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tation in the Proposal for a Council Directive on
a Common Consolidated Corporate Tax Base
(CCCTB)**

Lang Michael

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Research Papers

Michael Lang *

**The Principle of Territoriality and its Implementation
in the Proposal for a Council Directive on a Common Consolidated Corporate Tax Base
(CCCTB)**

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I. The CCCTB concept

The EU Commission put forward its proposal for a Directive for a "Common Consolidated Corporate Tax Base" with some delay after long preliminary work.¹ That proposal provides for a uniform corporate tax base which may be relied upon in all EU Member States. Its underlying objective is to reduce the administrative burden for companies.² A group which is subject to the CCCTB rules will no longer have to determine transfer prices. The concept therefore also assumes a consolidated tax base. The CCCTB system is optional and not intended to replace the set of corporate tax rules of the Member States. Businesses operating in several Member States no longer inevitably encounter different corporate tax systems, but are able to opt for one uniform tax base throughout the European Union.³ Still, the proposal provides only for a harmonisation of tax bases: Each Member State will be applying its own rates to its share of the taxpayer's tax base. Tax competition will be maintained, but will experience a higher degree of regulation and transparency.⁴

The CCCTB concept is ambitious. Accordingly, objections and obstacles existed from the very beginning: The parliaments of some Member States have issued comments, expressing doubts whether the proposal was compatible with the principle of subsidiarity enshrined in EU law.⁵ Some critics believe that the objective of consolidation simply goes too far: They

¹ *European Commission* of 16 March 2011, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), COM(2011) 121/4 [hereinafter: CCCTB proposal]. On the idea and history of CCCTB see *Aujean*, The CCCTB Project and the Future of European Taxation, in *Lang/Pistone/Schuch/Staringer* (eds), *Common Consolidated Tax Base* (2008) 11 (11 et seq).

² See the reasons for the CCCTB proposal, 4 (CONTEXT OF THE PROPOSAL).

³ See Art 6 in conjunction with Art 4 CCCTB proposal. See *Kubik/Massoner*, Der aktuelle Stand der Common Consolidated Corporate Tax Base (CCCTB) Was bisher geschah und noch geschehen wird, FJ 2009, 13 (13 et seq.); *Petutschnig*, Neuer Anlauf zur Common Consolidated Corporate Tax Base, ÖStZ 2011, 325 (327); *Riener-Micheler*, Gemeinsame konsolidierte Körperschaftsteuerbemessungsgrundlage: Ein Vorschlag der EU, CFOaktuell 2011, 95 (95); *Förster/Krauß*, Der Richtlinienentwurf der Europäischen Kommission zur Gemeinsamen konsolidierten Körperschaftsteuer-Bemessungsgrundlage (GKKB) 16 March 2011, IStR 2011, 607 (611); on the requirements for forming a group, see *Staringer*, Requirements for Forming a Group, in *Lang/Pistone/Schuch/Staringer* (eds), *Common Consolidated Tax Base* (2008) 1115 (115 et seq.).

⁴ See the reasons for the CCCTB proposal, 4 (CONTEXT OF THE PROPOSAL).

⁵ See the comments of the parliaments of the nine Member States: Bulgaria, Ireland, Malta, the Netherlands, Poland, Romania, Slovakia, Sweden, United Kingdom, available at <http://www.ipex.eu/IPEXL-WEB/result/simple.do?text=+ccctb+subsidiarity&start=> (access on 23 February 2012); see also *Vascega/van Thiel*, The CCCTB proposal: The Next Step towards a Corporate Tax Harmonization in the European Union? *European Taxation* 2011, 374 (377); *Von Brocke/Rottenmoser*, Harmonisierung direkter Steuern? Die GKKB im Lichte der Rechtsetzungskompetenzen der EU, IWB 2011, 620 (623); these concerns were invalidated in the reasons for the proposal, 10 et seq (LEGAL ELEMENTS OF THE PROPOSAL), according to which the "proposal is limited to combating tax obstacles caused by the disparities of national systems in computing the tax base between associated enterprises. [...] that the best results in tackling those obstacles would be achieved if a common framework regulated the computation of the corporate tax base and cross-border

advocate that the focus should be on a common tax base at least during an initial phase.⁶ There were also concerns that companies could either opt for the CCCTB or the national tax bases.⁷ Some Member States even generally rejected a harmonization of direct taxes, signalling that they would never agree with a CCCTB Directive that was applicable throughout the European Union.⁸ Many experts hence assume that the CCCTB concept could eventually only be a form of "enhanced cooperation" provided by Union law in which not all Member States are required to participate.⁹

The financial and economic crisis has boosted the discussions on tax harmonization. In a joint letter to *van Rompuy*, the President of the European Council, *Merkel and Sarkozy* pleaded for concluding the negotiations on a common consolidated corporate tax base until the end of 2012.¹⁰ Discussions on EU taxes are increasingly intense, and the Commission itself has meanwhile come forward with a proposal for a directive on a financial transaction tax, a tax

consolidation. Indeed, these matters may only be dealt with by laying down legislation at the level of the Union, since they are of primarily cross-border nature. This proposal is therefore justified by reference to the principle of Subsidiarity because individual action by the Member States would fail to achieve the intended results."

⁶ See *Herzig*, Harmonisierung der steuerlichen Gewinnermittlung in der EU; *StuW* 2006, 156 (161 et seq); *Mayr*, CCCTB: eine realistische Betrachtungsweise, *SWI* 2008, 288 (289); *Füllbier*, Überlegungen zum steuerlichen Konsolidierungsbegriff und zur Systematisierung von Gruppenbesteuerungssystemen vor dem Hintergrund europäischer Entwicklungen, in *Strunk/Wassermeyer/Kaminski* (eds), Unternehmenssteuerrecht und Internationales Steuerrecht - Gedächtnisschrift Dirk Krüger (2006) 211 (222).

⁷ Critically: *Pomp/Gerten*, Die Gemeinsame Körperschaftsteuer-Bemessungsgrundlage: (R)Evolution der Konzernbesteuerung? *IStR* 2008, 377 (392); an optional system was also rejected by the German government: Federal government's answer to an inquiry of MPs Dr. Thomas Gambke, Britta Haßelman, Lisa Paus, further MPs and Fraktion Bündnis 90/Die Grünen, Gemeinsame konsolidierte Körperschaftsteuer-Bemessungsgrundlage, 5. 5. 2011, available at: dip.bundestag.de/btd/17/056/1705748.pdf (access on 21 February 2012); disagreeing *Barenfeld*, A Common Consolidated Corporate Tax Base in the European Union – A Beauty or a Beast in the Quest for Tax Simplicity, *Bulletin for International Taxation* 2007, 258 (260). On the pros and cons of optionality, see *Hey*, CCCTB – Optionality, in *Lang/Pistone/Schuch/Staringer* (eds), Common Consolidated Tax Base (2008) 102 et seq.

⁸ The United Kingdom, Ireland, Estonia, the Czech Republic and Slovakia, critically also Germany: "The Federal Government is critical of the proposal in as far as it concerns consolidation and the relevant administrative part. As a result of the introduction of a CCCTB, Germany would risk considerable, lasting fiscal deficits", see comments of the Federal Government of 5 February 2011, see fn 7.

⁹ The principle of unanimity was relaxed by the Treaty of Nice, which provides for the possibility of enhanced cooperation ("Enhanced Cooperation Agreements") where at least eight states may cooperate without the other states being able to oppose. This facilitates the enforceability of coordination measures on political level, the Treaty of Lisbon provides that at least 9 Member States must be involved in cooperation, see Art 20 EU Treaty and Art 326 through 334 Treaty on the Functioning of the European Union; see *Mamut*, Auf dem Weg zur Common Consolidated Corporate Tax Base (CCCTB), *SWI* 2006, 425 (429, Fn 33); similarly *Mayr*, *SWI* 2008, 288 (288); *Cerioni*, European Union – Postponement of the Commission's proposal for a CCCTB Directive: Possible Ways Forward, *Bulletin for International Taxation* 2010, 98 (101 et seq); *Vascega/van Thiel*, *European Taxation* 2011, 374 (380); *Petutschnig*, *ÖStZ* 2011, 325 (333).

¹⁰ Joint German-French letter of 17 August 2011 to the President of the European Council *Herman Van Rompuy*; see *Traversa/Helleputte*, Taxation of EU resident companies under the current CCCTB Framework, in *Lang/Schuch/Staringer et al.* (eds), CCCTB (2012) in print.

that would at least partly directly flow into the EU budget.¹¹ Against this backdrop, it seems already less drastic to propose simply a harmonization of the national tax bases. In view of the dramatic economic developments in Greece and other EU Member States, critics could more willingly accept harmonization in the field of economic and fiscal policy. At the same time, the currency union is imperiled now more than ever. Due to erosion processes, also measures to create common tax bases could be put off to a time in the distant future.

For all these reasons, it is extremely uncertain at this point whether, when and in which form the forwarded CCCTB proposal will be part of Union law. The fact that a specific proposal for a Directive has been available since 2011 has further boosted the discussions. The scientific analysis involves not only mere considerations in respect of the concept of such a common consolidated corporate tax base, but also concrete proposals for the rules as such. It will be up to scholars to review that proposal critically and to point to doubts and weaknesses, if any, to pave the ground for an advancement of the proposal. If the competent EU bodies should decide to make the CCCTB concept reality, whatever its form may be, they should be able to rely on those considerations.

This paper will focus on some provisions of the proposal, which are relevant for companies which are tax resident outside the EU or for commercial activities carried out there, and for EU resident companies that operate in third countries. I will primarily discuss the territoriality principle, on which the CCCTB concept is based, and its legal technical structure. However, I will not discuss other provisions of the proposal, even if those should specifically address third country scenarios, such as those¹² concerning deductibility of donations¹², the transfer of assets¹³ or deductibility of interest¹⁴.

II. Achievement of the territoriality principle

1. Comprehensive taxation of resident companies

At least at first sight, the provisions of the CCCTB proposal distinguish between worldwide taxation and purely territorial taxation: Pursuant to Art 6 (6) of the proposal "*a company*

¹¹ *European Commission* of 28 September 2011, proposal for a Council Directive on a common system of financial transaction tax and amending Directive 2008/7/EC, COM(2011) 594.

¹² Art 12 in conjunction with Art 16.

¹³ Art 31.

¹⁴ Art 81.

resident in a Member State which opts for the system provided for by this Directive shall be subject to corporate tax under that system on all income derived from any source, whether inside or outside its Member State of residence". Art 6 (7) of the proposal on the other hand provides that *"a company resident in a third country which opts for the system provided for by this Directive shall be subject to corporate tax under that system on all income from an activity carried on through a permanent establishment in a Member State"*.

The Directive shall hence be applicable to companies resident both inside and outside the EU. Art 2 of the proposal distinguishes between *"companies established under the laws of a Member State"* (paragraph 1) and *"companies established under the laws of a third country"* (paragraph 2). The first group is subject to a "list system" primarily known from other fiscal Directives.¹⁵ A company established under the laws of a Member State is subject to the Directive if it takes one of the forms listed in Annex I and is subject to one of the corporate taxes listed in Annex II or to a similar tax subsequently introduced. However, Annex II treats the companies rather differently. The list of legal forms is exhaustive for some states. In other cases, there is a general clause, for example for *"other companies constituted under French law subject to the French Corporate Tax"*.¹⁶ While the list of companies, albeit different for each Member State, eventually seems to be exhaustive, there is a general clause for corporate taxes, which provides that not only the corporate taxes listed in Annex II, but also similar taxes subsequently introduced are eligible. Such a comparability test is known from Art 2 (4) OECD-MC¹⁷ or Art 3 (a) (iii) of the Interest and Royalties Directive.¹⁸ While the provisions of the OECD-MC and those of the Interest and Royalties Directive are largely consistent, the authors of the CCCTB proposal have used an entirely different language in Art 2 (1) (b). This is an unsuitable approach, because the objective of those regulations seems to be the same in all these cases. A different language will lead to the risk of legal practice inferring a divergent content.

¹⁵ Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in case of parent companies and subsidiaries of different Member States [hereinafter: Parent-Subsidiary Directive], OJ L 345/8, Annex I; 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, OJ L 157/49, Annex.

¹⁶ Annex I of the CCCTB proposal, k.

¹⁷ Accordingly, the Convention shall apply *"also to any identical or substantially similar taxes that are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes."*

¹⁸ Pursuant to Art 3 (a) (iii) of 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: *"to one of the following taxes 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"*. See now Art 2 (c) (iii) of the proposal of 11 November 2011, COM (2011) 714 final.

In addition, Art 2 (3) of the proposal provides that the Commission may adopt delegated acts *"in order to amend Annexes I and II to take account of changes to the laws of the Member States concerning company forms and corporate taxes"*. Pursuant to Art 127 (1) of the proposal, that power to adopt delegated acts shall be conferred on the Commission for an indeterminate period of time. Pursuant to Art 128 (1), the delegation of powers may be revoked at any time by the Council. Furthermore, pursuant to Art 129 (1), the Council may object to a delegated act within a period of three months from the date of notification. If, on the expiry of this period, the Council has not objected to the delegated act, it shall be published in the Official Journal of the European Union and shall enter into force on the date stated therein pursuant to Art 129 (2). The delegated act may be published in the Official Journal of the European Union if the Council has informed the Commission of its intention not to raise objections. Accordingly, the list of corporate forms referred to in Annex I may be extended by way of comitology.¹⁹ In case of *"a similar tax subsequently introduced"*, however, the adjustment must be made by the Member State itself or, in case of a lack or erroneous transposition by the Member State, the common tax base may be applied in direct reliance on the Directive. Other than the introduction of newly created corporate forms, the introduction of new taxes does not require a comitology procedure to ensure that these are covered by the Directive., obviously because Annex I contains a general clause anyway for those Member States that consider an automatic adjustment appropriate in case of new corporate forms. A similar provision can be found in Art 2 of the Parent-Subsidiary Directive and in Art 3 of the Interest and Royalties Directive. These Directives even provide for a similarly differentiated list system for the corporate forms. That system is not subject to change by way of comitology, while a comparability test is sufficient in case of corporate taxes within the framework of the CCCTB.

Art 2 (1) of the CCCTB proposal – just like Art 2 (2) – merely requires that the company *"is subject to"* one of the corporate taxes, while Art 2 (1) (c) of the Parent-Subsidiary Directive and Art 3 (1) (iii) of the Interest and Royalties Directive requires that the company be subject to tax *"without being exempt"*. This implies that the company may be subject to the CCCTB rules even if it is exempt.²⁰ Accordingly, we would have to distinguish between companies exempt from national corporate tax to which the Directive may be applied, and those

¹⁹ See in detail *Lyal*, Comitology in *Lang/Pistone/Schuch/Staringer*, Common Consolidated Corporate Tax Base (2008) 49 et seq.; CCCTB Working Group, CCCTB: possible elements of a technical outline, 26 July 2007, CCCTB/WP/057/, Items 10, 16, 25, 46 and 66.

²⁰ *Cerioni* also applies a broad interpretation in: The Commission's proposal for a CCCTB Directive: Analysis and Comment, Bulletin for International Taxation 2011, 515 (516).

companies that are not subject to national corporate tax in the first place and can thus not be subject to the scope of application of the Directive. There is little point in terms of legal policy to make that distinction, as that approach would make the coincidental national legislative techniques relevant for purposes of Union law.²¹ However, these differences in language must not be over-emphasized anyway, since also the Parent-Subsidiary Directive on the one hand and the Interest and Royalties Directive on the other hand are different, without that fact being material. While Art 2 (1) (c) of the Parent-Subsidiary Directive emphasizes that the company must be subject to one of the taxes stated therein "*without the possibility of an option*", that reference cannot be found in the Interest and Royalties Directive. Still, it would be desirable if the authors of the CCCTB proposal followed the wording of provisions of an already existing Directive in order to avoid additional problems of interpretation which can arise from these very differences.

Art 6 of the CCCTB proposal substantially distinguishes between companies which are resident for tax purposes in a Member State (paragraph 1) and companies which are not resident for tax purposes in a Member State (paragraph 2). The first group is entirely subject to the Directive if it opts for the system. When opting for the system, the second group can be subject to the provisions of the Directive only in respect of its permanent establishments located in the EU. Pursuant to Art 6 (3) of the proposal, a company that has its registered office, place of incorporation or place of effective management in a Member State shall be considered resident for tax purposes in that Member State. Contrary to Art 2 (a)(ii) of the Parent-Subsidiary Directive and Art 3 (a) (ii) of the Interest and Royalties Directive, the residence criteria must autonomously be derived from Union law²², without any reference to national law. The language of Art 6 (3) of the CCCTB proposal in turn rather reminds us of Art 4 (1) OECD-MC, although it is not fully identical with it: Art 4 (1) OECD-MC does not specifically mention the registered office and merely refers to the place of "*management*" and not to "*effective management*". The terms "*effective management*" however can be found in the so-called tie-breaker rule of Art 4 (3) OECD-MC. Rather than being similar to Art 4 (1) OECD-MC, Art 6 (7) of the CCCTB proposal is similar to Art 4 (1) UN-MC and to Art 4 (1) US-MC, both referring to the "*place of incorporation*". Again, regrettably enough, the authors of the proposal have not relied upon already existing expressions. This might have shed light

²¹ Cerioni, Bulletin for International Taxation 2011, 517.

²² See previously Art 2 (1) (b) of Council Directive 2003/123/EC of 22 December 2003 on the common system of taxation in the case of parent companies and subsidiaries of different Member States, OJ L 7/41; see now Art 2 (c) (ii) of the proposal of 11 November 2011, COM (2011) 714 final.

upon the meaning of those regulations in reliance on already issued opinions. Instead, they have followed their own course.

Art 6 (3) of the CCCTB proposal lays down an additional criterion to determine a company's residence, namely whether it "*is not, under the terms of an agreement concluded by that Member State with a third country, regarded as tax resident in that third country*". If the tie-breaker rule of a DTC hence makes the third country the country of residence, the company will lose its residence in the EU and will be considered a third country entity for tax purposes. Based on the DTCs that are modelled after the OECD Model Convention, a company's residence is determined by the place of "*effective management*". There are, however, a number of DTCs which deviate from the wording of the OECD-MC or which, in case of dual residence, do not grant treaty benefits at all or grant these benefits only after the conduct of mutual agreement procedures.²³ In these cases, a company will lose its EU-residence only if a mutual agreement procedure has been concluded. If a company is not considered resident in any state according to a DTC, it cannot be deemed resident in a third country. The same applies if there is no DTC with a third country or if the DTC is not applicable. If companies resident in two states are hence either not entitled to treaty benefits or are "*under observation*" for purposes of application of a DTC, and the competent authorities therefore reserve the right to clarify their entitlement by way of a mutual agreement procedure in a particular case, that disadvantage suddenly becomes a blessing for the purpose of the Directive. In terms of legal policy, that diametric difference in evaluation between DTC and proposal is not comprehensible at first sight.

Concededly, Art 2 of the Parent-Subsidiary Directive and Art 3 of the Interest and Royalties Directive are based on a similar concept,²⁴ although the CCCTB proposal has its own terminology. As a result of the two existing Directives, the absence of treaty benefits turns into an advantage for purposes of the Directive. Ultimately, the Directive's scope of application depends on the content of the concluded DTCs and can hence be different in each Member State. This can only be due to the fact that, as a result of the company's residence outside the EU for purposes of the DTC, the company can be taxed in the EU Member State only in respect of income from sources in the Member State, hence resembling more a non-

²³ See for the first example the DTC Austria-Liechtenstein. For the second example DTC Bulgaria-Latvia, Bulgaria-Lithuania, Estonia-Finland, Estonia-Canada, Estonia-Latvia, Estonia-Lithuania, Estonia-Turkey, Estonia-Belarus, Finland-Canada, Finland-Latvia, Finland-Lithuania, Finland-Turkey, Finland-Belarus, Canada-Mexico, Canada-Philippines, Canada-Thailand, Latvia-Canada, Latvia-Turkey, Latvia-Belarus, Lithuania-Canada, Lithuania-Turkey, Lithuania-Belarus, Thailand-Turkey.

²⁴ See now Art 2 of the proposal of 11 November 2011, COM (2011) 714 final.

resident than a resident. For the existing Directives and also for the CCCTB proposal, the question now is whether it is worth to accept for that objective the fact that the scope of the Directive varies from Member State to Member State and, on the other hand, depends on in which third country the company is still resident. Should these companies generally be regarded as being resident in the EU, it would be useful to adopt in the Directive the wording of the tie-breaker rule laid down in Art 4 (3) OECD-MC. In that case, however, companies taxable in respect of their world-wide income would sometimes be considered non-residents also in the EU for purposes of the CCCTB rules. Pursuant to Art (4) of the CCCTB proposal, companies resident in several Member States would be subject to precisely that rule in order to determine in which Member State they are finally resident.

Art 6 (6) CCCTB proposal provides that a company resident in a Member State which opts for the system provided for by this Directive *"shall be subject to corporate tax under that system on all income derived from any source, whether inside or outside its Member State of residence"*. Similarly, Art 6 (7) provides in respect of a company resident in a third country that it *"shall be subject to corporate tax under that system on all income from an activity carried on through a permanent establishment in a Member State"*. This language hence implies that the concept of income is very broad, because the focus is on "all" and – at least in Art 6 (6) – *"from any source, whether inside or outside its Member State of residence"*.

Art 10 CCCTB proposal provides that the tax base shall be calculated as revenues minus exempt revenues, deductible expenses and other deductible items. Revenues, in turn, are defined in Art 4 (8) of the proposal. Revenues hence include also *"subsidies and grants, gifts received, compensation and ex-gratia payments"*. The second sentence of Art 4 (8) of the proposal specifically notes that revenues shall not include equity raised by the taxpayer or debt repaid to it. "Income" can be defined also on the basis of other provisions: Art 9 (1) of the proposal provides that in computing the tax base, profits and losses *"shall be recognized only when realized"*. The concept of income is hence determined also by the realization principle. Pure appreciation of assets will hence not trigger taxable income. Exemptions from the realization principle - such as the provisions for controlled foreign companies pursuant to Art 82 of the CCCTB proposal - are specifically mentioned. Further indications are offered by the exemptions. Art 11 (d) specifically exempts proceeds from a disposal of shares. This implies that capital gains otherwise qualify as income.

2. Exemption of foreign permanent establishments, dividends, and capital gains

The provision of Art 11 (e) CCCTB proposal largely realises the territoriality principle. It exempts from corporate tax "*income of a permanent establishment in a third country*". At the same time, Art 11 (c) exempts received profit distributions and Art 11 (d) exempts proceeds from a disposal of shares. Other than the exemption of permanent establishments in third countries, both provisions apply regardless of the residence of the entity which distributes profits or whose shares are disposed of. It hence makes no difference whether an EU-resident company operates in a third country through a permanent establishment or through shares in another company. This provision is characterized by the principle of neutrality as to corporate form. Both profits of permanent establishments and the profit distributions of the companies are exempt. In both cases, also the capital gains are exempt.

However, in other cases, income from third countries may be subject to tax, for example if it is not "*income of a permanent establishment*". If a taxpayer engages in commercial activities in a third country without establishing a fixed place of business, he will therefore still be taxed on his worldwide income. Furthermore, the principle of attraction does not apply either. Consequently, not the mere existence of a permanent establishment in another state will lead to an exemption of all income generated in this state. As the proposal only exempts "*income of a permanent establishment*" the income has to be attributable to the permanent establishment.

The concept of permanent establishment is defined in detail in Art 5 of the proposal. That definition is largely modelled after Art 5 OECD-MC. The authors of the proposal hence have decided to follow neither the model of Art 3 (c) of the Interest and Royalties Directive, which merely defines permanent establishments *along the lines of* Art 5 (1) OECD-MC²⁵, nor Art 2 (b) of the Parent-Subsidiary Directive which combines this brief definition of a permanent establishment with a subject-to-tax-clause. Again, the proposal did not fully adopt Art 5 OECD-MC. Consequently, the meaning of the expression which is missing in the OECD Model, according to which the permanent establishment of a taxpayer must be "*in a State other than the State in which its central management and control is located*", remains unclear. There is no apparent reason for this derogation from Art 5 OECD-MC. Not only does this addition seem superfluous, it also raises doubts as will be shown below.

²⁵ See Art 2 (e) of the proposal of 11 November 2011, COM (2011) 714 final.

The proposal does not contain any provision which specifically refers to the allocation of profits. Since numerous provisions are parallel to those of the OECD-Model – such as those regarding permanent establishments – obviously, the principles relevant in connection with Art 7 OECD-MC could apply.²⁶ However, specifically the question of allocating profits to permanent establishments is not one for which there is a definite answer within the OECD: Art 7 OECD-MA was thoroughly restated by the Update 2010.²⁷ In the context of Union law, however, the question arises whether the allocation of profits to a permanent establishment should not be governed by those principles that are enshrined in the EU Arbitration Convention.²⁸ Art 4 (2) of the EU Arbitration Convention provides as follows: *"Where an enterprise of a Contracting State carries on business in another Contracting State through a permanent establishment situated therein, there shall be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment."*

This rule is visibly modelled after the former Art 7 (2) OECD-MC,²⁹ although the latter did not contain the reservation in respect of the special provisions of Art 7 (3) OECD-MC and Art 7 (3) OECD-MC, just like paragraphs (4) and (5) of Art 7 OECD-MC, is not reflected in the EU Arbitration Convention. Provided that the principles enshrined in the EU Arbitration Convention adopted in 1990 are considered relevant, it seems reasonable to allocate profits on the basis of the opinions adopted in the OECD-MC and the 1977 OECD Commentary. Already the bilateral DTCs do not provide any basis for the OECD Commentary's opinion that the current version of the OECD Commentary should be relied upon for an interpretation of DTCs concluded even earlier.³⁰ That position has to be even less relevant for an interpretation of the EU Arbitration Convention. That opinion, known as Authorized-OECD-

²⁶ CCCTB Working Group, An overview of the main issues that emerged at the third meeting of the subgroup on International aspects (SG4), 13 December 2006, CCCTB/WP/049/, Sections 13 et seq.

²⁷ On the implementation of the AOA in Art 7 of the OECD-MC 2010, see *Plansky*, Die Gewinnzurechnung zu Betriebsstätten im Recht der Doppelbesteuerungsabkommen (2010) 248 et seq; see also *Bendlinger*, Paradigmenwechsel bei der Auslegung des Betriebsstättenbegriffs im DBA-Recht durch die OECD, SWI 2006, 358 (358 et seq); *Bendlinger*, Die Betriebsstätte im OECD-Musterabkommen 2010, SWI 2011, 61 (61 et seq).

²⁸ Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises; original version of 23 July 1990 (90/436/EEC).

²⁹ See Art 7 (2) OECD-MC 2008.

³⁰ See *Lang*, Die Bedeutung des Musterabkommens und des Kommentars des OECD-Steuerausschusses für die Auslegung von Doppelbesteuerungsabkommen, in *Gassner/Lang/Lechner* (eds), Aktuelle Entwicklungen im Internationalen Steuerrecht (1994) 13 (25); *Lang*, Keine Bedeutung der jüngeren Fassung des Kommentars des OECD-Steuerausschusses für die Interpretation älterer Doppelbesteuerungsabkommen, IWB 1996, 923 et seq; *Lang*, Introduction to the Law of Double Taxation Conventions (2010) 45 et seq.

Approach (AOA), could prevail only if it can be inferred from the principles already enshrined in the 1977 OECD-MC and the Commentary.

However, the provisions of Articles 78 and 79 of the CCCTB proposal should be taken into account. Although concerning only associated enterprises and, at least at first sight, not the relations between headquarters and permanent establishment, the last subparagraph of Art 78 (1) provides that a taxpayer "*shall be regarded as an associated enterprise to its permanent establishment in a third country*", and similarly a non-resident taxpayer "*shall be regarded as an associated enterprise to its permanent establishment in a Member State*". This implies that the relations between headquarters and permanent establishments are governed by the provisions on relations between associated companies laid down in Art 78, although that is not absolutely certain. Art 79 governs "*relations between associated enterprises*" and hence presupposes at least the existence of *two* associated companies, while the last subparagraph of Art 78 (1) regards the taxpayer as an "*associated enterprise to its permanent establishment*", hence does not stipulate that both the taxpayer and its permanent establishment must each be considered as "*associated*" companies. Once these concerns are overridden, the legal consequences laid down in Art 78 (f) of the proposal are relevant also for the relations between headquarters and permanent establishment. However, Art 79 is somehow - albeit not fully - modelled after Art 9 OECD-MC and Art 4 (1) of the EU Arbitration Convention.³¹ This could be a reason to grant the permanent establishment greater independence from its headquarters in the context of attributing its profits than this would be possible pursuant to Art 4 (2) of the EU Arbitration Agreement. Against this backdrop, the provisions of the proposal could also be inspired by the fundamental idea of the Authorized OECD Approach.

Furthermore, Art 11 (e) of the CCCTB proposal can also lead to an exemption of income from sources within the EU. That exemption applies also if a permanent establishment's income in a third country includes also interest or royalties from the EU. If the assets of a US-based permanent establishment of a German company include, inter alia, French bonds and interest is attributable to that permanent establishment, also French interest is exempt.

Revenues which are specifically exempt pursuant to Art 11 (c) of the CCCTB proposal include also "*received profit distributions*". The proposal apparently wants to avoid economic double taxation of profits by exempting the profit distributions as such. The proposal obviously wants to leave it at the fact that the lower-level entity is regularly taxable, its tax

³¹ CCCTB Working Group, Related parties in CCCTB, 13 December 2006, CCCTB/WP/041/, Sections 13 et seq.

base being determined according to national law or the CCCTB Directive. The recipient entity should not be taxable again. There is no minimum holding period or minimum shareholding requirement. This provision does not differentiate by residence of the distributing company and is hence also applicable to "*received profit distributions*" from third countries. Again, the language the authors of the proposal have selected is not fully consistent with the language of the Parent-Subsidiary Directive. While the Parent-Subsidiary Directive refers to "*distributions of profits*", the CCCTB proposal refers to "*received profit distributions*". One explanation could be that the exemption can thereby be distinguished from the tax liability of certain "*non-distributed income of an entity*" expressed as an exception in Art 82 (1) in conjunction with Art 83 (5).

The exemption of "*received profit distributions*" does not define the legal nature of the participation which establishes the right to receive profit distributions. It is therefore uncertain whether corporate law is relevant here or whether a mere obligation is sufficient, provided a corresponding share is held in equity. Similarly, the specific requirements which an entity has to fulfill to qualify as a source of "*distributions of profits*" are not defined.

Some indications for a definition of "*distributions of profits*" could be found in Art 82 (1) (a) of the proposal: The provisions for "*controlled foreign companies*" are supposed to subject to direct taxation income received by the foreign entity at the level of the shareholder or persons with a similarly controlling position. These provisions shall apply if the taxpayer by itself, or together with its associated enterprises, holds a direct or indirect participation of more than 50% of the voting rights, or owns more than 50% of the capital or is entitled to receive more than 50% of the profits of that entity. Supposedly, taxpayers could also receive distributions of profits if they either have voting rights or hold capital or are entitled to profits. However, pursuant to Art 83 (2) of the proposal, the income to be included in the tax base "*shall be calculated in proportion to the entitlement of the taxpayer to share in the profits of the foreign entity*". This, in turn, implies that only an entity that is entitled to the profits can have a "*received profit distribution*".

Another approach could be based on the definition of dividends. Although the CCCTB proposal does not contain such a definition, its Art 81 (2) specifies interest in conformity with Art 11 (3) OECD-MC, which has also been adopted in the Interest and Royalties Directive.³²

³² Lang, *Hybride Finanzierungen im internationalen Steuerrecht* (1990) 114 et seq; Nowotny, *VwGH zum abkommensrechtlichen Begriff der Einkünfte aus Zinsen* iSv Art 11 Abs 3 OECD-MA, *ÖStZ* 2004, 137 (137 et seq); CCCTB Working Group, 23 September 2005, CCCTB/WP/017, Section 15; Andersson, *Comments on*

Impliedly, the authors of the proposal could have understood dividends pursuant to Art 10 (3) OECD-MC. Again, it is an entirely different question whether "*received profit distributions*" could be clarified based on that understanding. In connection with revenues, Art 4 (8) of the proposal refers *inter alia* to "*proceeds from disposal of assets and rights, interest, dividends and other profit distributions*", that rather suggesting that profit distributions must be understood much broader than dividends. Paragraph 11 of the Directive's recitals, on the other hand, assumes that "*income consisting in dividends, the proceeds from the disposal of shares held in a company outside the group and the profits of foreign permanent establishments should be exempt*". Quite obviously, the authors of the proposal had in mind the exemptions of Art 11 (c), (d) and (e), which include "*received profit distributions*", "*proceeds from a disposal of shares*" and "*income of a permanent establishment in a third country*". This clearly shows that the expressions "*income consisting in dividends*" and "*received profit distributions*" were used synonymously in this context.

Furthermore, Art 11 (d) of the proposal exempts proceeds from a disposal of shares, regardless of holding period and extent of the shareholding. In terms of terminology, that provision does not build on the previously discussed exemption of "*received profit distributions*". Due to the systematic context, it is presumably a requirement that the entity in which a share is held and which is exempt in respect of "*received profit distributions*" is the same form of entity. The CCCTB rules are hence broader than the Parent-Subsidiary Directive, which merely necessitates the exemption of profit distributions. This is a consistent systematic approach, since a shareholder frequently faces the option of realizing the profits generated by his entity either in the form of profit distributions or in the form of capital gains.

For all these cases, Art 72 provides that for determining the tax rate applicable to a taxpayer, without prejudice to Article 75, revenue which is exempt from taxation pursuant to Art 11 (c), (d) or (e) may be taken into account. That exemption with progression will be of little relevance whenever the rate of corporate tax is flat. The exemption with progression rules could be significant whenever different tax categories or different rates are applicable to distributed and retained profits. Interestingly enough in this context, this provision refers to "*revenue*" while the proposal uses the terms "*proceeds*" or "*income*" elsewhere. This could be significant in respect of a possible negative exemption by progression. The fact that this provision mentions only revenue and hence a positive gross amount, could imply that the

document CCCTB\WP\042 (2006) 1 et seq.; Art 11 (4); *Wassermeyer in Wassermeyer/Lang/Schuch*(2010), *Doppelbesteuerung - OECD-Musterabkommen DBA Österreich - Deutschland, Kommentar*², MA Art 11 para 71.

CCCTB should not allow a negative exemption with progression. Based on the assumption that revenue is a gross figure, the expenses attributable to third-country income could not be taken into account. This would hardly make sense in terms of legal policy, as this would not lead to an exemption of foreign income in cases of high related expenses.

3. Taxation of EU permanent establishments and third-country residents

Companies resident in third countries may also be subject to the CCCTB in respect of their EU-based permanent establishments. In determining the tax base, the profits attributable to the permanent establishment will be included.³³ The non-resident then forms a group together with that permanent establishment and the other qualified subsidiaries.

Pursuant to Art 2 of the proposal, the proposed Directive shall apply to a company established under the laws of a third country if it has a similar form to one of the forms listed in Annex I and if it is subject to one of the corporate taxes listed in Annex II. A similarity test must hence be carried out in respect of companies established under the laws of a third country. That provision hence differs from that applicable to EU-resident companies, although it does not specify the relevant parameters needed to make a comparison. Presumably, that comparison shall not involve the corporate forms accepted in the *specific Member State*, as third countries should not be qualified differently in each Member State. Still, the common features of the corporate forms listed in Annex I are not evident. That similarity test is even more complicated by the fact that the list of Annex I may be supplemented by way of a comitology procedure, with no similarity test being necessary, obviously leaving broader scope for discretion: The Commission is supposed "*to take account of changes to the laws [...]*". This gives also the similarity test a dynamic element, and it may be different depending on the status of Annex I.

Interestingly enough, other than for companies established in the EU, no similarity test is necessary in respect of corporate tax; the company must rather be subject to one of the corporate taxes listed in Annex II. I presume that this is an editorial error, since it is hard to see why companies that are subject to a similar tax introduced later on in respect of their EU permanent establishments should not automatically be covered by the Directive in that case.

³³ CCCTB Working Group, The territorial scope of the CCCTB, 9 March 2006, CCCTB/WP/026/, Section 30.

In view of the non-discrimination of permanent establishments enshrined in existing DTCs with third countries, that discrimination could raise concerns.

Pursuant to Art 3 (1) of the proposal, the Commission shall adopt annually a list of third country company forms. That list shall meet the requirements laid down in Art 2 (2) (a) of the proposal and shall be adopted in accordance with the examination procedure provided therein. In that case, a simplified authorization procedure applies: Pursuant to Art 5 of Regulation No 182/2011³⁴, the committee shall deliver its opinion by the majority laid down in Art 16 (4) and (5) of the Treaty on European Union and, where applicable, Art 238 (3) TFEU, for acts to be adopted on a proposal from the Commission. Where the committee delivers a positive opinion, the Commission shall adopt the draft implementing act.

However, the corporate forms are not listed exhaustively. Nevertheless, the fact that a company form is not included in the list of third country company forms referred to in paragraph 1 shall not preclude the application of this Directive to that form. This makes sense, because the Commission cannot always keep track of all changes in legislation worldwide. In this context, however, the question arises whether national legislators must implement that provision in a manner to allow administrative authorities and, eventually, the courts to carry out an examination procedure, or whether the national legislator itself is required to carry out an examination procedure and make continuous adjustments. Since the national legislator, just like the Commission, cannot always keep track of all changes in legislation worldwide, the national legislator might content itself with ordering an examination procedure by way of a general clause, which shall then be handled pursuant to the list prepared by the Commission according to Art 3 (2). The company forms referred to in that list must be regarded as similar in any case, although the fact that a company form is not included in the list does not preclude the application of this Directive to that form.

In view of the tax base, Art 6 (7) of the proposal combines territorial taxation with world-wide taxation of income: A company resident in a third country is subject to tax only on income from an activity carried on through a permanent establishment in a Member State. This means that a permanent establishment must exist and that income must be attributable to the permanent establishment. On the other hand, income from that activity is taxable whether the activity concerns only the state of the permanent establishment or another EU Member State

³⁴ Regulation (EU) No 182/2011 of the European Parliament and of the Council of 16 February 2011 laying down the rules and general principles concerning mechanisms for control by Member States of the Commission's exercise of implementing powers, OJ L 55/13.

or even a third country: Consequently, if a US-resident company has a permanent establishment in the EU to which interest from the US is attributable, that permanent establishment is taxable under the CCCTB regime.

Pursuant to Art 6 (2) of the proposal, a company which is not resident for tax purposes in a Member State may opt for the system provided for by this Directive under the conditions laid down therein in respect of a permanent establishment maintained by it in a Member State. Whether or not a permanent establishment exists again depends on the definition set forth in Art 5 of the proposal. As discussed above, that definition is largely modelled after the OECD Model Convention.

As a consequence, the question arises whether the numerous exemptions discussed above are applicable to non-resident companies as well. This would be the case under Union law only if the freedom of establishment applied. Besides situations involving EEA states, this could only refer to situations within the European Union. Arguably, the free movement of capital will not necessitate an extension of these exemptions to permanent establishments in relation to other third countries. However, this may be necessary since DTCs with third countries contain provisions which prohibit discrimination of permanent establishments.

The wording of the relevant exemptions as such is regularly not confined to resident companies. Art 11 of the proposal does not contain such a restriction at all: That provision generally exempts from corporate tax the proceeds mentioned therein without distinguishing as to whether these are earned by an EU resident or non-EU resident. Accordingly, the exemptions laid down in Art 11 (c), (d) and (e) are applicable as well.

Consequently, if the dividends are attributed to the permanent establishment according to any of the principles discussed above, profit distributions are also exempt at the level of the permanent establishment. The same applies to proceeds from a disposal of shares which are part of the business assets of that permanent establishment.

The exemption of a permanent establishment's income in a third country could be relevant as well. Let me use a construction company as an example to illustrate this: If a construction company resident in a third country has a permanent establishment in an EU state and carries out from that state a building site in a third country, that building site qualifies as a permanent establishment pursuant to Art 5 of the proposal if it lasts longer than twelve months. If that is the case, the building site profits cannot be taxed at the level of the permanent establishment

in the EU Member State³⁵. Although one could argue that it is not a permanent establishment of a taxpayer which is located in a state other than the state in which the taxpayer's central management and control is located, we should nevertheless not overemphasize that inadequacy of Art 5 of the proposal. Otherwise, the results would be different if the state of residence of the company is a third country other than the country in which the building site is carried out. It would be inappropriate to arrive at different results here.

Another question is whether the exemption with progression referred to in Art 72 of the CCCTB proposal would be applicable in these and other situations. Again, that provision certainly does not specifically refer to EU resident taxpayers. There is hence no obstacle to applying the exemption with progression clause here as well. For systematic reasons, there are frequent calls also in the field of national tax systems for an application of the exemption with progression also in the state of limited tax liability to avoid inappropriate preferred treatment as a result of the exemption method.³⁶ Against this backdrop, nothing speaks against applying Art 72 in this situation.

III. Derogation to the principle of territoriality

1. Taxation of interest and royalties

The CCCTB concept is characterized by the principle of territoriality. The authors of the proposal have initially assumed a comprehensive concept of income which is not confined to EU sources and have then restricted that taxation of worldwide income through the exemptions discussed above. As a consequence, however, any income is taxable which is subject to that concept and not exempt. Business profits generated outside the EU which are not attributable to a permanent establishment located outside the EU are therefore taxable pursuant to the CCCTB rules.

³⁵ On the DTC problems of "sub permanent establishment" see *Buciek* "Unterbetriebsstätte" und Außensteuerrecht, in *Klein/Stihl/Wassermeyer/Piltz/Schaumburg* (eds), *Unternehmen, Steuern - Festschrift Flick* (1997) 647 (647 et seq); *Gassner/Hofbauer*, Die Unterbetriebsstätte, in *Gassner/Lang/Lechner/Schuch/Staringer* (eds), *Die beschränkte Steuerpflicht im Einkommen- und Körperschaftsteuerrecht* (2004) 83 (85 et seq); *Lang*, Die Unterbetriebsstätte im Abkommensrecht, in *Gocke/Gosch/Lang* (eds), *Körperschaftsteuer, Internationales Steuerrecht, Doppelbesteuerung - Festschrift Wassermeyer* (2005) 709 (715 et seq).

³⁶ *Haunold/Tumpel/Widhalm*, EuGH: Negativer Progressionsvorbehalt bei beschränkter Steuerpflicht geboten, *SWI* 2007, 486 (486 et seq); *Marschner*, Die Steuerpflicht nach § 1 Abs. 4 EStG und das Gemeinschaftsrecht, *SWK* 2007, S 692 (692 et seq).

The same applies to other non-exempt income, in particular interest and royalties. The authors of the proposal have emphasized the taxable nature of that income by having incorporated in Art 76 a credit for foreign taxes. This provision requires income to be included in the tax base and being taxable in the EU.

2. The switch-over clause

Under certain circumstances, a switch-over from the exemption method to the credit method is possible in respect of the exemptions referred to in Art 11 (c), (d) and (e). This witch-over is possible if the company which made the profit distributions, the entity the shares of which are disposed of or the permanent establishment were subject to tax at a rate which was too low in the country of residence of the company.³⁷ This fact will revive the tax liability, while the exemptions referred to in Art 11 (c), (d) and (e) are eliminated with the aim of avoiding double non-taxation or taxation under the general regime in a country.

The switch-over pursuant to Art 73 shall apply if "*under the general regime in that third country*" the entity which made the profit distributions, the entity the shares in which are disposed of or the permanent establishment were subject, in the entity's country of residence or the country in which the permanent establishment is situated is subject to "*a tax on profits at a statutory corporate tax rate lower than 40% of the average statutory corporate tax rate applicable in Member States*". Alternatively, that provision shall apply if the company or the permanent establishment is subject to "*a special regime in that third country that allows for a substantially lower level of taxation than the general regime*".

The first provision of Art 73 (a) of the proposal merely asks if the taxpayer is subject to "*a tax on profits, under the general regime in that third country, at a statutory corporate tax rate lower than 40% of the average statutory corporate tax rate*". Relevant is only the nominal tax rate and not the taxpayer's specific tax burden. The switch-over occurs in any event if the nominal tax rate is lower than this threshold. The switch-over applies even if the tax burden is high due to broad tax bases with only few exceptions, and even if it is higher than in the controlling shareholder's Member State.

Let me give you an example: A company resident in a Member State has a permanent establishment in a third country which generates profits of 100,000 determined according to CCCTB rules. Due to other tax base rules in that state, the permanent establishment's profit

³⁷ CCCTB Working Group, Possible elements of a technical outline, 26 July 2007, CCCTB/WP/057, Section 120.

amounts to 500,000 according to the domestic law of the third country. At a nominal tax rate of 8%, the corporate tax burden is hence 40,000. The switch-over clause applies although the actual tax burden in the other state - in relation to the CCCTB tax base - is 40%.

On the other hand, Art 73 (a) does not apply if the nominal tax rate exceeds the threshold, but if the effective tax burden is low or even zero due to the tax base provisions. In that case, the switch-over could take place only if the requirements of Art 73 (b) are fulfilled. For purposes of Art 73 (a) the question arises whether there can be several "*general regimes*", for example if different tax rates apply to different types of corporate forms or if different tax rates apply to profit distributions and retained profits. Art 73 (b) of the CCCTB proposal seems to preclude that, as it refers to "*the general regime*". In those cases, it can be rather difficult to identify a single "*general regime*".

The alternative requirement of Art 73 (b) applies only if the taxpayer is subject to "*a special regime in that third country that allows for a substantially lower level of taxation than the general regime*". Again, let me give you an example: The corporate tax rate is generally 40% in the third country. A company may take advantage of a 20% special tax rate due to the fact that the permanent establishment is located in an area of the third country for which tax subsidies are granted. This "*allows for a substantially lower level of taxation than the general regime*". Art 73 (b) also requires this tax rate to be "*substantially*" lower than the general regime. There is no identifiable standard to measure substantiality. Let us assume that a tax rate which is 20% lower than the general regime qualifies as substantially lower rate. This example shows that a 20% special tax rate may trigger a switch-over, while a 15% regular tax rate will regularly not do so as long as the average applicable statutory corporate tax rate is lower than 15%.

Other than paragraph a, paragraph b of Art 73 does not refer to the "*statutory corporate tax rate applicable in the Member States*", but only to the "*level of taxation*", apparently not referring to the nominal tax rate, but simply comparing the tax rate under the general regime with that which the special regime "*allows for*". Consequently, special provisions concerning the tax base should presumably fall under this provision. Let me give you an example: The corporate tax rate is generally 40% in the third country. Since the company's permanent establishment is located in an area of the third country for which tax subsidies are granted, the company may recognize special depreciation. Its profit therefore amounts to 500,000. Profits would have amounted to 1,000,000 without that special depreciation. The tax burden would have amounted to 400,000 at a 40% tax rate, but only 200,000 of tax are payable under the

special regime. The taxpayer reduced its tax burden to 20% in relation to the general regime. The requirements for the application of Art 73 (b) are fulfilled³⁸.

Some of these examples show that the provision can also apply in cases where there is no need for it in terms of legal policy. Particularly Art 73 (b) of the proposal leads to unjustified differentiation. If the tax rate under the general regime and the tax rate allowed for under a special regime do not amount to 40% and 20% respectively, but to 11% and 9%, the latter will presumably not be regarded as substantially lower as required under Art 73 (b). If the average rate of taxation relevant under Art 73 (a) is 10%, it will hence not trigger a switch-over, although the tax rate under the special regime is lower. Furthermore, a third country which disguises its benefits as general regimes and provides for a nominally higher tax rate can allow the resident companies or permanent establishments to escape the provision of Art 73. These differentiations are undoubtedly dubious.

The legal uncertainty which this regime creates is however alarming: The applicable average corporate tax rate pursuant to Art 73 (a) of the proposal is easily determinable and will be notified by the Commission in advance. However, the proposal does not clearly define a standard based on which the "*substantiality*" Art 73 (b) calls for must be determined. The 40% threshold defined by Art 73 (a) can at best be an indication, yet in a different context. If one nevertheless relied upon that threshold, the above examples involving a 20% tax rate under a special regime would not be substantially lower and therefore not trigger the applicability of Art 73 (b): The 20% would merely represent 50% of the regular tax rate.

It can be just as difficult in a particular case to identify a "*special regime*". Which provisions qualify as "*special regimes*" will probably have to be determined in comparison with the "*general regime*". On the other hand, the CCCTB regime will have to be the standard. Exemptions available in the third country for capital gains, profit distributions or profits generated by permanent establishments in other third countries will presumably not be special regimes.

Although Art 73 of the proposal is titled "*Switch-over clause*", the clause as such merely provides for an exception from the exemptions referred to in Art 11 (c), (d) and (e) and triggers a revival of the tax liability in respect of that income. The clause does not provide for

³⁸ According to the German wording of Art 73 (b), a switch-over would also occur under "*a special regime*" ("*Sonderregelung*"), if it were applicable in a Member State: While Art 73 (a) refers to "*in that third country*" ("*betreffenden Drittland*") this requirement is missing in Art 73 (b) of the German version. The English version, however, clarifies that also Art 73 (b) is applicable only to a special regime "*in that third country*".

a credit as such. Still, Art 74 gives that impression: "*Where Article 73 applies to the income of a permanent establishment in a third country, its revenues, expenses and other deductible items shall be determined according to the rules of the system provided for by this Directive.*" This provision would make sense only if the permanent establishment's income were to be taken into account for the CCCTB tax base for purpose of the credit method and specifically the calculation of the maximum credit. However, neither Art 73 nor Art 74 of the proposal provides for an obligation to credit.

A credit obligation can however be derived from Art 76 of the proposal. If income has already been taxed in another Member State or in a third country, the foreign tax can be credited under that provision, except in respect of income that is exempt pursuant to Art 11 (c), (d) or (e). The text of these provisions hence does not mention as requirements the terms "*interest*" and "*royalties*" which are mentioned in the title. The underlying objective is to credit foreign tax in order to eliminate double taxation in all cases in which it is not eliminated by way of exemption.

In the absence of other available provisions, Art 76 of the proposal can be relied upon as basis for the credit obligation connected with the switch-over. Its wording so permits, because it refers to "*income which has been taxed [...] in a third country*" and exempts only "*income which is exempt under Article 11 (c), (d) or (e)*". The exemption pursuant to Art 11 (c), (d) and (e) does not apply, because it is precluded by Art 73.

It is questionable whether the scope of application of Art 76 is so broad to procure also an *indirect* credit of corporate tax imposed upon the third country entity in the cases in which Art 73 of the proposal denies an exemption for "*received profit distributions*". Such an indirect credit is necessary if the switch-over is supposed to eliminate double taxation just like the exemption provided in Art 11 (c). The Parent-Subsidiary Directive maps out that option as an alternative to an exemption.³⁹ Although express provisions for the calculation of the prior tax burden in the third country do not exist, that is certainly permissible according to the

³⁹ Art 4: "*Where a parent company or its permanent establishment, by virtue of the association of the parent company with its subsidiary, receives distributed profits, the Member State of the parent company and the Member State of its permanent establishment shall, except when the subsidiary is liquidated, [...] 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 fall within the definitions laid down in Article 2 and meet the requirements provided for in Article 3, up to the limit of the amount of the corresponding tax due.*" See Kofler, Mutter-Tochter-Richtlinie (2010) Art 4 para 23 et seq.

wording of Art 76. Art 76 (5) of the proposal merely refers to "*deduction for the tax liability in a third country*". The provision does not specify whose tax liability in the third country that is. Based on that wording, those cases would allow both a direct and an indirect credit. It does not expressly regulate the criteria according to which the corporate tax of the distributing company, to which the distribution is attributable, shall be determined.

Whoever considers it necessary that "*received profit distributions*" be credited indirectly pursuant to Art 76 need not necessarily defend that view also in respect of capital gains, which Art 73 precludes from the exemption of Art 11 (d) and which are again considered taxable, because it is even more difficult to attribute the Company's underlying corporate tax to the capital gains: Capital gains need not exclusively represent the amount of profits generated but not yet distributed by the company. The appreciation of the share earned by way of capital gains may also be based on assumed future expected yields, reflect general market developments or be marked by subjective ideas of buyer and seller. In any event, if profits are distributed to the new shareholder after the sale, the company's corporate tax would again be credited. This being so, an indirect credit of corporate tax should not be acceptable in case of sales.

However, assuming that a majority of arguments speaks against an indirect credit in case of a sale, there is indeed doubt whether that form of crediting foreign tax is permissible in case of received profit distributions. The wording of the relevant rules does not seem to provide any indication for a differentiation between the two cases. Another argument strengthens these doubts: Only Art 76 of the proposal can be viewed as a legal basis for an indirect credit; its wording is open. A broad interpretation of Art 76 of the proposal risks making its scope of application endless. In that case, one would also have to consider crediting the tax of the paying company in case of interest and royalties. The authors of the proposal cannot be supposed to have intended that consequence. In addition, Art 74 of the proposal simply refers to the computation of income of a permanent establishment in the third country, without regulating the "translation" of profits from a company in a third country. All this speaks for leaving it at a direct credit based on the current proposal and, in case of taxable profit distributions or proceeds from the sale of shares, to credit only the tax of the third country imposed upon the recipient. The title of Art 76 of the proposal which refers to taxes "*at source*" seems to point into the same direction. The lacking option of an indirect credit however is not convincing in terms of legal policy.

3. Controlled foreign companies (CFCs)

A mere switch-over is not always the only option. In selected situations, the proposal also considers it acceptable to look through the entity resident outside the EU. Art 82 of the proposal contains such a CFC clause.⁴⁰ The tax base shall include the non-distributed income of an entity resident in a third country where certain conditions are met. The Commission has opted for such a rule although certainly not all Member States have adopted CFC rules in their national tax systems.⁴¹ It has preferably adopted a provision which allows a look-through approach only if certain rather strict conditions are met. In any event, it specifically exempts companies, whose principal class of shares is regularly traded on one or more recognized stock exchanges. Furthermore, pursuant to Art 82 (2) of the proposal, companies resident in an EEA state with which there is an agreement on the exchange of information under international law are exempt as well.

The rule is applicable to entities "*resident in a third country*". There is no separate definition of what resident is supposed to mean. According to their very wording, the provisions of Art 6 (2) and (3) of the proposal are not applicable, because they govern only the residency of *companies*, but not that of *entities*. The fact that Art 6 (3) and (4) do not only simply refer to *companies* but state that the criteria laid down in Art 6 (3) are relevant "*for purposes of paragraphs 1 and 2*" suggests that an analogous application of these rules is impossible.

Furthermore, an application of Art 82 of the proposal requires that the taxpayer "*by itself, or together with its associated enterprises, holds a direct or indirect participation of more than 50% of the voting rights*" or "*owns more than 50% of the capital*" or "*is entitled to receive more than 50% of the profits of that entity*". There must hence be a participation of more than half of the voting rights, of the capital, or of the profits of the enterprise. At least in respect of voting rights, an indirect participation is sufficient. Furthermore, the rule applies also if the

⁴⁰ For CFC rules in the CCCTB system, see *Kofler*, CFC Rules, in *Lang/Pistone/Schuch/Staringer* (eds), *Common Consolidated Tax Base* (2008), 725 (725 et seq).

⁴¹ *Haslinger*, National Report Austria, in *Lang/Aigner/Scheuerle/Stefaner* (eds), CFC Legislation, Tax Treaties and EC Law (2004) 73 (75); *von Frenckell*, National Report Belgium, in *Lang/Aigner/Scheuerle/Stefaner* (eds), CFC Legislation, Tax Treaties and EC Law (2004) 97 (99); *Dado/Sedmihradsky*, National Report Czech Republic, in *Lang/Aigner/Scheuerle/Stefaner* (eds), CFC Legislation, Tax Treaties and EC Law (2004) 125 (127); *Matsos*, National Report Greece, in *Lang/Aigner/Scheuerle/Stefaner* (eds), CFC Legislation, Tax Treaties and EC Law (2004) 281 (283); *Noguera/Steichen*, National Report Luxembourg, in *Lang/Aigner/Scheuerle/Stefaner* (eds), CFC Legislation, Tax Treaties and EC Law (2004) 409 (411); *Peters*, National Report Netherlands, in *Lang/Aigner/Scheuerle/Stefaner* (eds), CFC Legislation, Tax Treaties and EC Law (2004) 433 (435); For Bulgaria, Ireland, Latvia, Malta, Poland, Romania, Slovakia, Slovenia, Cyprus see CFC Key Features Comparison at http://online.ibfd.org/kbase/#topic=kf-compare&format=ghtml&WT.z_nav=search&collection=kf&files=kf_bg,kf_cy,kf_ie,kf_lv,kf_mt,kf_pl,kf_ro,kf_sk,kf_si (access on 23 March 2012) Belgium.

taxpayer fulfills this requirement only "*together with its associated enterprises*". Consequently, however, there can be more than one taxpayer who can hold "*by itself, or together with its associated enterprises, [...] a direct or indirect participation of more than 50% of the voting rights*" of the foreign entity. That brings us to the following question: To which of these enterprises will the CFC rule apply? According to its wording, several enterprises subject to the CCCTB regime could have to apply Art 83 of the proposal in respect of the same foreign entity. Art 83 (2) of the proposal clarifies however that "*income to be included in the tax base shall be calculated in proportion to the entitlement of the taxpayer to share in the profits of the foreign entity*".

Alongside the switch-over clause in Art 73 of the proposal, the CFC rule applies only if under the general regime of the third country profits are subject to corporate tax at a statutory rate of less than 40% of the average statutory rate of corporate tax applicable in the Member State or if the entity can rely on a special regime which allows for a substantially lower level of taxation than the general regime. Accordingly, the look-through approach shall apply only if, in the third country, there is a low rate of taxation either under the general regime or specifically in respect of the enterprise. Consequently, Art 82 can also be relevant if the lower rate of corporate taxation is subject to a high rate of effective corporate taxation by virtue of a different tax base in the third country.⁴²

Furthermore, more than 30% of the entity's income must fall under one or several of the categories referred to in paragraph 3. Those categories are interest or any other income generated by financial assets (paragraph 3 (a)), royalties or any other income generated by intellectual property (paragraph 3 (b)), dividends and income from the disposal of shares (paragraph 3 (c)), income from movable property (paragraph 3 (d)), income from immovable property – unless the Member State of the taxpayer would not have been entitled to tax the income under an agreement concluded with a third country (paragraph 3 (e)) – and income from insurance, banking and other financial activities (paragraph 3 (f)). The provision of Art 82 (1) (c) initially creates the impression that it is irrelevant whether the above income is attributable to only one or to several of those categories. The crucial aspect under Art 82 (1) (c) is that more than 30% of the income accruing to the entity falls "*within one or more of the categories set out in paragraph 3*". Eventually, however, the introductory sentence of Art 82 (3) clearly shows that the category is decisive: "*The following categories of income shall be taken into account for the purposes of point (c) of paragraph 1, in so far as more*

⁴² CCCTB Working Group, Anti-abuse rules, 26 March 2008, CCCTB/WP/065/, Sections 26 et seq.

than 50% of the category of the entity's income comes from transactions with the taxpayer or its associated enterprises." A single form of income or – as referred to in Art 82 (1) (c) – "*category*" is taken into account for the purpose of computing the 30% threshold only if more than 50% of the category of the entity's income comes from transactions with the taxpayer or its associated enterprises. Every category of income shall apparently be taken into account separately.

Example: A company resident in a low-tax country derives 60% of its profits from trading goods of any kind with independent third parties, and 20% each from interest and royalties. 40% of interest and 80% of royalties come from transactions with the shareholder. In that case, Art 82 is not applicable, since only royalties are harmful income, but these represent only 20% of total profits. However, if 60% of interest and 60% of royalties come from transactions with the shareholder, Art 82 will be applicable to the entire profit, because interest and royalties are then considered harmful and together represent 40% and hence more than 30%.

It is difficult to see the meaning behind this regime. The differentiation by "*categories of income*" or "*categories*" seems to produce arbitrary results. Similarly, it is not understandable why income from immovable property (Art 82 (3) (e)) should exclusively be exempt if the Member State of the taxpayer would not have been entitled to tax the income under an agreement concluded with a third country. Admittedly, the state of residence can lose the right to tax according to the OECD-MC, yet there are numerous bilateral DTCs which also exempt certain categories of interest in the state of residence.⁴³ There is no reason why different rules should apply here.

The consequences of an application of Art 82 are governed in Art 83 of the proposal, which provides that income to be included in the tax base shall be calculated according to the rules of Articles 9 to 15. Thus, rather than directly relying upon the tax base of the company in the third country, the tax base is recalculated, obviously based on the assumption that companies in third countries are resident in the EU. As a result, dividends or proceeds from a disposal of shares must be exempt pursuant to Art 11 of the proposal. The same is true for proceeds from a disposal of shares derived from the third country or another third country. Similarly, the income of a permanent establishment in a third country shall not be included in the tax base. Art 11 itself does not distinguish whether or not the income is then taxed in that other third

⁴³ Lang, Überlegungen zur österreichischen DBA-Politik, SWI 2012, 108 (111 et seq).

country. However, if the company is actually resident in the EU, Art 73 orders an exception from the exemptions provided under Art 11 (c), (d) and (e). According to its spirit, the exception laid down in Art 73, as such triggering a switch-over, should also be applicable in these situations. Yet it is not applicable according to its wording, because Art 83 (1) simply refers to Articles 9 to 15 of the proposal. That provision differs from the last sentence of Art 84 (1), which is applicable to transparent entities and provides that "*the income shall be computed under the rules of this Directive*", and it also differs from Art 74, which provides that the "*revenues, expenses and other deductible items*" of a permanent establishment in a third country "*shall be determined according to the rules of the system provided for by this Directive*".

Let me give you an example: A company subject to the CCCTB regime holds a 100% participation in a company resident in the low-tax country A. That company exclusively derives income from dividends which come from a participation in a low-tax country B. The company resident in B generates its profits from interest earned from loans granted to other group companies and is taxed at a rate of only 5% on those profits. Provided that Art 82 is applicable to the company resident in A, the income shall be calculated pursuant to Articles 9 to 15. The dividends from B would have to be exempt, which is why the CFC rule would eventually not apply. However, if Art 73 is applied in addition, the dividends must be included in the tax base and the CFC rule becomes effective.

The legal consequence of Art 83 of the proposal does not consist in a full "*look-through approach*". Pursuant to the second sentence of Art 83, losses of the foreign entity shall not be included in the tax base, but shall be carried forward and taken into account when applying Art 82 in subsequent years.⁴⁴

Art 83 of the proposal prevents economic double taxation if the foreign entity distributes profits in subsequent years or if its shares are disposed of in subsequent years. Accordingly, the income previously included in the tax base pursuant to Art 82 is deducted again when the entity's profits are distributed or its shares disposed of. Art 83 (4) and (5) apparently presupposes that the otherwise relevant exemption of Art 11 (c) and (d) does not apply, because the application of Art 82 also triggers a switch-over pursuant to Art 73.

⁴⁴ On the treatment of losses in the CCCTB system, see *Moreno González/Sanz Díaz-Palacios*, The Common Consolidated Corporate Tax Base, Treatment of Losses, in *Lang/Pistone/Schuch/Staringer* (eds), *Common Consolidated Tax Base* (2008) 441 (441 et seq).

IV. Transparent entities

1. Qualification of entities in third countries

The proposal contains also rules on transparent entities.⁴⁵ Where an entity is treated as transparent, a taxpayer holding an interest in the entity shall include its share in the income of the entity in its tax base. For the purpose of this calculation, the income shall be computed under the rules of this Directive. Transactions between a taxpayer and the entity shall be disregarded in proportion to the taxpayer's share of the entity. There are no regulations on the criteria to be relied upon for the computation of the taxpayer's share, such as those for controlled foreign companies.

Pursuant to Art 84 (1), for entities resident in a Member State, the relevant criterion is their treatment in that Member State. If the entity is treated as transparent in the Member State of its location, the shareholder's state of residence must also adopt that qualification. This Article does not define any criteria to determine residency. An analogous application of Art 6 (3) of the proposal is problematic for the reasons discussed above, as these provisions refer only to companies and are specifically relevant only for the purposes of the paragraphs 1 and 2.

Pursuant to Art 85 of the proposal, transparency in the case of third country entities is determined in a diametrically opposed form, based on the *"law of the Member State of the taxpayer"*. *"If at least two group members hold an interest in the same entity located in a third country, the treatment of the latter shall be determined by common agreement among the relevant Member States. If there is no agreement, the principal tax authority shall decide."*

Art 85 of the proposal does not provide for independent legal consequences in case of shares in third country entities. These can be inferred from Art 84 of the proposal. The income of the transparent entity is considered to be a proportion of the shareholder's tax base. Pursuant to Art 84 (3) of the proposal, the taxpayer shall be entitled to relief for double taxation in accordance with Art 76 (1), (2), (3) and (5). Again, the question arises whether an indirect credit is acceptable as well. If the third country entity is not treated as transparent there, the tax will be imposed for the account of a taxpayer other than the legal entity that is taxable under the law of the Member State. Even if an indirect credit is not regarded as acceptable on the basis of Art 76, the situation might be different here: The provisions of Art 84 (3) of the

⁴⁵ CCCTB Working Group, Personal scope of the CCCTB, 26 July 2006, CCCTB/WP/040/, Sections 17 et seq.

proposal could suggest such an understanding: Art 84 (3) would lose its meaning otherwise, as the general obligation to credit third country taxes already arises from Art 76 anyway. In the context of Art 84, the reference to Art 76 could suggest an indirect credit.

If the entity which is treated as transparent has a permanent establishment in the third country which fulfills the requirements laid down in Art 5, the entity's assumed transparency will lead to the permanent establishment being regarded proportionally as that of the taxpayer. Consequently, the exemption of Art 11 (e) of the proposal applies and the income must be disregarded for the purpose of calculating the tax base. If a third country entity is qualified as non-transparent, received profit distributions are exempt pursuant to Art 11 (c) and proceeds from a disposal of shares are exempt pursuant to Art 11 (d). Against that backdrop, it makes little difference whether a third country entity is treated as transparent, as the profits generated there and from that entity are obviously exempt anyway. However, if the third country entity is treated as transparent, it is exempt within the EU if it has a permanent establishment in the third country and if the profits can be attributed to it. In other words, if the third country entity is a corporation established under the laws of that country, which derives only interest and does not have its own permanent establishment, Art 85 of the proposal will subject to tax the interest received by the third country entity at the level of its shareholders in the EU. If indirect credit is considered unacceptable, this situation may even give rise to double taxation, because the same interest is attributable to the company located in the third country according to the law of that third country and, according to the proposal, to the shareholder in the EU.

In a mirroring case, however, even double non-taxation may occur: If the third country entity without a permanent establishment is treated as transparent in its state of establishment, interest it receives might not be taxed at all in that state. However, if it is not regarded as transparent pursuant to Art 85 of the proposal, income will not be attributed to the EU-resident shareholder for the purpose of the Directive and any subsequent transfer of the third country entity's profits is then qualified as received profit distribution and is exempt pursuant to Art 11 (c) of the proposal. A tax liability could at best be inferred from Art 73 of the proposal if the profits are not taxed in the third country, for example because there is no permanent establishment. Then again, the application of Art 73 is opposed by the fact that the tax exemption is the result of its treatment as transparent rather than the consequence of a low rate of taxation. If that consequence arises from the tax system as a whole, there will be no "*special regime*" which could also trigger the application of Art 73.

A "dividend" paid by the third-country entity to the EU shareholder cannot be taxed. In case of transparent entities, it is more difficult to derive that tax exemption from Art 11 (c) of the proposal, because a look-through approach is applied to the "distributing" entity pursuant to Art 84 (f). Consequently, the "distributing" entity cannot be identified easily. However, to assume a tax liability would be inconsistent with the purpose of the rule, as it lies in the very nature of transparency to immediately tax the company's profits without having to wait for their transfer to the shareholder. As a consequence, the lack of taxability of profits transferred to the shareholder can obviously be derived from the system laid down in Art 84 (f).

2. EU permanent establishments of third-country entities and transparency

In any event, the criteria which may be relied upon pursuant to Art 85 of the proposal for third country entities differ from those which are relevant pursuant to Art 2 (2) for the companies established according to the law of a third country. Pursuant to Art 85, the only criterion is the qualification according to the national law of the shareholder's state of residence in the EU. Pursuant to Art 2 (2), it is decisive whether the company "*has a similar form to one of the forms listed in Annex I*". In reliance on the opinion discussed above, the different forms must be compared and the major features of all forms listed in Annex I must be identified. Even if the focus is merely put on a similarity with those forms which are listed in Annex I for the relevant state of the permanent establishment, the criteria need not be the same as those which apply according to the national laws of that state for the purpose of classifying foreign companies for purposes of corporate tax. Difficult interpretation problems and even distortions may arise from the differences between Art 85 and Art 2 (2) of the proposal.⁴⁶

Let me give you an example: A company resident in EU Member State A holds a 50% share in a subsidiary in a third country which does not have a permanent establishment in that country. The third country entity has a permanent establishment in EU Member State B. The third country regards the company resident in that state as taxpayer while it is treated as transparent according to the national tax law of state A. If state B applies the examination procedure required in Art 2 (2) of the proposal in respect of the permanent establishment

⁴⁶ See also *Matthijs Vogel*, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base ('CCCTB'); comments by Peter Adriaansen, Hans Bakker, Imme Kam, Thies Sanders, Paul Simonis, Matthijs Vogel, Jochem van der Wal and Dennis Weber in *Highlights & Insights on European Taxation 2011*, 5 (60).

located in its territory, the entity of the third country qualifies as "*company*" according to the proposal.

In this event, the subsidiary's income shall be included proportionally into the tax base of the company which is resident in A pursuant to Art 85. The same is true for the profits attributable to the third country's permanent establishment in the EU. After all, the permanent establishment is no independent enterprise and can hence not be qualified pursuant to Art 84. The permanent establishment's income cannot be exempt, since Art 11 (e) applies only to permanent establishments in a third country. The third country entity itself, however, is regarded as taxpayer in Member State B. Pursuant to Art 6 (2) of the proposal, it may opt for the application of the rules of the Directive for its EU permanent establishment. In that case, a group cannot be formed with the company resident in A, because the share amounts to only and not more than 50%. As a consequence, the profits attributable to the permanent establishment located in state B must be recognized both at the level of the company resident in A and also at the level of the third country entity itself and are hence taxable in state B where the permanent establishment is located. In this case, the application of the Directive leads to double taxation in the EU. The tax imposed in B can at best be credited in A if the reference in Art 84 (3) to Art 76 of the proposal is interpreted as to allow also an indirect credit.

3. Controlled foreign companies and transparency

Another question is the relationship between the rules in Art 84 (f) on transparent entities and those in Art 82 (f) on controlled foreign companies. This question seems unimportant at least at first sight: Both sets of rules pierce the corporate veil in that the profits of the third country entity are proportionally attributed to the shareholder's profits. The legal consequences hence seem to be the same. That result is however called to question if we consider the profits subsequently transferred to the shareholder: As discussed, such payments are not taxable at the level of the shareholder if the third country entity is treated as transparent pursuant to Art 85. However, distributions are taxable if the CFC rules of Art 82 (f) are applicable: Due to the exception laid down in Art 73, the exemption of Art 11 (c) of the proposal does not apply. Art 83 (4) of the proposal indirectly confirms that tax liability, stipulating that the amounts of income previously included in the tax base shall be deducted from the tax base.

In this case, there is evidence to support the supposition that the CFC rule is not relevant, because it can be found in Chapter XIV of the proposal which, by its title, deals with "*Anti-abuse rules*". If a general rule such as that on transparent entities regulates the attribution of income to the EU shareholder, there is no necessity to bring the anti-abuse rules into play.

V. Double taxation conventions (DTCs)

1. Priority of DTCs with third countries

The relationship between the Directive and the DTCs is complex.⁴⁷ There is a tight network of DTCs between the EU Member States and between Member States and third countries. The provisions of Union law take precedence over DTCs in the relations between the Member States. Although already emanating from primary law,⁴⁸ that principle is repeated in Art 8 of the CCCTB proposal: "*The provisions of this Directive shall apply notwithstanding any provision to the contrary in any agreement concluded between Member States.*" Still, the DTCs do not entirely lose their meaning in the scope of application of this Directive. Treaty law takes precedence only if the DTC rules are *opposed to* a regulation of the Directive. Within the EU, this is certainly not always the case. For example, Art 76 of the proposal regulates the credit of those taxes which were already paid in another Member State or even in a third country. Accordingly, subject to Art 76, withholding taxes imposed on interest, royalties and any other income taxed at source in a Member State or in a third country may be credited in the taxpayer's state of residence. That credit is not available if a DTC exists between the state of residence and the other Member State which prevents the other Member State from imposing withholding tax. Accordingly, the DTC continues to be applicable after all.

⁴⁷ CCCTB Working Group, International aspects in the CCCTB, 18 November 2005, CCCTB/WP/019/, Sections 17 et seq; *Cerioni*, Bulletin for International Taxation 2011, 518; *Matthijs Vogel*, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base ('CCCTB'); comments by Peter Adriaansen, Hans Bakker, Imme Kam, Thies Sanders, Paul Simonis, Matthijs Vogel, Jochem van der Wal and Dennis Weber in Highlights & Insights on European Taxation 2011, 5 (60).

⁴⁸ See *Schuch/Stieglitz*, DBA- und EU-Diskriminierungsverbote und Verfahrensrecht, in *Lang/Schuch/Staringer* (eds), Die Diskriminierungsverbote im Recht der Doppelbesteuerungsabkommen (2006), 401 (417 et seq); *Kofler*, Doppelbesteuerungsabkommen und Europäisches Gemeinschaftsrecht (2007), 265 (265 et seq); *Laudacher*, Rechtsfindung nationaler Richter im Fall der unionsrechtskonformen Auslegung und des Anwendungsvorrangs, UFSjournal 2010, 164 (164 et seq) with further reference; see also *Schindler*, Vorrang für Menschenrechte oder Marktfreiheiten? RdW 2009, 807 (808 et seq).

The CCCTB proposal does not contain general rules in respect of third countries. Art 351 TFEU stipulates that the rights and obligations from agreements concluded before 1 January 1958 or, for acceding States, before the date of their accession, between Member States and third countries shall not be affected by this Treaty. To the extent that such agreements are not compatible with the Treaty, the Member States shall take all appropriate steps to eliminate the incompatibilities. This can even necessitate the termination of the international treaty.⁴⁹ Based on an *a contrario* reasoning, however, later treaties that are incompatible with Union law must even be disregarded and Union law will therefore have precedence in any event.⁵⁰ According to the – albeit controversial⁵¹ – opinion of Advocate General *Kokott*, an analogous application of Art 351 (1) TFEU⁵² is conceivable "*where an international obligation on the part of a Member State conflicts with a subsequently agreed measure of secondary law*".⁵³ This can mean that the currently applicable DTCs with third countries are still applicable and will take precedence over the Directive until the change or termination of the DTC.

However, Art 351 TFEU regulates only conflicts between DTCs and the Directive. Such a conflict does not exist if a DTC allows dividends to be credited and if those dividends must be exempt under the Directive. An exemption within the EU is not incompatible with the DTC as the latter does not impose a liability to tax. In that event, the credit may eventually be meaningless, if the maximum amount of credit under the DTC is zero.

There is, however, a conflict between a DTC and the Directive if a DTC - in derogation to the OECD-MC – stipulates an exemption of interest in the state of residence, while Art 6 (6) and Art 76 of the CCCTB proposal subject that interest to tax. In such a case, the DTC exemption has priority within the scope of application of Art 351 TFEU - possibly extended by way of analogy. Similarly, if the DTC exempts income from a permanent establishment in the third

⁴⁹ *Kofler*, Doppelbesteuerungsabkommen, 432 et seq.

⁵⁰ See already the comments in fn (37).

⁵¹ The opinion which rejects an analogous application relies upon the Member States' obligation not to impair the Community's later exercise of competence; see *Manzini*, The Priority of Pre-Existing Treaties of EC Member States within the Framework of International Law, EJIL 2001, 781 (785 et seq).

⁵² Corresponds to Art 307 EC Treaty.

⁵³ Advocate General *Kokott*, Opinion of 13 March 2008 in Case C-188/07, *Commune de Mesquer*, 2008, I-0000, 94 et seq; the analogous application of Art 307 (1) EC Treaty (corresponds to Art 351 TFEU) to agreements concluded before 1 January 1958 or after the accession of a Member State in an area of competence for which the Community did not yet have competence on the execution date is predominantly affirmed by legal scholars; see *Pache/Bielitz*, Das Verhältnis der EG zu den völkerrechtlichen Verträgen ihrer Mitgliedstaaten, EuR 2006, 316 (316 et seq); *Lorenzmeier*, EGV Art. 307 Verhältnis zu früheren Verträgen der Mitgliedstaaten (Nizza-Fassung), in *Grabitz/Hilf* (eds), Das Recht der Europäischen Union⁴⁰ (2009); *Schmalenbach*, AEUV Art. 351 (ex-Art. 307 EGV) Verhältnis zu früheren Verträgen der Mitgliedstaaten, in *Calliess/Ruffert* (eds), EUV/AEUV – das Verfassungsrecht der Europäischen Union mit Europäischer Grundrechtecharta⁴ (2011) with further reference.

country and a permanent establishment for purposes of treaty law has already existed for six months in case of construction projects, a conflict exists which must be resolved in favour of the DTC. The same applies if a DTC between a Member State and a third country qualifies a construction project to be a permanent establishment only if it has existed more than eighteen months and a non-resident needs 15 months for a construction projection in an EU state: According to the Directive, the company resident in the third country could already opt for the CCCTB system in respect of its permanent establishment, while the DTC prevents that state's taxation right, so that the Directive will prevail subject to Art 351 TFEU.

Finally, some Articles of the CCCTB proposal directly address DTC rules. For example, Art 76 (5) of the proposal stipulates that the creditable third country tax may not exceed the final corporate tax liability of a taxpayer *"unless an agreement concluded between the Member State of its residence and a third country states otherwise"*. That provision apparently has in mind the obligation to refund a withholding tax imposed by a third country, similar to what the ECJ had in mind in the Case *Amurta*⁵⁴. Such rules must certainly be borne in mind even if they are included in a later DTC. Similarly, there is no obligation to amend those DTCs as would otherwise be necessary pursuant to Art 351 (2) TFEU.

2. DTCs and foreign controlled companies

Against that backdrop, we now need to answer the question whether DTCs preclude the application of the CFC rules. Art 82 of the CCCTB proposal addresses bilateral agreements twice: Pursuant to Art 82 (2) of the proposal, paragraph 1 shall not apply where the third country is party to the European Economic Area and *"there is an agreement on the exchange of information comparable to the exchange of information on request provided for in Directive 2011/16/EU"*.⁵⁵ Art 82 (3) lists as one of the categories of potentially harmful income also income from immovable property *"unless the Member State of the taxpayer would not have been entitled to tax the income under an agreement concluded [with a third country]"*. Still, both regulations do not provide any indication to generally clarify the relationship between Art 82 (f) and the DTCs.

⁵⁴ ECJ 8 November 2007, Case C-379/05, *Amurta*.

⁵⁵ *Matthijs Vogel*, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base ('CCCTB'); comments by Peter Adriaansen, Hans Bakker, Imme Kam, Thies Sanders, Paul Simonis, Matthijs Vogel, Jochem van der Wal and Dennis Weber in *Highlights & Insights on European Taxation 2011*, 5 (59).

DTC rules which - possibly by way of analogy - fall within the ambit of Art 351 TFEU can preclude the application of Art 82 (f) only if the provisions of the Directive are incompatible with them. The decisive question is whether there is such a conflict. Courts that had to address the relationship between national CFC rules and DTCs have given completely different answers to that question. Let me give you two examples: The Finnish Supreme Court held the application of the Finnish CFC rule compatible with the DTC⁵⁶. The judgment was primarily based on the objective and purpose of the DTC and the OECD Commentary. The French Conseil d'Etat adopted an entirely different opinion in its judgment of 28 June 2002 which concerned *Schneider SA*⁵⁷: The 1966 DTC between France and Switzerland, modified in 1969 and modelled after Art 7 (1) OECD-MC requires the exemption of income which may be taxed in Switzerland pursuant to Art 7 (1) of the DTC, because the Swiss subsidiary has its place of management in Switzerland and does not have a permanent establishment in France. The Court held that the goal of preventing double taxation did not allow any other interpretation of the treaty rules.

It is unproductive for a solution to rely on the objective of the DTCs alone.⁵⁸ Although DTCs shall prevent double taxation, they shall do so only within their scope of application.⁵⁹ As a result of CFC rules, the two states will attribute the income to different persons, and the DTCs usually do not focus on ensuring protection against such economic double taxation.⁶⁰ The Commentary does not offer a solution either: It is the treaty rule which is decisive, and its content must be interpreted in reliance on the Commentary. Based on an appropriate view, however, that applies only if the version of the Commentary which addresses the issue had already been available when the relevant DTC was concluded.⁶¹

In case of those DTCs which are modelled after the OECD Model, Art 7 is one possible distributive rule. Pursuant to Art 7 OECD MC, the profits of an enterprise of a Contracting

⁵⁶ A Oyi Abp, 20 March 2002, KHO 596/2002/26, 4 International Tax Law Reports 2002, 1009; see also *Marjaana Helminen*, National Report Finland in *Lang et al.*, CFC regulations, Tax Treaties and EC Law, Kluwer Law vol 8 2004, 191 (204 et seq).

⁵⁷ *Société Schneider Electric*, 28 June 2002, Conseil d'Etat No. 232276, 4 International Tax Law Reports 2002, 1077; see also *Douvier/Bouzora*, France: Court of Appeal Confirms Incompatibility of CFC Rules with Tax Treaties, *European Taxation* 2001, 184 (184 et seq).

⁵⁸ *Lang*, Die Besteuerung von Einkünften bei unterschiedlichen Personen aus dem Blickwinkel des DBA-Rechts, *SWI* 2000, 527 (527 et seq)

⁵⁹ *Lang*, *SWI* 2000, 533 et seq.

⁶⁰ OECD-MC Commentary, Art 23A and B, §2.

⁶¹ Supreme Administrative Court 31 July 1996, 92/13/0172, 21 May 1997, 96/14/0084; see also *Lang*, Das OECD-Musterabkommen 2001 und darüber hinaus: welche Bedeutung haben die nach Abschluss eines Doppelbesteuerungsabkommens erfolgten Änderungen des OECD-Kommentars? *Internationales Steuerrecht*, 2001, 538; see also *Avery Jones*, The Effect of Changes in the OECD Commentaries after a Treaty is Concluded, 56 *Bulletin for International Fiscal Documentation* 3 2002, 102.

State shall be taxable only in that State, unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein and the profits are attributable to that permanent establishment. The state of residence does not have a right to tax if those profits must be exempt under the method of taxation rules. In the case of such a foreign controlled company the profits which are attributable to the EU company, the DTC can achieve that effect only if the attribution of profits, for purposes of treaty law, also leads to its qualification as a permanent establishment of the EU company. It is, however, highly doubtful whether that attribution, decided on national level, could also impact Art 7 OECD MC.⁶² Art 7 OECD-MC is however applicable only if Art 10 OECD-MC does not apply, as the latter has priority pursuant to the rules of subsidiarity of treaty law. If the participation in such an entity represents a share in a company, I believe that the requirements for an application of Art 10 OECD-MC are fulfilled, as the share is causal for the tax liability pursuant to Art 82 (f).⁶³ This applies not only to the distribution of profits, but also to the profit itself. The application of Art 10 OECD-MC is occasionally doubtful, for example because there is no payment.⁶⁴ In my opinion, however, the term "pay" must not be construed so restrictively and covers any event which triggers a tax liability within the scope of Art 10 OECD-MC.⁶⁵ Whoever considers Art 10 OECD-MC applicable will conclude that the EU Member State is not prevented from applying Art 82 (f).

3. DTCs and transparency

The same considerations could apply in respect of participations in those companies which are qualified as taxpayers in the third country, while being treated as transparent in the EU Member State in which the shareholder is resident. Foreign controlled companies are only one special case of those scenarios. These cases must hence be treated equally for purposes of treaty law. The fact that the title of Chapter XIV which concerns foreign controlled companies is "*Anti-abuse rules*" does not change anything. Consequently, there is strong evidence that those profits can be recognized in the Member State pursuant to Art 84 (f), either pursuant to Art 10 OECD MC or pursuant to Art 7 OECD-MC, if the third country entity's permanent establishment is not regarded as permanent establishment of the shareholder.

⁶² Lang, Personengesellschaften im DBA-Recht, SWI 2000, 60 (65); *idem* CFC-Regelungen und Doppelbesteuerungsabkommen, IStR 2002, 717 (718 et seq).

⁶³ Lang, CFC Regelungen und Doppelbesteuerungsabkommen, IStR 2002, 717 (721).

⁶⁴ Kofler, CFC Rules in Lang *et al.*, *Common Consolidated Corporate Tax Base*, 725 (738 et seq).

⁶⁵ Aigner, CFC-Gesetzgebung und DBA-Recht, SWI 2002, 407 (411 et seq); see also Lang, CFC Regulations & Double Taxation Treaties, Bulletin for International Fiscal Documentation 2003, 51 (56 et seq). Vogel in Klaus Vogel on Double Taxation Conventions³ (1997) Art 10 para 22.

Distributions undoubtedly fall under Art 10 OECD-MC. The fact that they are exempt in the Member State under Art 11 (c) of the proposal should not prevent the third country from applying the DTC and the limitation of withholding tax as provided therein. Treaty benefits may be claimed despite the fact that proceeds from shares are exempt. However, the last sentence of Art 76 (1) of the proposal prevents a credit of the remaining withholding tax which is lawfully imposed.

VI. Conclusion and legal outlook

The proposal represents an impressive legal achievement. Its authors were able to propose provisions, which largely make the principles of the proposal a reality in a convincing manner. Still, especially those of the proposal's rules which are relevant for third country scenarios give rise to difficult questions of interpretation. Given the complexity of the matter, these or other instances of doubts would presumably arise even if the authors had chosen another method of regulating it.

Besides detailed suggestions, the following legal improvements could be made to the proposal:

- When regulating certain questions, the authors of the OECD MC and of some other Directives - such as the Parent-Subsidiary Directive and the Interest and Royalties Directive - encountered similar challenges. Having recognized this, the authors of the proposal have followed those rules in many respects. That makes sense, as it would be a waste of resources to re-invent the wheel. Incorporating existing provisions by reference rather allows practitioners to rely upon scholarly legal writing and case law issued in respect of existing legislation. The fact that the provisions of the proposal largely, but not entirely, follow those models affects that advantage and gives rise to many an interpretation difficulty. The editors of the proposal are called upon to opt for and - if the factual context suggests - to fully build each provision on a certain model.
- Certain provisions of the proposal unnecessarily build on the national laws of the Member States, such as for example, the transparency rules, which are determined by the national law of the shareholder's Member State. In some partial areas, this approach thwarts the objective of the Directive, which is to create a common tax base,

and makes its application more difficult. The Directive's provisions should be autonomous whenever possible without having to refer to the national law.

- The transparency rules are one example that the Directive regulates the same question - namely how to classify foreign entities for the purpose of the Directive - in a different manner. Many a problem of interpretation could be avoided if those questions were resolved according to uniform criteria.