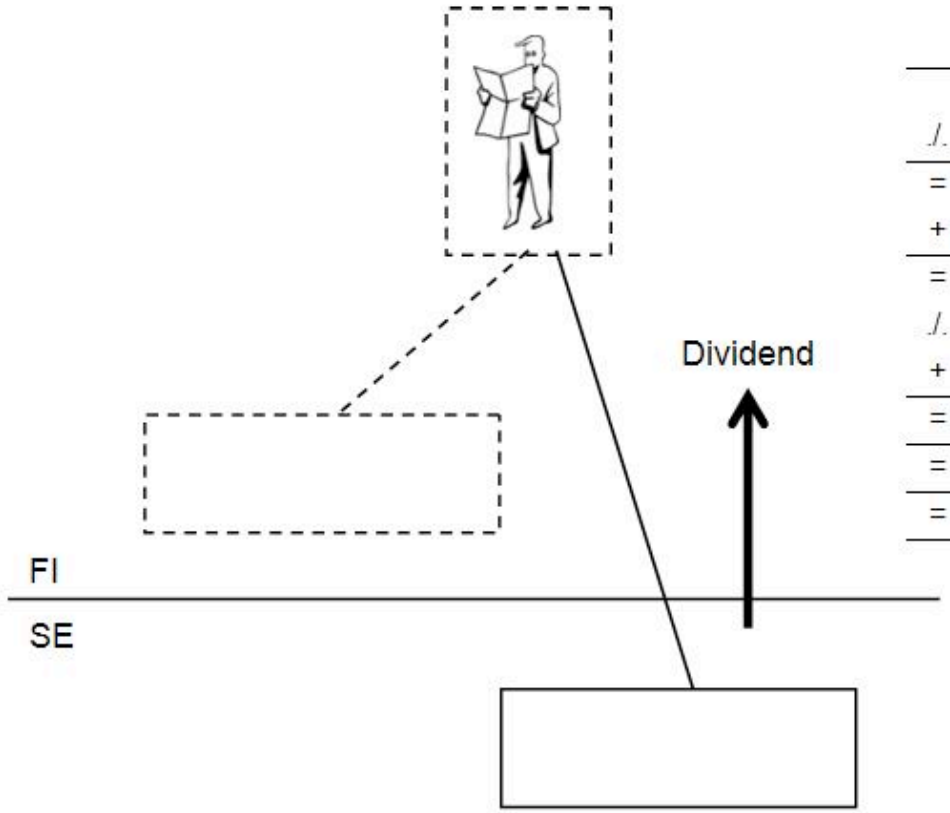
- **Schedular Relief Systems** — ECJ, 15 July 2004, C-315/02, ***Lenz*** [2004] ECR I-7063



		AT	MS
	Corporate Tax Bae	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

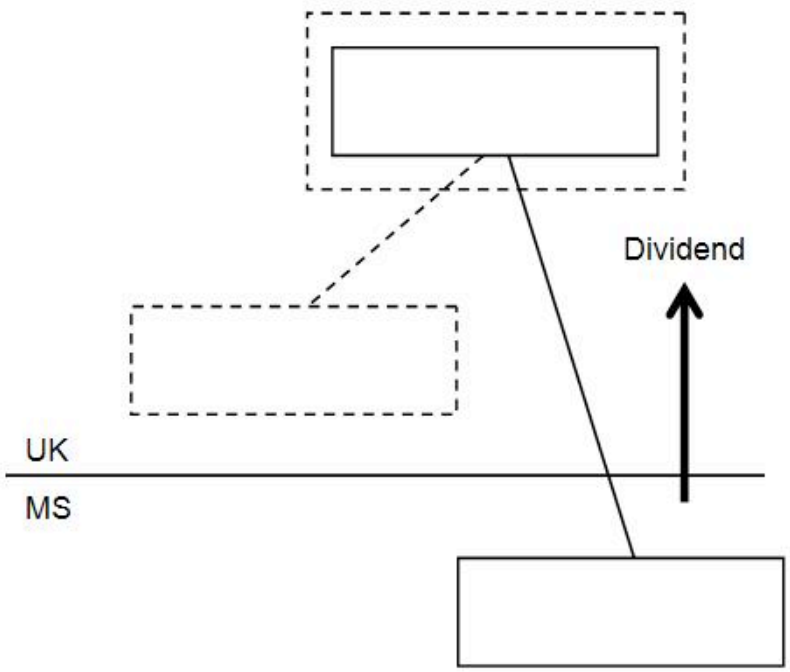
- **Imputation Systems** — ECJ, 7 September 2004, C-319/02, ***Manninen*** [2004] ECR I-7477, and ECJ, 6 March 2007, C-292/04, ***Meilicke***, [2007] ECR I-1835



		FI Dividend	SE Dividend
	Corporate Tax Base	100	100
./.	Corporate Tax (29%)	(29)	(29)
=	Dividend	71	71
+	Credit (29/71)	29	—
=	Income Tax Base	100	71
./.	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

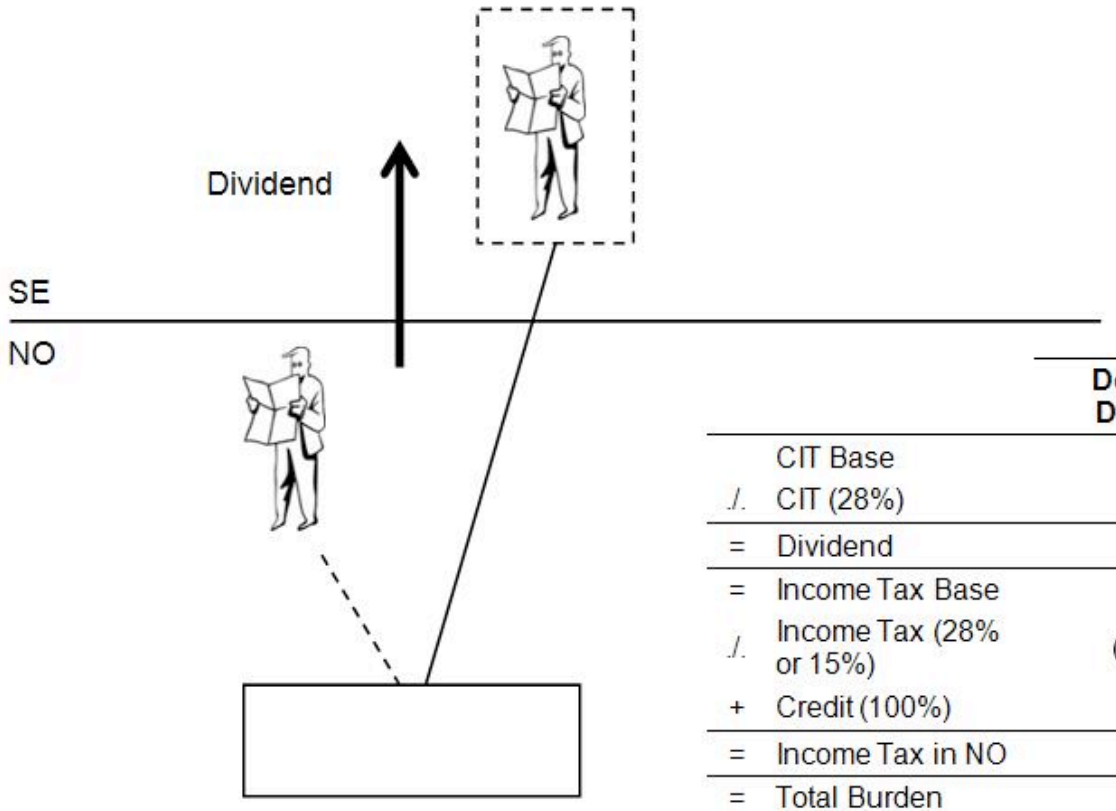
- **Participation Privilege – Different Systems for Domestic and Foreign Source Dividends** — ECJ, 12 December 2006, C-446/04, ***FII Group Litigation*** [2006] ECR 11753; most recently ECJ 10 February 2011 C-436/08, ***Haribo***, and C-437/08, ***Österreichische Salinen***.



		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

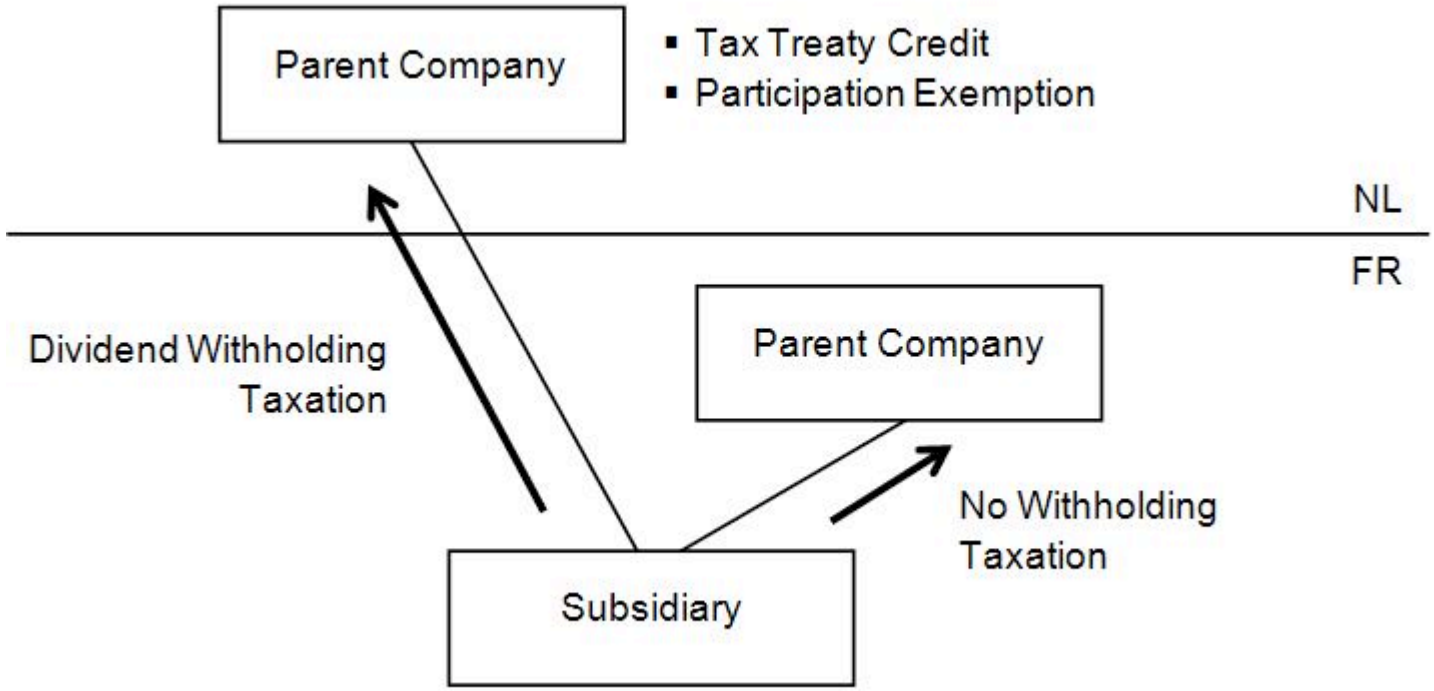
- **Strict Single Country Approach** —EFTA-Court, 23 November 2004, E-1/04, ***Fokus Bank ASA*** [2004] EFTA Court Report 11



		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

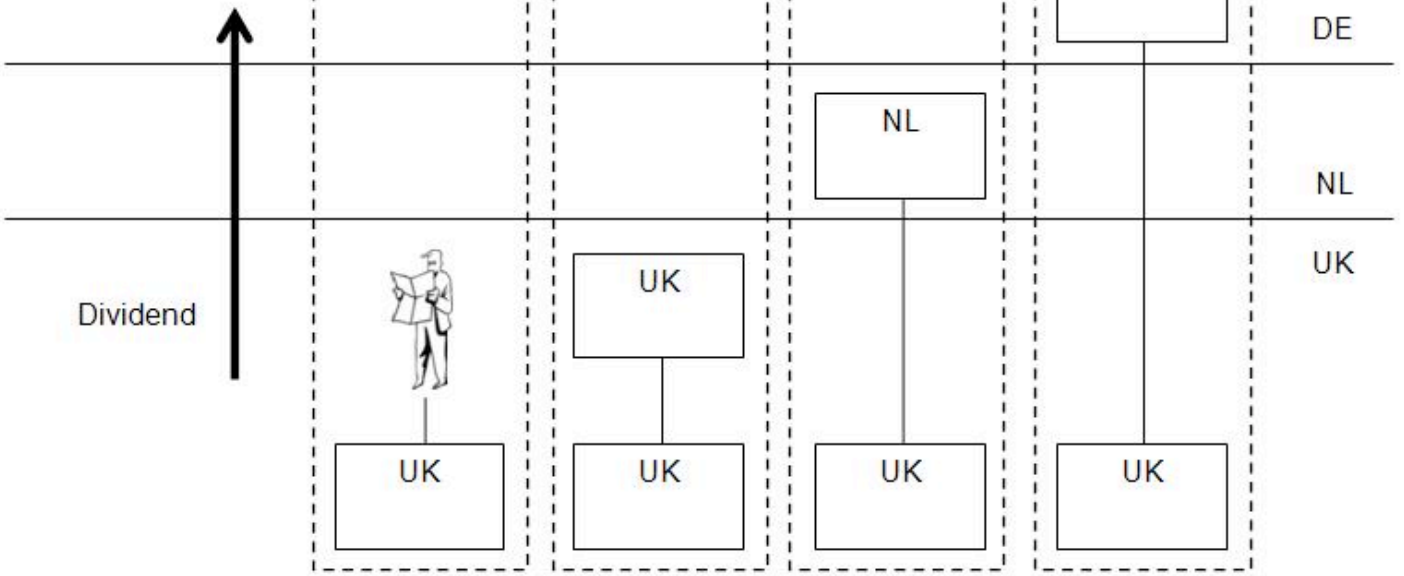
- **"Equality in a Box", but DTC Obligations** → ECJ, 14 December 2006, C-170/05, ***Denkavit Internationaal*** [2006] ECR I-11949, and ECJ, 8 November 2007, C-379/05, ***Amurta*** [2007] ECR I-9569



Outbound Dividends

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

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



Summary

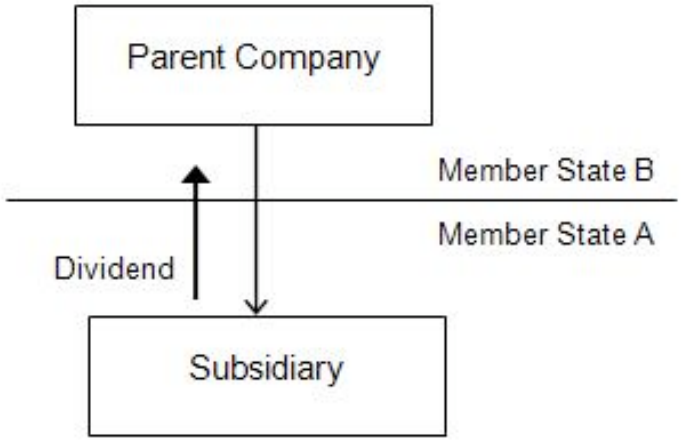
		Classical System	Schedular System	Full Imputation System	Exemption System
Shareholder's Residence State		—	▪ Same treatment as for domestic dividends (***Verkooijen***, ***Lenz***)	▪ Credit for foreign corporate tax (***Manninen***, ***Meilicke***, ***FII Group Litigation***) ▪ Limited by the level of domestic corporate tax (***FII Group Litigation***)	▪ Same treatment as for domestic dividends (***A***) ▪ However, a Member State may decide to grant an indirect foreign tax credit instead (***FII Group Litigation, Haribo*** and ***Salinen***: including credit carry forward)
Source State = Company's Residence State	**Taxation of Non-Resident Shareholder**	—	▪ Same treatment as for resident shareholders	▪ 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***) ▪ "Neutralisation"? (***Denkavit***, ***Amurta***)	▪ Same treatment as for resident shareholders (***Saint-Gobain***, ***Denkavit***, ***Amurta***, ***Commission v. Netherlands***, ***Aberdeen***, ***Gaz de France***) ▪ "Neutralisation"? (***Denkavit***, ***Amurta***)
	Taxation of Company's Profits	Not affected by fundamental freedoms (***ACT Group Litigation***)			

Part IV
Secondary EU 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**

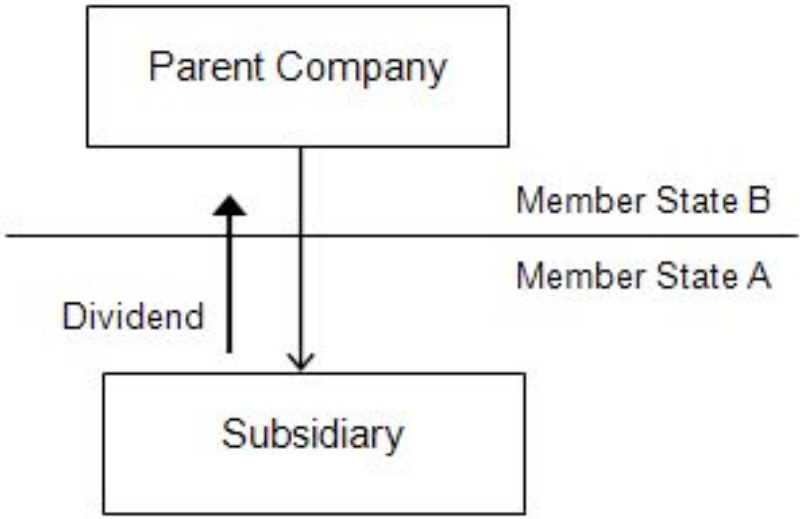
- ***Legal Texts***
  - *Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, [1990] OJ L 225, p. 6, with correction in [1990] OJ L 266, p. 20.*
  - *Council Directive 2003/123/EC of 22 December 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 expected end 2010*

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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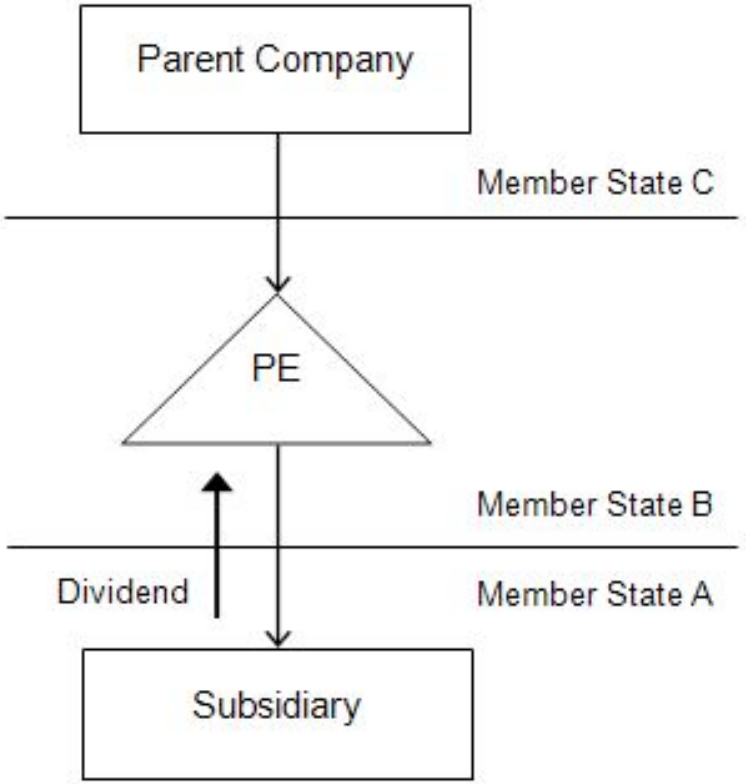

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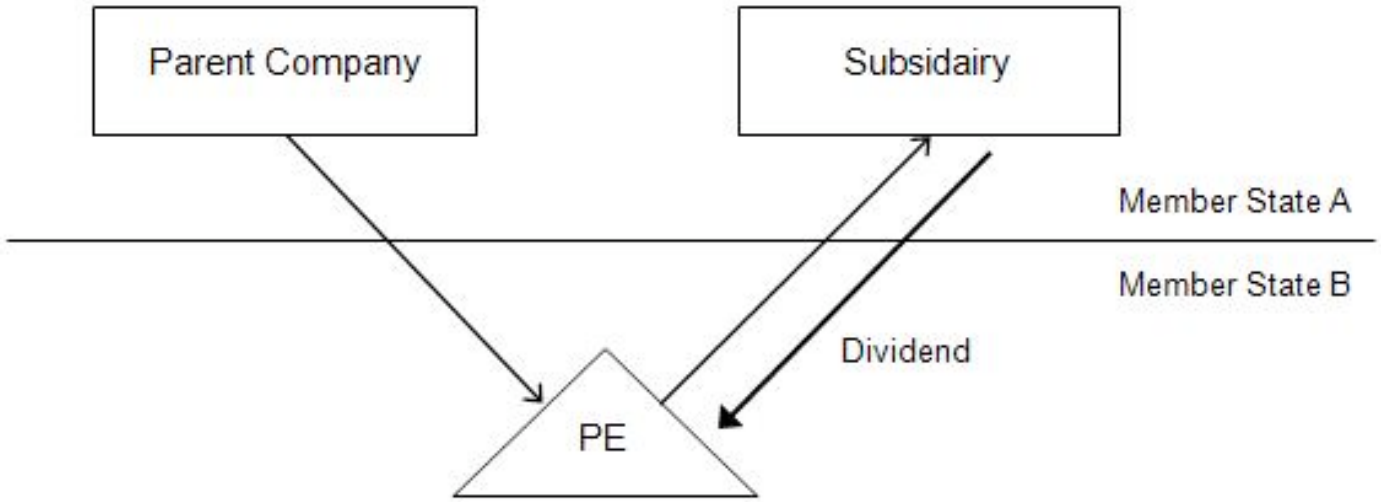

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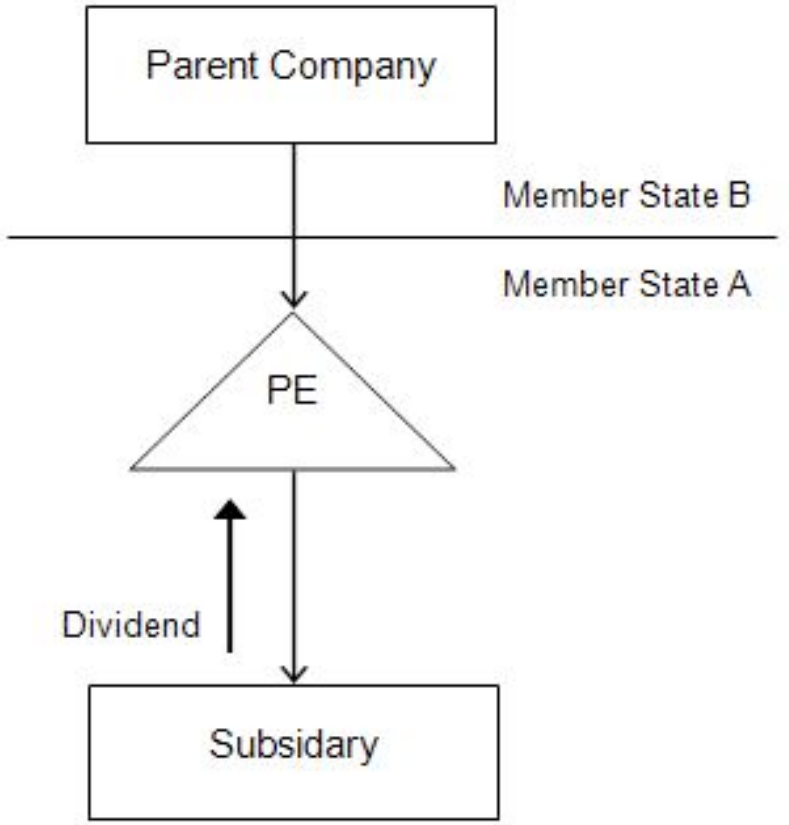

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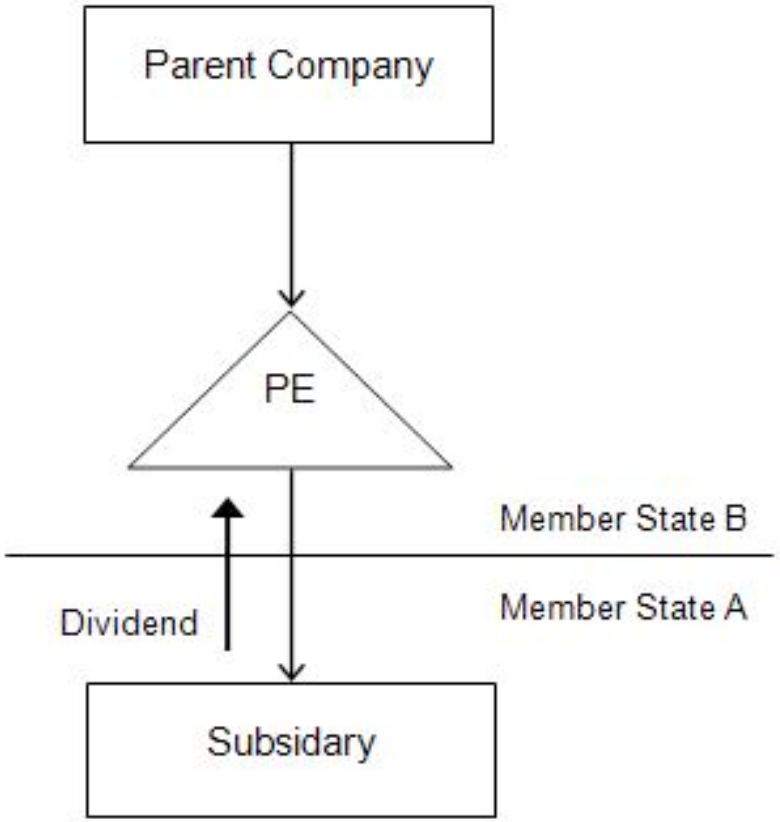

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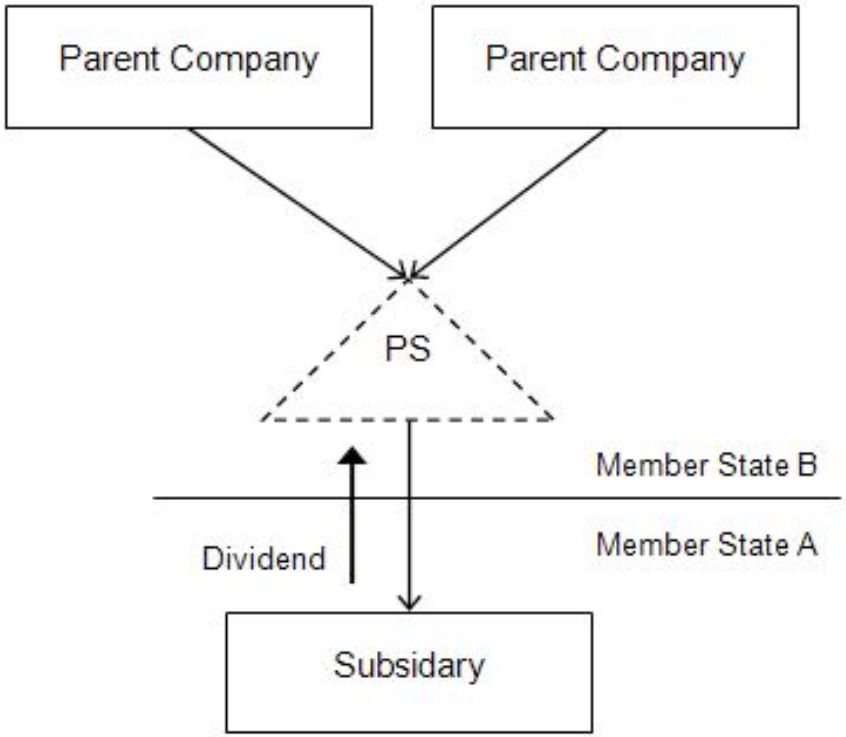


Definitions: Company of a MS and PE

- 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**.

Holding Requirement

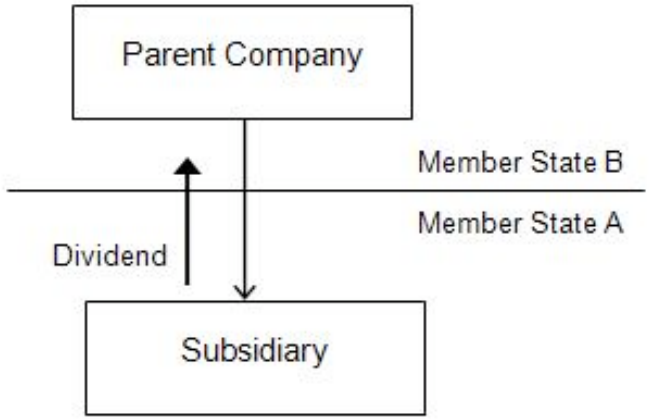
- **Minimum Holding Requirement → Art 3(1)**
  - Liberalization
    - 20% from 1 January 2005 to 31 December 2006;
    - 15% from 1 January 2007 to 31 December 2008;
    - 10% from 1 January 2009.
  - Main Features
    - Directly in the foreign subsidiary or indirectly in a domestic subsidiary via a 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."*
  - 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 indent
    - No Netting with Losses → ECJ, 12 February 2009, C-138/07, *Cobelfret*
  - Indirect Tax Credit at the Parent Level → Art 4(1) 2nd indent
- **"Distributions of profits" in Art 1 and 4**
  - „Any 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

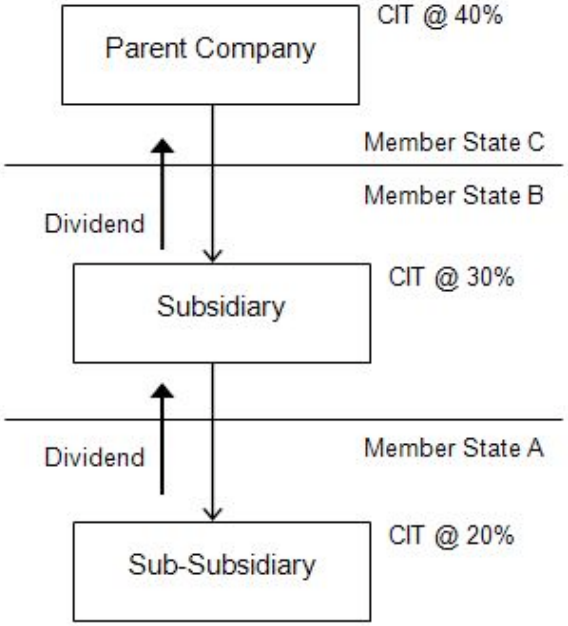
- **Art 4(1)** → Where a parent company or its permanent establishment, by virtue of the association of the parent company with its subsidiary, receives distributed profits, the State of the parent company and the State of its permanent establishment shall, except when the subsidiary is liquidated, either: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



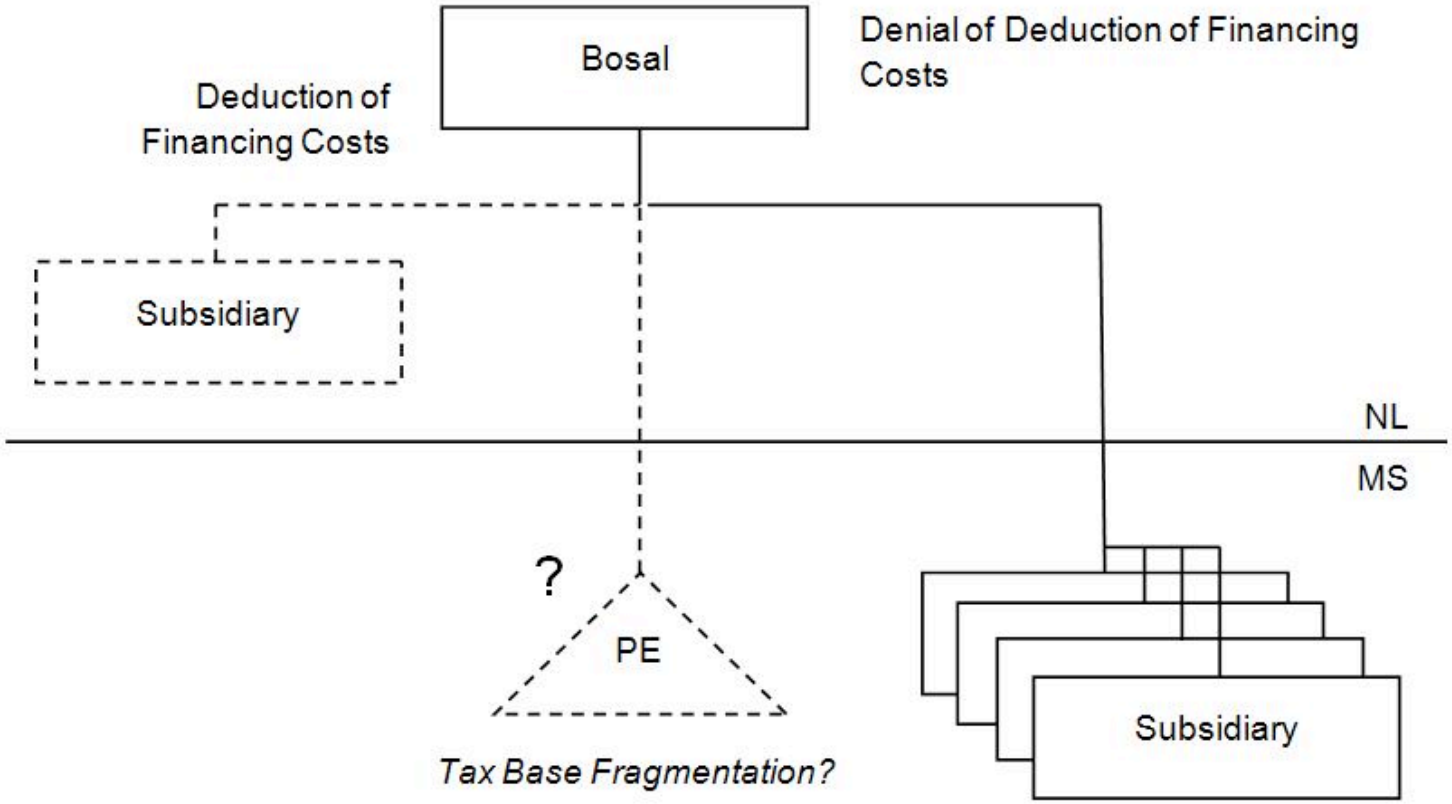
	MS S: Exemption		MS S: Credit	
	Domestic	Directive	Domestic	Directive
CIT in **MS SS** (20%)	***20***	***20***	***20***	***20***
Income in MS S	80	80	100	100
Tentative CIT in MS S (30%)	24	24	30	30
Credit (Min(20;100@30%))	—	—	(20)	(20)
Exemption	(24)	(24)	—	—
CIT in **MS S**	***0***	***0***	***10***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

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 ":**
    - Autonomous EU term irrespective of national definitions
    - 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 conguaglio* 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 credit?
  - ECJ, 25 September 2003, C-58/01, *Océ van der Grinten* [2003] ECR I-9809

Juridical Double Taxation

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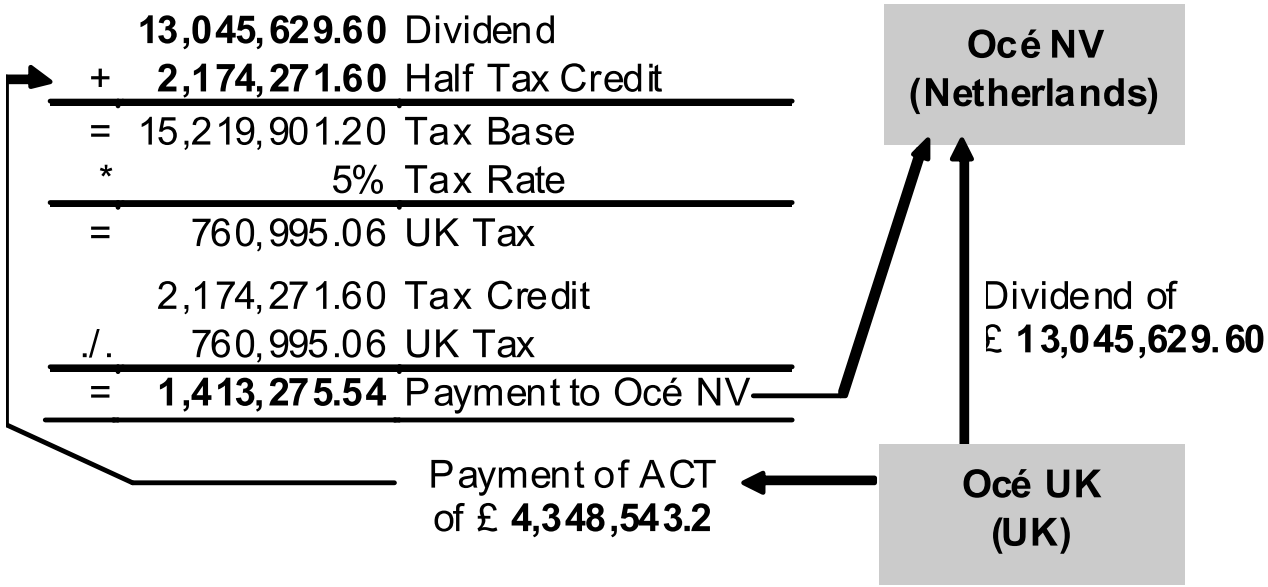


Part IV-2

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 benefial owner → Art 3

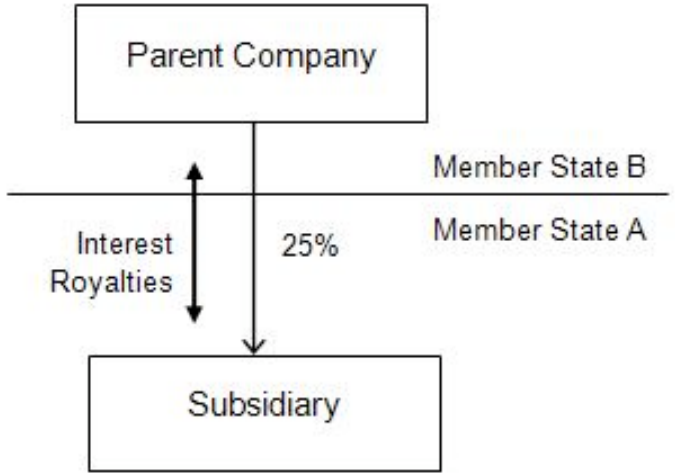
- ***Legal Text***
  - *Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, [2003] OJ L 157, p. 49.*

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 owne**r 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

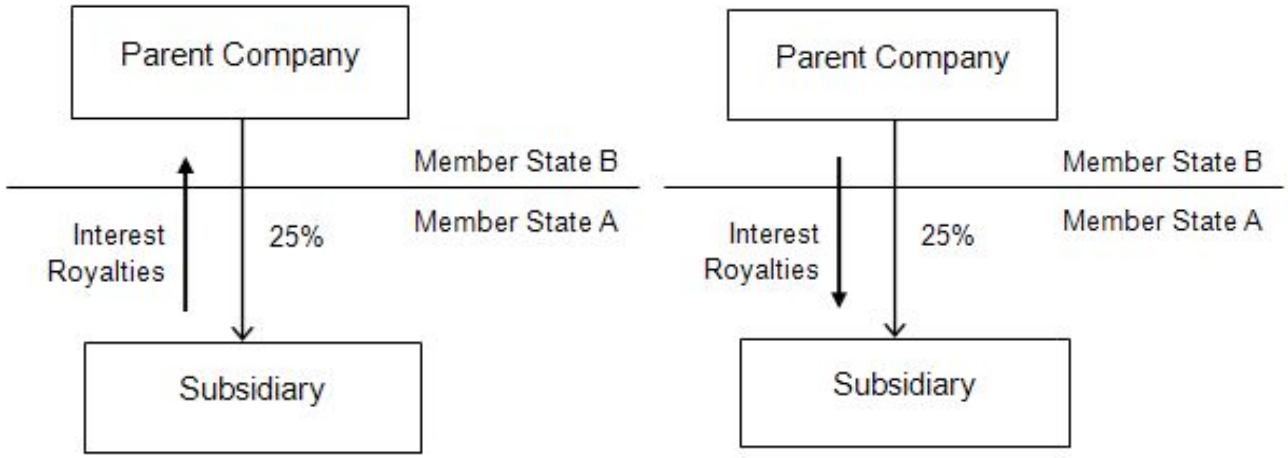
- **Associated Company** requirement → Art 1 Abs 7 → Art 3(b)
  - The exemption (Art 1(1)) requires that "*the company which is the payer, or the company whose permanent establishment is treated as the payer, of interest or royalties **is an associated company** of the company which is the beneficial owner, or whose permanent establishment is treated as the beneficial owner, of that interest or those royalties*".

Scope of Application

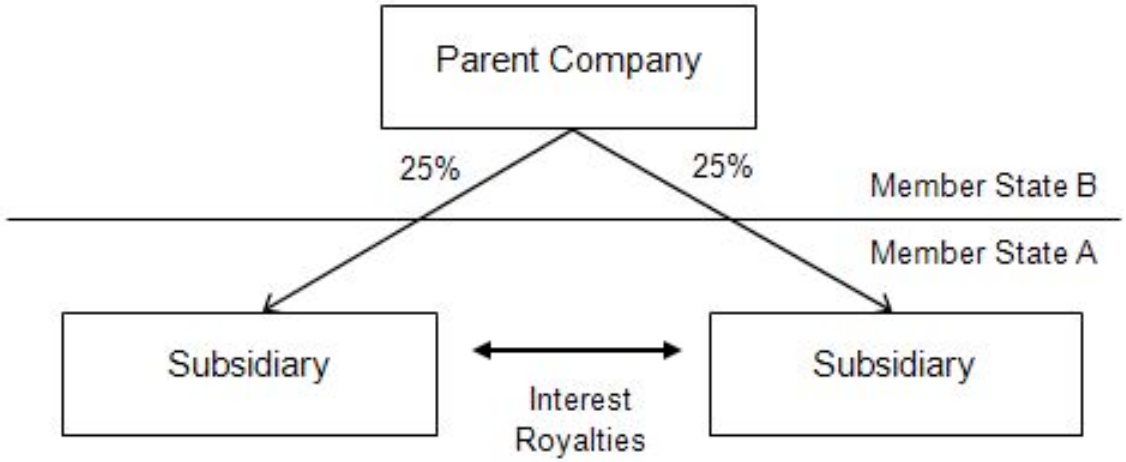
- **Art 3(b)**: Two companies are **"associated"** if:
  - either company has a direct minimum holding of **25%** in the capital (or voting rights) of the other company (***Parent-subsidiary relationship***), or
  - a third company has a direct minimum holding of **25%** in the capital (or voting rights) of two other companies (***Common control – sister companies***).
- **Minimum Holding Period**: Option not to exempt where associated for less than two years:
  - 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

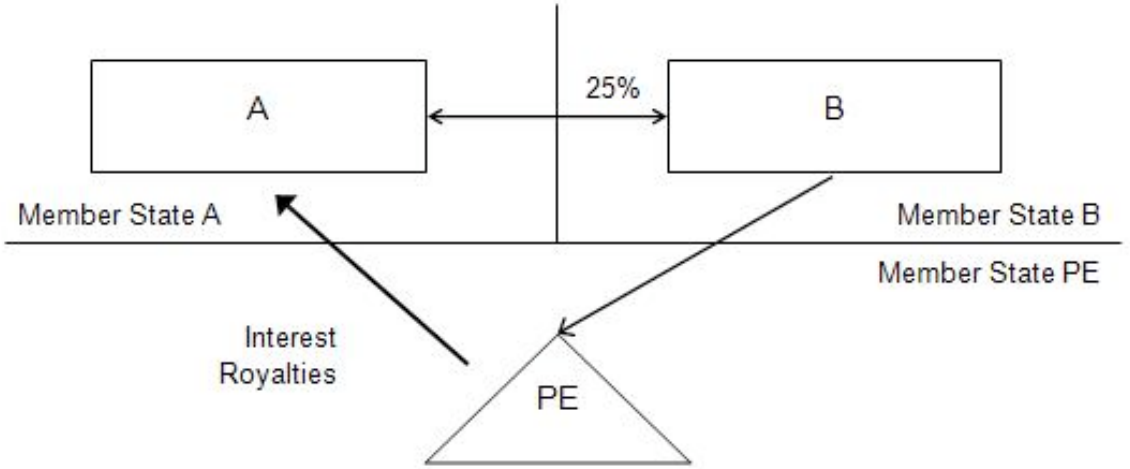


Payments Between Sister Companies

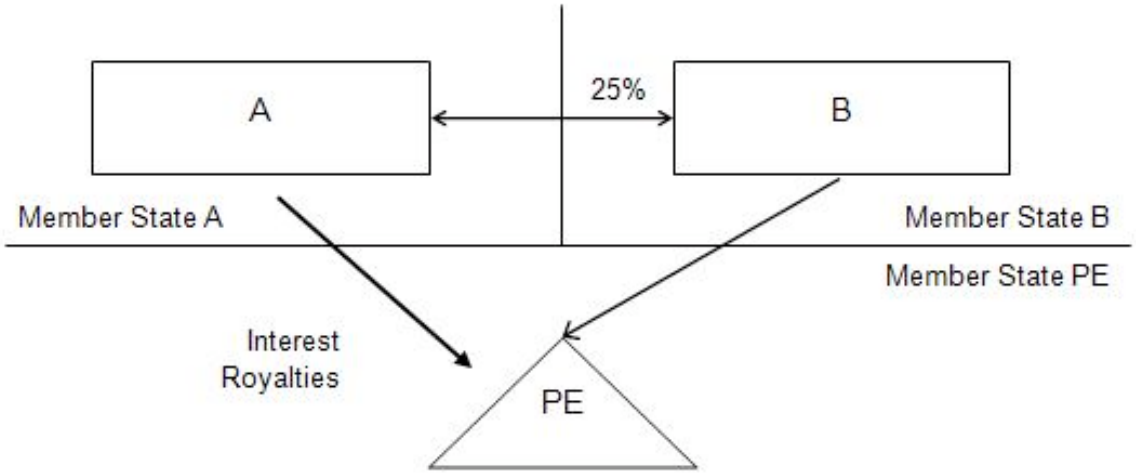


Scope of Application

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) OECD-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) OECD-MC

Definitions

- Art 3(a) → **"Company of a Member State"**:
  - Taking the **legal form** listed in the Annex to the Directive → Art 3(a)(i)
  - **Resident in that Member State and not**, because of a DTC concluded with a third state, considered to be **resident for tax purposes outside the Community** → Art 3(a)(ii)
  - **Subject to one of the taxes** listed in Art 3(a)(iii) and not exempt from tax.

- Art 3(c) → **"Permanent establishment":**
  - "*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 for an internal market
    - ought not to be hampered by restrictions, disadvantages or distortions arising from tax
    - Require competition-neutral tax rules: allow enterprises to adapt to the common market, increase productivity and competitive strength at international level;
    - must not be treated more burdensome than domestic mergers etc.

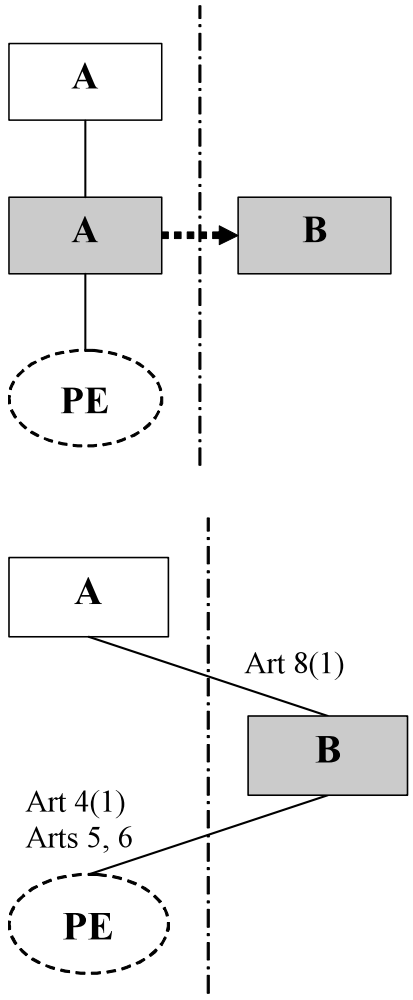
- ***Legal Texts***
  - *Council Directive **90/434/EEC** of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States, [1990] OJ L 225, p. 1.*
  - *Council Directive **2005/19/EC** of 17 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 (Directive 2009/133)*

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

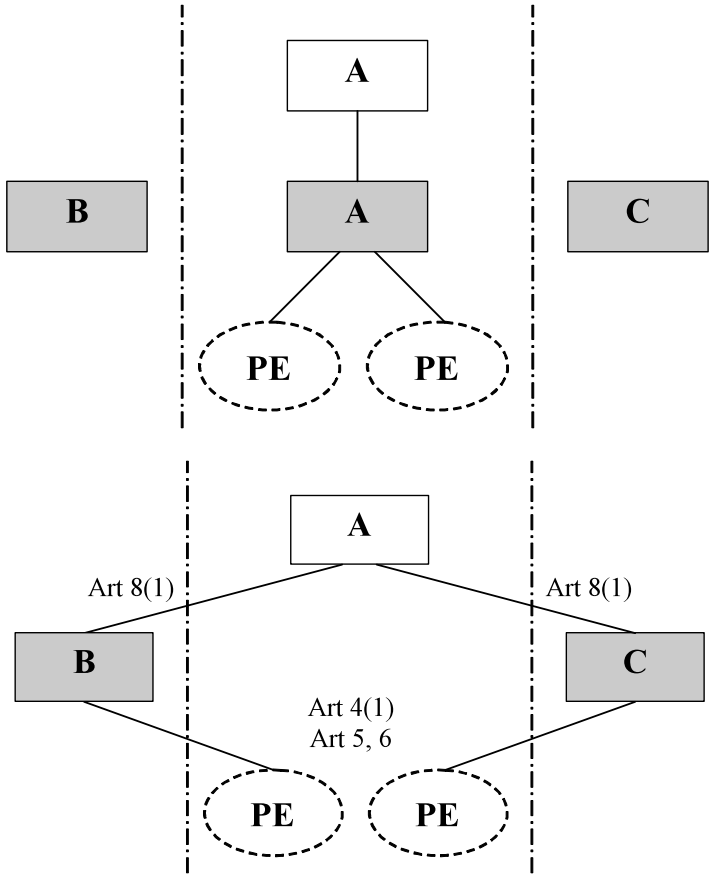
Scope of Application

- **3 Kinds of merger** → Art 2(a)
  1. 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)
  2. Transfer of all assets and liabilities from two or more transferring companies" (A) to a the pre-existing "receiving company" (B)
  3. Up-stream-merger of a 100% subsidiary
- **Taxation**
  - Neutrality on the ***Company Level***
    - PE 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) (→ carry over of historic costs after "share exchange")



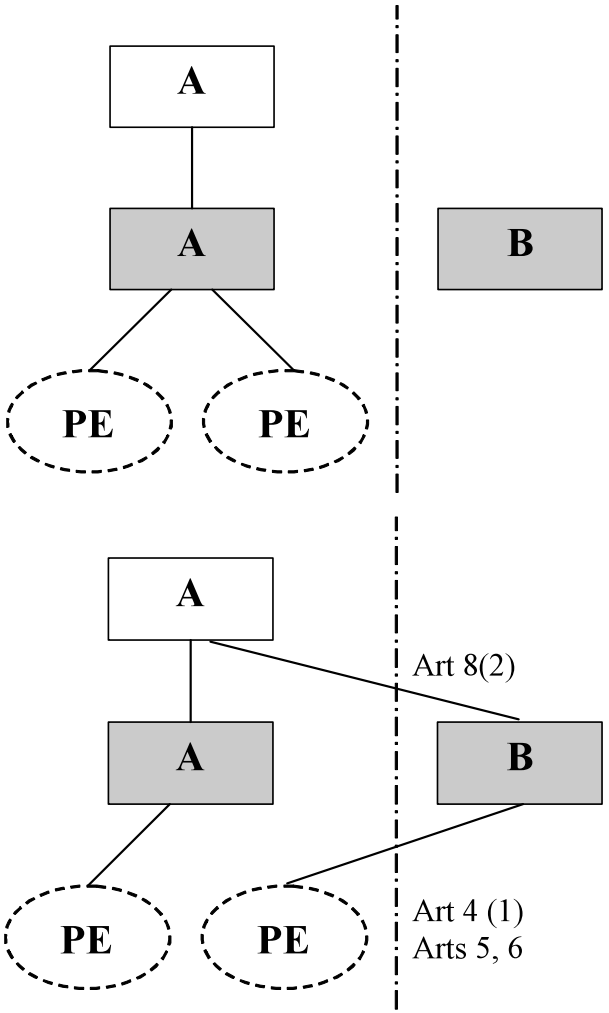
Scope of Application

- **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
    - PE 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)



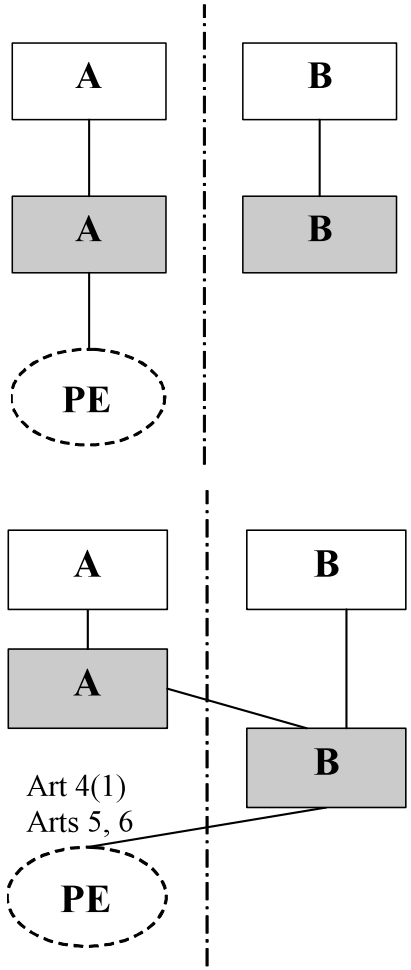
Scope of Application

- **Partial Division** → Art 2(c)
  - 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
    - PE 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)



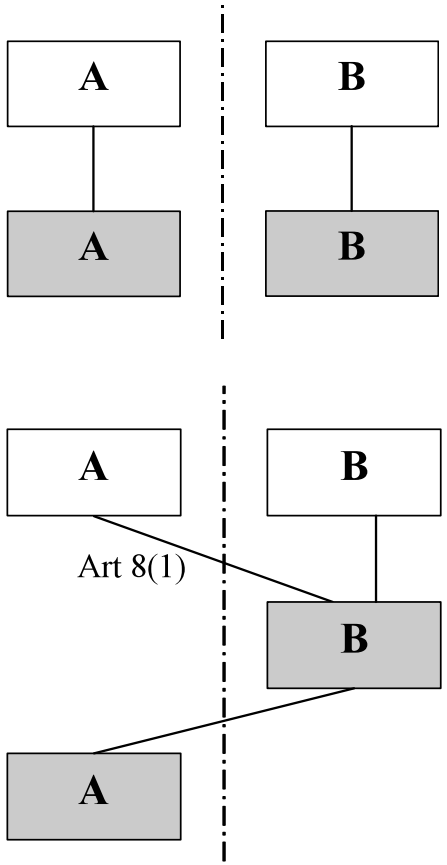
Scope of Application

- **Transfers of Assets** → Art 2(d)
  - 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
    - PE 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



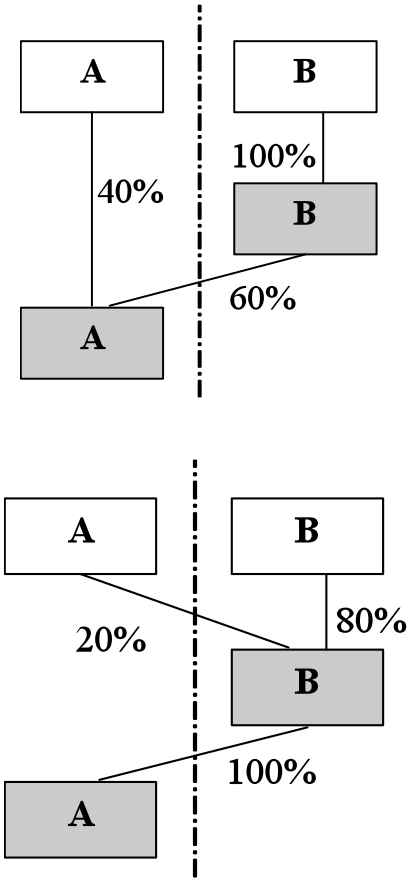
Scope of Application

- **Exchange of Shares** → Art 2(e)
  - "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 companiy" (B) to a shareholder in exchange for securities representing the capital of the "acquired company" (A) → Art 8(1)



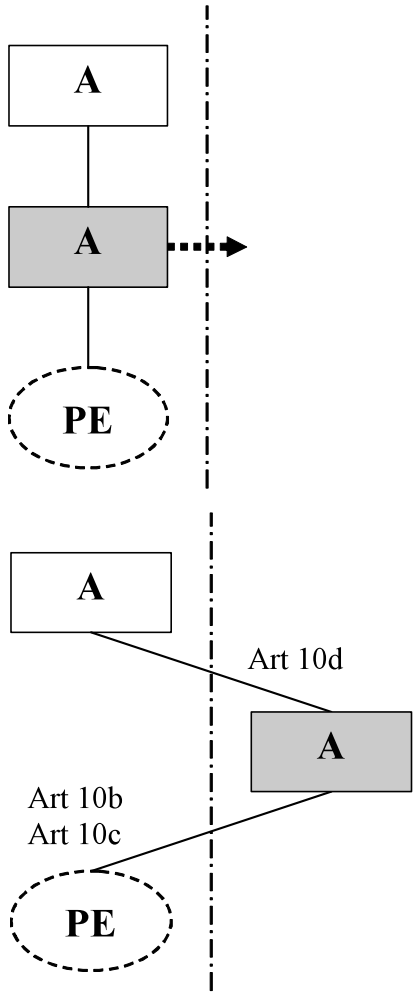
Scope of Application

- **Exchange of Shares** → Art 2(e)
  - **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(e) 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(k)
  - 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
    - PE requirement → Art 12
    - Carry-over of provisions or reserves → Art 13
  - Neutrality on the Shareholder Level
    - No taxation because of the change in qualification of the shares (domestic versus foreign company) → Art 14



Scope of Application – Overview

	Company Level			Shareholder Level
	Assets	***Losses***	***Reserves***	
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(c)	Art 4(1)	Art 6	Art 5	Art 8(2)
Transfer of Assets Art 2(d)	Art 9 → Art 4(1)	Art 9 → Art 6	Art 9 → Art 5	—
Exchange of Shares Art 2(e)	—	—	—	Art 8(1)
Transfer of the Registered Office Art 2(k)	Art 12	Art 13(2)	Art 13(1)	Art 14

Qualified Companies

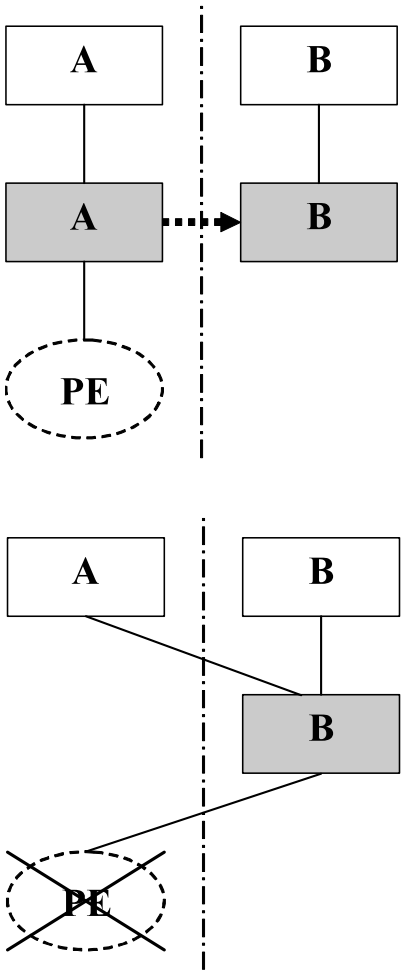
- Art 3 → "Company from a Member State" is any company:
  - Taking a **legal form** listed in the Annex to the Directive → Art 3(a)
  - **Resident in that State for tax purposes *and***, under a DTC with a third State, is **not considered to be resident outside the Community** → Art 3(b)
  - is **subject 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 12**
  - **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(2)(b)) and their **values for tax purposes** (→ Art 4(2)(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 12
    - Deferral under Art 12, 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 12**
  - 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

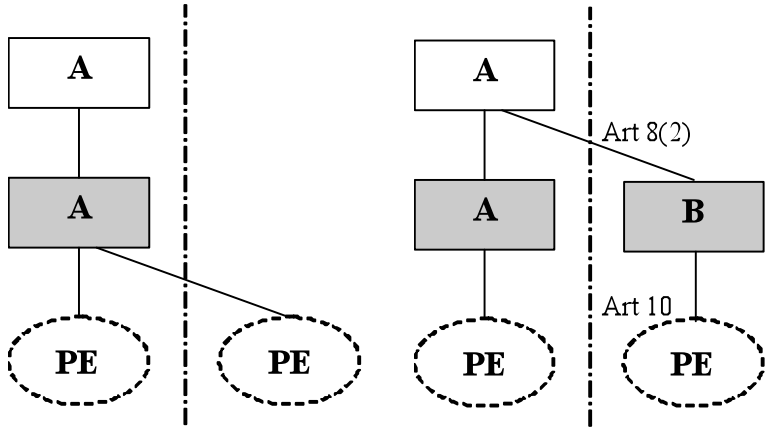


Permanent Establishments

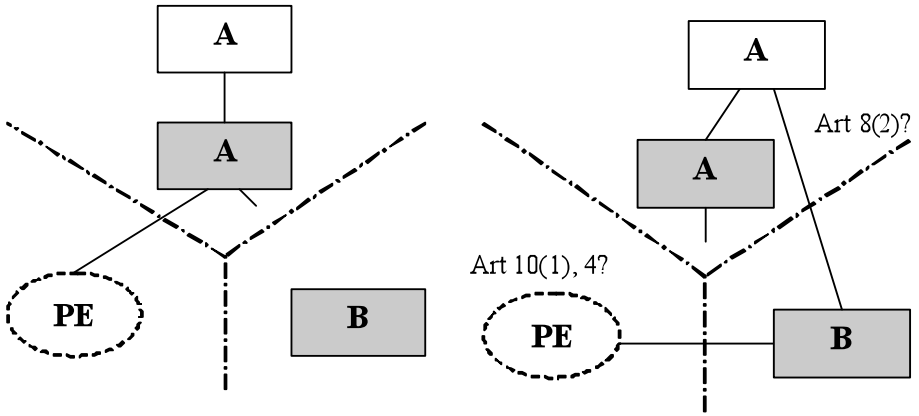
- **Treatment of Permanent Establishments → Art 10**
  - Art 10 applies to mergers, divisions, partial divisions and transfers of assets, but not to transfers of the registered office of an SE or an SCE
  - **PE Member State and Residence Member State of the *Receiving* Company**
    - **Legal fiction 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)
      - **No taxation of PE** upon transfer → Art 10(1) 1st sentence
      - **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***

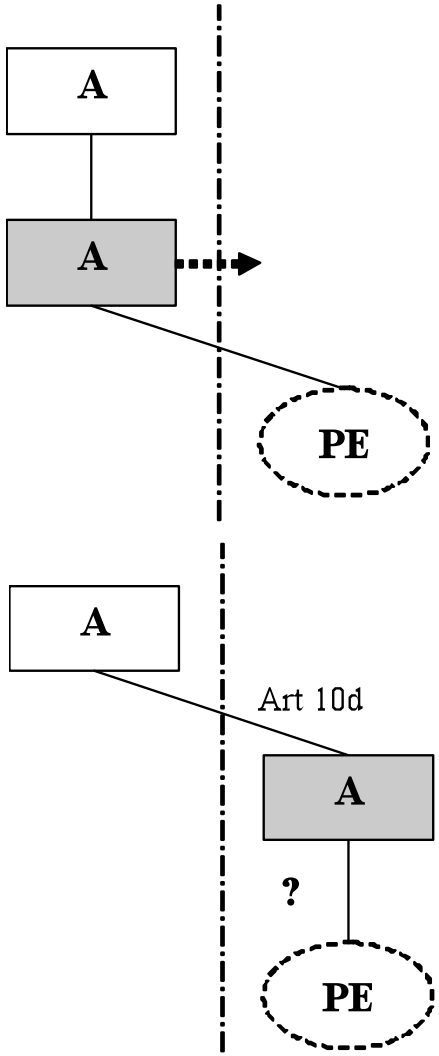


- **"Split-off" of a Permanent Establishment in a Third Member State?**
  - Point 14 of the Preamble of Directive 2005/19/EC → "*it should be made clear that this transaction, being the transfer of assets from a company of a Member State of a permanent establishment located in a different Member State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



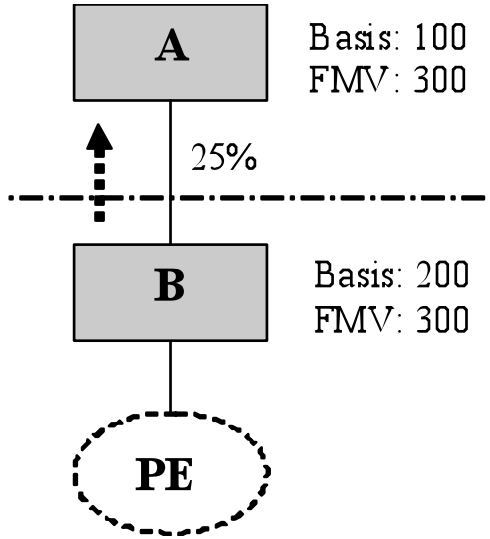
Permanent Establishments

- **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*.”
- Minimum holding (corresponds to Parent-Subsidiary Directive)
  - *Art 7(2)*: “*The Member States may derogate from paragraph 1 where the receiving company has a holding* ***of less than 15% [10% since 2009]*** *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