

Tax Treaties between Member States and Third Countries

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Question:

Are anti-abuse clauses in Tax treaties MS/TS incompatible with EC Law?

Proposal:

Case-by-case analysis, which means Tax Treaties still have to be negotiated bilaterally, even though some guiding-principles could be included in an European Model Treaty or “Tratado-Quadro” (Rahmen-Vertrag)

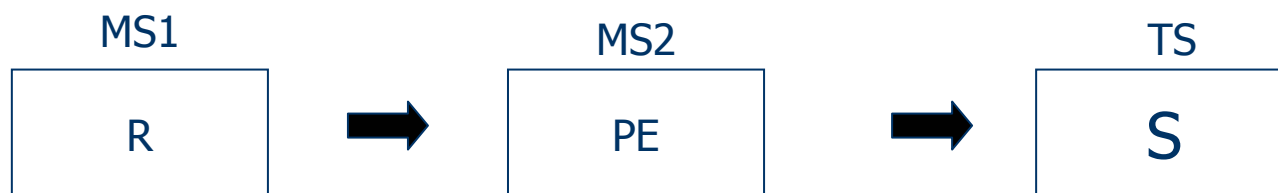
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- Case 1
- If PE and R have a higher tax level in comparison to S, and PE and R apply the ordinary credit method, treating the PE as a resident does not necessarily bring lower taxation in comparison to DTC R-S
- If PE and S have a more favourable tax system than R, and PE is not identified under the Code of Conduct as harmful tax regime: anti-abuse clauses are at first sight incompatible with the EC Treaty
- Present EC regime (if PE is to be treated as a resident) is advantageous when PE exempts income from S or applies the ordinary credit method and has lower taxation than S and R exempts income; or when R eliminates all double tax: “



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- If R adopts the exemption method and PE does not tax, S may invoke a LOB clause under DTC R-S and withhold tax on 100% of dividends.
- Does R violate art. 10 EC Treaty (Community preference)?
- Centros, Eurowings cases are not opposed to LOB clauses when TS are involved
- But there is economic double taxation in S, the TS, although not EC economic double taxation
- CIN, if underlying the ECJ decisions, is indirectly violated in this case, because although R and PE would not tax in both situations, R did not avoid an EDT of EC shareholders
- However, if the example changes to royalties or interest paid by S to PE, there is no taxation (under DTC R-S) and what has been called as the single-tax principle in ITL is violated. A LOB clause would be acceptable in this case as it would not cause any EDT



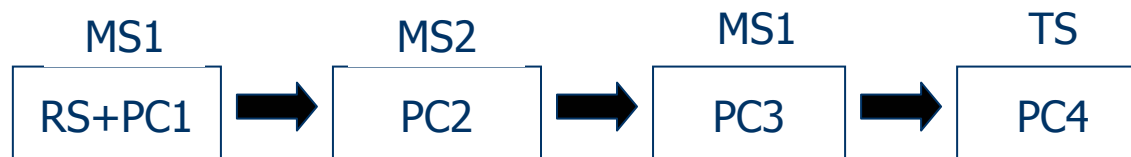
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- Case 2
- LOB Clause in DTC R2-S: corporations in R2 must be controlled by residents in R2 or S
- Resident companies are treated differently according to residence of the shareholders
- If R2 or R1 credited the whole amount of withholding tax there would be no DET
- Otherwise this LOBC could violate the ECTreaty: Art. 10, Art. 43



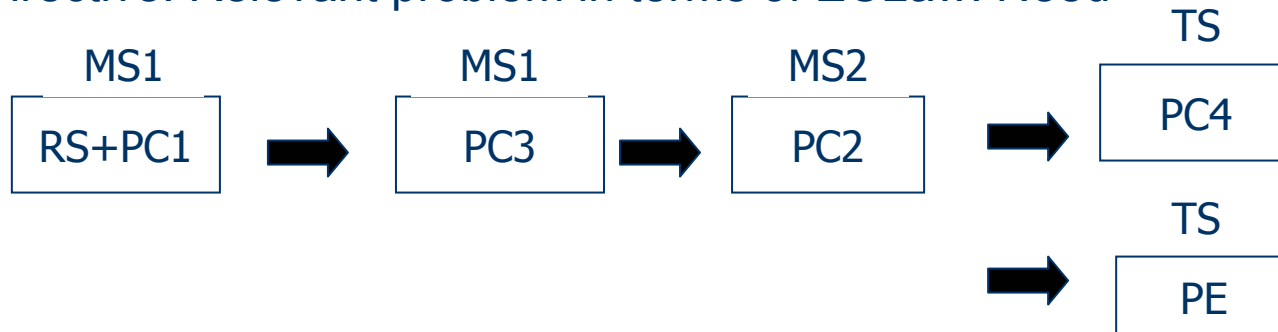
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- Case 3 a)
- PC4 is a CFC in a low taxation TS
- PC3 located in a preferential tax regime territory, not declared as harmful tax practice by the CC.
- DTC PC2-PC1(3) provides for a tax sparing credit even when PC3 exempts dividends
- Could PC1 or PC2 apply a CFC clause without violating the Parent/Sub. directive?
- Or instead an anti-abuse clause?
- Case 3 b)
- Or, if PC4 (applying normal taxation) did not withhold tax on dividends under DTC PC1-PC4, it could exclude PC3 in the same DTC (LOB clause for residents in the normal tax territory). Same MS(MS1). No relevant problem for the EC Law



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- Case 4
- The problem would be different if a LOB were part of DTC PC2-PC4 (LOB to residents of both CS)
- LOB may divert investment from MSPC2 and TSPC4
- Case 5
- The problem would again be different if instead of a PC4 we had a PE in TS paying interest to PC2, and PC1 applied a CFCC under DTC PC1-PC2: PE is an EC company. Does not fall under the scope of Interest/Royalties Directive. Relevant problem in terms of ECLaw. Needs iustification



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Some conclusions:

- LOB are not incompatible with EC law if they do not violate Capital Export Neutrality in the EC territory (CEN means here that exporting companies, if they were taxed once in the EC territory (and accepting universal taxation and the credit method as legitimate), they would nearly pay the same amount of tax whether they have EC or Third Contracting State source)
- Additionally LOB clauses should not contribute to EDT
- LOB resulting in EDT might still be justified as counteracting harmful tax practices in an international perspective
- If we invoke the principle of good faith in the negotiations of DTC (Vienna Convention), we cannot defend the MS should refuse an LOB - at least in the 2 first mentioned cases
- As Hugh Ault remind us, the MFNC was thought of to eliminate duties among CS – which is not the case in the EC in respect of direct taxes, moreover in relation with TS
- If we are searching for a comparison with the GATT clauses, it should also be reminded that Regional Integrations themselves are exceptions to the MFNC (section XXIV, GATT) and only consistent with it if trade created is not overcome by trade diverted

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- In respect of CFC clauses – they are domestically applied to domestic companies but affect corporations' freedom of establishment
- Centros and Eurowings cases do not exclude CFCC in respect of Third Countries: in this case, they are not a measure to assure Capital export neutrality in a Member State – they assure CEN in the EC territory
- They must however observe the control test, low taxation in the Source State test, be applied to passive income and observe the principle of proportionality
- ICI case accepted prevention of tax avoidance as a legitimate objective (“wholly artificial arrangements”)
- CFCC are in a sense the reverse of a LOB
- CFCC are related to universal taxation, and their non-application has been judged as a subsidy contrary to the GATT rules: USA was condemned by the GATT panel for not applying CFCC to all countries (DISC Regime case, 1970s) – “but for, otherwise due, same income” test
- We may say, that EC globally considered and a TS (for ex, the USA) with normal taxation level, may assure CEN, as long as they tax universal income and are allowed to. Prohibiting CFCC and LOBC would mean there is an obligation of accepting tax competition (also, harmful tax competition) at an international level.