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## 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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ARTICLE

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IMPLEMENTATION IN THE PROPOSAL FOR A  
COUNCIL DIRECTIVE ON A COMMON  
CONSOLIDATED TAX BASE (CCCTB)

*Michael Lang*

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All references and citations to sections in this issue are to sections of the Internal Revenue Code of 1986, as amended, unless otherwise indicated. All references and citations to regulations are to Treasury Regulations under the Internal Revenue Code of 1986, as amended, unless otherwise indicated.

# FLORIDA TAX REVIEW

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## THE PRINCIPLE OF TERRITORIALITY AND ITS IMPLEMENTATION IN THE PROPOSAL FOR A COUNCIL DIRECTIVE ON A COMMON CONSOLIDATED CORPORATE TAX BASE (CCCTB)

by

Michael Lang\*

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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 (“CCCTB”) with some delay after long preliminary work.<sup>1</sup> That proposal provides for a uniform corporate tax base that may be relied upon in all EU Member States. Its underlying objective is to reduce the administrative burden for companies.<sup>2</sup> A group that 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 will no longer inevitably encounter different corporate tax systems but will, according to the Proposal of the European Commission, be able to opt for one uniform tax base throughout the European Union.<sup>3</sup> Still, the proposal provides only for a harmonization of tax bases, as 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.<sup>4</sup>

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1. *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 Michel Aujean, *The CCCTB Project and the Future of European Taxation*, in COMMON CONSOL. CORP. TAX BASE 11 (Michael Lang, Pasquale Pistone, Joseph Schuch & Claus Startinger eds., 2008).

2. See *CCCTB Proposal*, *supra* note 1, at 4; J.A.R. van Eijdsden, *The One-Stop-Shop Approach: A Discussion of the Administrative and Procedural Aspects of the CCCTB Draft Directive*, in CCCTB: SELECTED ISSUES 127, 127 (Dennis Weber ed., 2012).

3. See *CCCTB Proposal*, *supra* note 1, art. 4, 6; Kubik & Massoner, *Der aktuelle Stand der Common Consolidated Corporate Tax Base (CCCTB): Was bisher geschah und noch geschehen wird*, 48 FJ 13 (2009); Matthias Petutschnig, *Neuer Anlauf zur Common Consolidated Corporate Tax Base*, ÖStZ 2011, 325, 327; [hereinafter Petutschning, *Neuer Anlauf*]; Elisabeth Riener-Micheler, *Gemeinsame konsolidierte Körperschaftsteuerbemessungsgrundlage: Ein Vorschlag der EU*, CFOaktuell 2011, 95 (95); Guido Förster & Sebastian Krauß, *Der Richtlinienvorschlag der Europäischen Kommission zur Gemeinsamen konsolidierten Körperschaftsteuer-Bemessungsgrundlage (GKKB)* 16 March 2011, IStR 2011, 607, 611. For the requirements of forming a group, see Claus Startinger, *Requirements for Forming a Group*, in COMMON CONSOLIDATED CORPORATE TAX BASE, *supra* note 1, at 115.

4. See *CCCTB Proposal*, *supra* note 1, art. 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.<sup>5</sup> Some critics believe that the objective of consolidation simply goes too far and advocate that the focus should be on a common tax base at least during an initial phase.<sup>6</sup> There were also concerns that companies could either opt for the CCCTB or the national tax bases.<sup>7</sup> Some Member States even generally

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5. See IPEX, <http://www.ipex.eu/IPEXL-WEB/result/simple.do?text=+ccctb+subsidiarity&start=> (for the comments of the parliaments of the nine Member States: Bulgaria, Ireland, Malta, the Netherlands, Poland, Romania, Slovakia, Sweden, United Kingdom); see also Rita Szudoczky, *Is the CCCTB Proposal in Line with the Principle of Subsidiarity?: Negative Opinions Submitted by National Parliaments in the 'Yellow Card Procedure,'* in CCCTB: SELECTED ISSUES 93, 93–94 (Dennis Weber ed., 2012); Vascega & van Thiel, *The CCCTB Proposal: The Next Step towards a Corporate Tax Harmonization in the European Union?*, 51 EUROPEAN TAX'N 374, 377 (2011) [hereinafter Vascega & van Thiel, *Next Step*]; K. Von Brocke & G. 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, see *CCCTB Proposal*, *supra* note 1, at 9–10, according to which,

[t]he 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 consolidation. Indeed, these matters may only be dealt with by laying down legislation at the level of the Union, since they are of primarily a 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 N. Herzig, *Harmonisierung der steuerlichen Gewinnermittlung in der Europäischen Union*, *StuW* 2006, 156 (161 *et seq.*); Mayr, *CCCTB: eine realistische Betrachtungsweise*, 18 *SWI* 288, 289 (2008) [hereinafter Mayr, *realistische Betrachtungsweise*]; R.U. Füllbier, *Überlegungen zum steuerlichen Konsolidierungsbegriff und zur Systematisierung von Gruppenbesteuerungssystemen vor dem Hintergrund europäischer Entwicklungen*, in *UNTERNEHMENSSTEUERRECHT UND INTERNATIONALES STEUERRECHT — GEDÄCHTNISSCHRIFT DIRK KRÜGER* 211, 222 (Strunk, Wassermeyer & Kaminski eds., 2006).

7. See Richard D. Pomp & Andreas Gerten, *Die Gemeinsame Konsolidierte Körperschaftsteuer-Bemessungsgrundlage: (R)Evolution der Konzernbesteuerung?* 17 *IStR* 377, 392 (2008). An optional system was also rejected by the German government. See Federal Government's answer to an inquiry of MPs Dr. Thomas Gambke, Britta Häßelman, Lisa Paus, further MPs and Fraktion Bündnis 90/Die Grünen, *Gemeinsame konsolidierte Körperschaftsteuer-Bemessungsgrundlage*, 6

rejected a harmonization of direct taxes signaling that they would never agree with a CCCTB directive that was applicable throughout the European Union.<sup>8</sup> Many experts 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.<sup>9</sup>

Meanwhile, the European Parliament has dealt with the proposal and has proposed several changes.<sup>10</sup> The Danish presidency of the Council of the European Union has also grasped the opportunity to suggest a “compromise proposal.”<sup>11</sup> The proposed changes deal with details as well as questions of principle. The European Parliament, for instance, has expressed its desire to limit the optionality of the system:

European Companies and European Cooperative Societies,  
which are, by definition, transnational, are considered to

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June 2011. *But see* Jesper Barenfeld, *A Common Consolidated Corporate Tax Base in the European Union — A Beauty or a Beast in the Quest for Tax Simplicity*, 61 BULL. FOR INT’L TAX’N 258, 260 (2007). On the pros and cons of optionality, see Johanna Hey, *CCCTB — Optionality*, in COMMON CONSOLIDATED CORPORATE TAX BASE, *supra* note 1, at 102–08.

8. These states were the United Kingdom, Ireland, Estonia, the Czech Republic, Slovakia, and critically Germany who stated: “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, n.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 a political level. The Treaty of Lisbon provides that at least nine Member States must be involved in cooperation. *See* Consolidated Version of the Treaty on European Union art. 20, Mar. 3, 2010, 2010 (C 83) 27; Consolidated Version of the Treaty on the Functioning of the European Union, art. 326–34, Mar. 30, 2010, 2010 O.M. (C 83) 189; M-A. Mamut, *Auf dem Weg zur Common Consolidated Corporate Tax Base (CCCTB)*, 16 SWI 425, 429, n.33 (2006); Mayr, *realistische Betrachtungsweise*, *supra* note 6, at 288; Luca Cerioni, *European Union — Postponement of the Commission’s proposal for a CCCTB Directive: Possible Ways Forward*, 64 BULL. FOR INT’L TAX’N 98, 101 *et seq.* (2010); Vascega & van Thiel, *Next Step*, *supra* note 5, at 380; Petutschnig, *Neuer Anlauf*, *supra* note 3, at 333.

10. *See generally* European Parliament legislative resolution of 19 April 2012 on the proposal for a Council directive on a Common Consolidated Corporate Tax Base (CCCTB), PROV (2012) 0135 [hereinafter European Parliament Resolution].

11. Presidency Note, Council of the European Union, 4 April 2012, No. 8387/12 [hereinafter Presidency Note].

have opted to apply this Directive from two years after its date of application. All other companies that qualify under this Directive, except for micro, small and medium-sized enterprises, as defined in Commission Recommendation 2003/361/EC, should also apply this Directive not later than five years after its date of application. When evaluating the impact of the CCCTB, the Commission should examine whether it should also be made mandatory for such micro, small and medium-sized enterprises.<sup>12</sup>

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.<sup>13</sup> 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 that would at least partly directly flow into the EU budget.<sup>14</sup> 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, measures to create common tax bases could also 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 become part of Union law. The fact that a specific proposal for a Directive has been

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12. European Parliament Resolution, *supra* note 10, at amend. 14 (footnote omitted). The skepticism concerning the optionality of the system becomes clear when one thinks of the tax planning possibilities that would arise due to this optionality. However, companies will be able to avoid the application of the CCCTB rules by choosing a legal form that is not covered by the scope of the directive, for instance the establishment as a partnership. The provisions currently in force of the many tax systems allow for changes in the legal form of a company without additional tax burdens. Mandatory application of rules carries the inherent risk of motivating taxpayers and their advisers to explicitly plan their structure in order to fall within the set requirements or not.

13. Letter from Angela Merkel, Chancellor of Germany and Nicolas Sarkozy, President of France to Herman Van Rompuy, President of the European Council (Aug. 17, 2011); *see also* Traversa & Helleputte, *Taxation of EU resident companies under the current CCCTB Framework*, in CCCTB (Lang/Schuch/Staringer et al. eds., forthcoming 2012).

14. *Proposal for a Council Directive on a common system of financial transaction tax and amending Directive 2008/7/EC*, COM (2011) 594.

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 that are relevant for companies that are tax residents outside the European Union or for commercial activities carried outside the EU, and for EU resident companies that operate in third countries. This paper will primarily discuss the territoriality principle, on which the CCCTB concept is based, and its legal technical structure. However, this paper will not discuss other provisions of the proposal, even if those should specifically address third-country scenarios, such as those concerning deductibility of donations,<sup>15</sup> the transfer of assets,<sup>16</sup> or deductibility of interest.<sup>17</sup>

## II. ACHIEVEMENT OF THE TERRITORIALITY PRINCIPLE

### A. *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 Article 6(6) of the proposal of the Commission, “[a] company resident in a Member State that 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.” On the other hand, Article 6(7) provides that “[a] company resident in a third country that 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 that are resident both inside and outside the European Union. Article 2 of the proposal distinguishes between “companies established under the laws of a Member State” and “companies established under the laws of a third country.” The first group is subject to a “list system” primarily known from

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15. *CCCTB Proposal*, *supra* note 1, art. 12, 16.

16. *CCCTB Proposal*, *supra* note 1, art. 31.

17. *CCCTB Proposal*, *supra* note 1, art. 81. According to the compromise proposal of the Danish Presidency, this article should be deleted and replaced by an “interest limitation rule.” Presidency Note, *supra* note 11, art. 14a.

other directives in the area of taxation.<sup>18</sup> 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.”<sup>19</sup> 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 Article 2(4) of the Organization for Economic Corporation and Development Model Convention (“OECD-MC”)<sup>20</sup> or Article 3(a)(iii) of the Interest and Royalties Directive.<sup>21</sup> 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 Article 2(1)(b). This is an unsuitable approach because the objective of those regulations seems to be the same in all these cases. Different language will lead to the risk of legal practice inferring a divergent content.

In addition, Article 2(3) of the proposal provides that the Commission may adopt delegated acts “in order to amend Annexes I and II

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18. 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, Annex I, 2011 O.J. (L 345) 8 [hereinafter Parent-Subsidiary Directive]; 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, Annex, 2003 O.J. (L 157) 49.

19. *CCCTB Proposal*, *supra* note 1, Annex I(k).

20. ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, COMM. ON FISCAL AFFAIRS, MODEL TAX CONVENTION ON INCOME AND CAPITAL, art. 2, ¶ 4 (updated 2010) [hereinafter OECD-MC]. 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.” *Id.*

21. 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, art. 3(a)(iii), 2003 (L 157) 51 (stating “to one of the following taxes without being exempt, or to a tax which is identical or substantially similar and which is imposed after the date of entry into force of this Directive in addition to, or in place of, those existing taxes.”); *see also Proposal for a Council Directive on a Common System of Taxation Applicable to Interest and Royalty Payments Made Between Associated Companies of Different Member States*, art. 2(c)(iii), COM (2011) 714 final (Nov. 11, 2011) [hereinafter Interest and Royalties Directive].

to take account of changes to the laws of the Member States concerning company forms and corporate taxes.” Pursuant to Article 127(1) of the proposal, the power to adopt delegated acts shall be conferred on the Commission for an indeterminate period of time. Pursuant to Article 128(1), the delegation of powers may be revoked at any time by the Council. Furthermore, pursuant to Article 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 Article 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.<sup>22</sup> 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 Article 2 of the Parent-Subsidiary Directive and in Article 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.

Article 2(1) of the CCCTB proposal — just like Article 2(2) — merely requires that the company “is subject to” one of the corporate taxes, while Article 2(1)(c) of the Parent-Subsidiary Directive and Article 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.<sup>23</sup> Accordingly, we would have to distinguish between companies exempt from national corporate tax to which the Directive may be applied, and those companies that are not subject to national corporate tax in the first place and thus cannot be subject to the scope of application of the Directive. There is little point in terms of legal

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22. See Richard Lyal, *Comitology*, in COMMON CONSOLIDATED CORPORATE TAX BASE, *supra* note 1 at 49; CCCTB Working Group, CCCTB: Possible Elements of a Technical Outline, 26 July 2007, CCCTB/WP/057/, Items 10, 16, 25, 46, 66.

23. See Luca Cerioni, *The Commission’s proposal for a CCCTB Directive: Analysis and Comment*, 65 BULL. FOR INT’L TAX’N, 515, 516 (2011) (applying a broad interpretation).

policy to make that distinction, as that approach would make the coincidental national legislative techniques relevant for purposes of EU law.<sup>24</sup> However, these differences in language must not be over emphasized because while the Parent-Subsidiary Directive, on the one hand, and the Interest and Royalties Directive, on the other hand, are different, that fact is not material. While Article 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,” this 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 that can arise from these very differences.

Article 6 of the CCCTB proposal substantially distinguishes between companies that are residents for tax purposes in a Member State and companies that are not residents for tax purposes in a Member State. The first group is entirely subject to the Directive. 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 Article 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 a resident for tax purposes in that Member State. Contrary to Article 2(a)(ii) of the Parent-Subsidiary Directive and Article 3(a)(ii) of the Interest and Royalties Directive, the residence criteria must be autonomously derived from EU law,<sup>25</sup> without any reference to national law. The language of Article 6(3) of the CCCTB proposal in turn rather reminds us of Article 4(1) OECD-MC, although it is not fully identical with it. Article 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 Article 4(3) OECD-MC. Rather than being similar to Article 4(1) OECD-MC, Article 6(7) of the CCCTB proposal is similar to Article 4(1) UN-MC and to Article 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 on the meaning of those regulations in reliance on already issued opinions. Instead, they have followed their own course.

Article 6(3) of the CCCTB proposal lays down an additional criterion to determine a company’s residence, namely whether it “is not,

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24. *Id.* at 517.

25. *See* 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, art. 2(1)(b), 2003 O.J. (L 7) 41; Interest and Royalties Directive, *supra* note 21, art. 2(c)(ii).



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 European Union and will be considered a third-country entity for tax purposes. Based on the DTCs that are modeled after the OECD Model Convention, a company’s residence is determined by the place of “effective management.” There are, however, a number of DTCs that deviate from the wording of the OECD-MC or in case of dual residence, do not grant treaty benefits at all or grant these benefits only after the conduct of mutual agreement procedures.<sup>26</sup> 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. This also applies if there is no DTC with a third country or if the DTC is not applicable. If companies that are a resident of two states either are not entitled to treaty benefits or are “under observation” for purposes of application of a DTC, and the competent authorities reserve the right to clarify their entitlement by way of a mutual agreement procedure in a particular case, this disadvantage suddenly becomes a blessing for the purpose of the Directive. In terms of legal policy, the diametric difference in evaluation between DTC and the proposal is not comprehensible at first sight.

Concededly, Article 2 of the Parent-Subsidiary Directive and Article 3 of the Interest and Royalties Directive are based on a similar concept,<sup>27</sup> 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 European Union 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 nonresident than a resident. For both the existing Directives and the CCCTB proposal, the question now is whether it is worth accepting that the scope of the Directive not only varies from Member State to Member State, but also, on the other

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26. For the first example, see the DTC Austria-Liechtenstein. For the second example, see 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.

27. See Interest and Royalties Directive, *supra* note 21, art. 2.

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 out in Article 4(3) OECD-MC. In that case, however, companies taxable in respect of their world-wide income would sometimes be considered nonresidents also in the European Union for purposes of the CCCTB rules. Pursuant to Article (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 a resident.

Article 6(6) of the CCCTB proposal provides that a company resident in a Member State that is covered 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, Article 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 Article 6(6) — “from any source, whether inside or outside its Member State of residence.”

Article 10 of the 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 Article 4(8) of the proposal. Revenues hence include also “subsidies and grants, gifts received, compensation and ex-gratia payments.” The second sentence of Article 4(8) of the proposal specifically notes that revenues shall not include equity raised by the taxpayer or debt repaid to it. Income can also be defined on the basis of other provisions: Article 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, hence, is determined also by the realization principle. Pure appreciation of assets will therefore not trigger taxable income. Exemptions from the realization principle — such as the provisions for controlled foreign companies pursuant to Article 82 of the CCCTB proposal — are specifically mentioned. Further indications are offered by the exemptions. Article 11(d) specifically exempts proceeds from a disposal of shares. This implies that capital gains otherwise qualify as income.

*B. Exemption of Foreign Permanent Establishments, Dividends, and Capital Gains*

The provision of Article 11(e) of the CCCTB proposal largely recognizes the territoriality principle. It exempts from corporate tax “income of a permanent establishment in a third country.” At the same time, Article 11(c) exempts “received profit distributions,” and Article 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 that distributes profits or whose shares are disposed. It 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, the capital gains are exempt.

The compromise proposal of the Danish presidency, however, weakens this concept. Received profit distributions shall only be exempt from corporate tax if a minimum holding of 10 percent exists. The same should hold for proceeds from a disposal of shares. Further exceptions of the exemption are envisaged for profit distributions from shares held for trading as well as profit distributions received by life insurance undertakings. The limit of 10 percent appears to be derived from the Parent-Subsidiary Directive. The terminology, however, does not match. The minimum holding requirement of 10 percent is especially unsuitable for the CCCTB rules because, due to the exemption of permanent establishments in third countries, profits made through minimal holdings in partnerships are not included in the tax base. The requirement of a minimum holding therefore makes little sense.

However, in other cases, income from third countries may be subject to tax. For example, if it is not “income of a permanent establishment” or if a taxpayer engages in commercial activities in a third country without establishing a fixed place of business, it will still be taxed on his worldwide income. The principle of attraction does not apply either. Consequently, the mere existence of a permanent establishment in another state will not lead to an exemption of all income generated in this state. Since 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 Article 5 of the proposal. This definition is largely modeled after Article 5 of the OECD-MC. The authors of the proposal hence have decided to follow neither the model of Article 3(c) of the Interest and Royalties Directive, which merely defines permanent establishments along the lines of Article 5(1) of the OECD-MC,<sup>28</sup> nor Article 2(b) of the Parent-Subsidiary Directive that combines this brief definition of a permanent establishment with a subject-to-tax-clause. Again, the proposal did not fully adopt Article 5 of the OECD-MC. Consequently, the meaning of the expression that 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

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28. See Interest and Royalties Directive, *supra* note 21, art. 2(e).

apparent reason for this derogation from Article 5 of the OECD-MC. Not only does this addition seem superfluous, it also raises doubts as will be shown below.

The Danish presidency has now proposed to replace the phrase “in which its central management and control is located” with “in which it is resident for tax purposes.”<sup>29</sup> With this amendment, the new version of the definition of a permanent establishment also deviates from the example set in Article 5 of the OECD-MC. The question why the drafters of this definition did not completely align to the OECD-Model Convention cannot be answered. Now, difficulties in interpretation may arise.

The proposal, as provided by the Commission, does not contain any provision that specifically refers to the allocation of profits. Since numerous provisions are parallel to those of the OECD-Model — such as those regarding permanent establishments — the principles relevant in connection with Article 7 of the OECD-MC could apply.<sup>30</sup> However, specifically the issue of allocation of profits to permanent establishments has no definite answer within the OECD. Article 7 of the OECD-MA was thoroughly restated by the Update 2010.<sup>31</sup> In the context of EU 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.<sup>32</sup> Article 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 that 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.

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29. Presidency Note, *supra* note 11, art. 4(7).

30. 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/, §§ 13 *et seq.*

31. See PLANSKY, DIE GEWINNZURECHNUNG ZU BETRIEBSSTÄTTEN IM RECHT DER DOPPELBESTEUERUNGSABKOMMEN 248 *et seq.* (2010) (regarding the implementation of the AOA in Article 7 of the OECD-MC 2010); see also S. Bendlinger, *Paradigmenwechsel bei der Auslegung des Betriebsstättenbegriffs im DBA-Recht durch die OECD*, 16 SWI 358; Bendlinger, *Die Betriebsstätte im OECD-Musterabkommen* 21 SWI 61 (2011).

32. Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises 90/463/EEC, 1990 O.J. (L 225) 10.

This rule is visibly modeled after the former Article 7(2) of the OECD-MC,<sup>33</sup> although the latter did not contain the reservation in respect of the special provisions of Article 7(3) of the OECD-MC and Article 7(3) of the OECD-MC, just like paragraphs (4) and (5) of Article 7 OECD-MC are 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.<sup>34</sup> This position is even less relevant for an interpretation of the EU Arbitration Convention. This opinion, known as Authorized-OECD-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 Article 78(1) provides that a taxpayer "shall be regarded as an associated enterprise to its permanent establishment in a third country," and similarly a nonresident 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 Article 78, although that is not absolutely certain. Article 79 governs "relations between associated enterprises" and hence presupposes at least the existence of *two* associated companies, while the last subparagraph of Article 78(1) regards the taxpayer as an "associated enterprise to its permanent establishment," and thus 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 Article 78(f) of the proposal are relevant also for the relations between headquarters and permanent establishment. However, Article 79 is somewhat — albeit not fully —

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33. See OECD-MC, *supra* note 20, art. 7(2).

34. See Michael Lang, *Die Bedeutung des Musterabkommens und des Kommentars des OECD-Steuerausschusses für die Auslegung von Doppelbesteuerungsabkommen*, in AKTUELLE ENTWICKLUNGEN IM INTERNATIONALEN STEUERRECHT (1994); Michael Lang, *Keine Bedeutung der jüngeren Fassung des Kommentars des OECD-Steuerausschusses für die Interpretation älterer Doppelbesteuerungsabkommen*, IWB 1996, 923 *et seq.*; MICHAEL LANG, INTRODUCTION TO THE LAW OF DOUBLE TAXATION CONVENTIONS 45 *et seq.* (2010).

modeled after Article 9 of the OECD-MC and Article 4(1) of the EU Arbitration Convention.<sup>35</sup> This could be a reason to grant the permanent establishment greater independence from its headquarters in the context of attributing its profits; this would be possible pursuant to Article 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.

If the proposal of the Danish presidency would be implemented, these doubts would disappear as Article 79, according to the compromise proposal, would receive a second paragraph in which the determination of income attributable to a permanent establishment shall be defined more clearly:

Income attributable to a permanent establishment is the income the permanent establishment might be expected to earn, in particular in its dealings with other parts of the taxpayer, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the taxpayer through the permanent establishment and through the other parts of the taxpayer.<sup>36</sup>

This wording was noticeably, if not completely, taken from the 2010 version of Article 7(2) OECD-MC. It therefore carries, also with regard to the contents, the same understanding of a broad independence of the permanent establishment, which is connected to this provision.

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

Revenues that are specifically exempt pursuant to Article 11(c) of the CCCTB proposal include also "received profit distributions." The authors apparently want to avoid economic double taxation of profits by exempting the profit distributions as such. Obviously, the authors want to leave it at the fact that the lower-level entity is regularly taxable, its tax base being determined according to national law or the CCCTB Directive. The recipient

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35. CCCTB Working Group, Related parties in CCCTB, 13 December 2006, CCCTB/WP/041/, §§ 13 *et seq.*

36. Presidency Note, *supra* note 11, art. 79.

entity should not be taxable again. This provision does not differentiate by residence of the distributing company and, hence, is 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 Article 82(1) in conjunction with Article 83(5). Based on the proposal of the Danish presidency, however, the reference to “non-distributed” income of an entity would be omitted at least in Article 82(1).<sup>37</sup> This is the consequence of the extension of the scope of the CFC rules to permanent establishments in low tax countries.

The exemption of “received profit distributions” does not define the legal nature of the participation that 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 that 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 Article 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 percent of the voting rights, owns more than 50 percent of the capital, or is entitled to receive more than 50 percent of the profits of that entity. Supposedly, taxpayers could also receive distributions of profits if they either have voting rights, hold capital, or are entitled to profits. However, pursuant to Article 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,” implying that only an entity entitled to the profits can have a “received profit distribution.”<sup>38</sup>

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37. Presidency Note, *supra* note 11, art. 82.

38. The compromise proposal of the Danish Presidency even extended the requirements set in Article 82(1)(a) to cases in which the taxpayer holds because of an agreement with other investors more than 50% of the voting rights, or has because of an agreement the full control over the financial and operating policies of the entity, or has the authority to appoint or dismiss members of the board of directors jointly holding more than 50% of the voting rights in the board of directors, or power to cast more than 50% of the votes in the board of directors.

Another approach could be based on the definition of dividends. Although the CCCTB proposal does not contain such a definition, its Article 81(2) specifies interest in conformity with Article 11(3) of the OECD-MC, which has also been adopted in the Interest and Royalties Directive.<sup>39</sup> One could infer that the authors of the proposal understood dividends pursuant to Article 10(3) of the OECD-MC.<sup>40</sup> Again, it is an entirely different question whether “received profit distributions” could be clarified based on that understanding. In connection with revenues, Article 4(8) of the proposal refers, among other things, to “proceeds from disposal of assets and rights, interest, dividends and other profit distributions,” suggesting that profit distributions must be understood much broader than dividends. Paragraph 11 of the Directive’s recitals, on the other hand, assumes that “[i]ncome 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 Article 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 shows that the expressions “income consisting in dividends” and “received profit distributions” were used synonymously in this context.

Furthermore, Article 11(d) of the proposal exempts proceeds from a disposal of shares. 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 that is exempt in respect of “received profit distributions” is the same form of entity. The CCCTB rules are 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

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Presidency Note, *supra* note 11, art. 82(1)(a).

39. MICHAEL LANG, HYBRIDE FINANZIERUNGEN IM INTERNATIONALEN STEUERRECHT 114 *et seq.* (1990); Clemens Nowotny, *VwGH zum abkommensrechtlichen Begriff der Einkünfte aus Zinsen iSv Art 11 Abs 3 OECD-MA*, *ÖStZ* 2004, 137; CCCTB Working Group, Taxable Income, 23 September 2005, CCCTB/WP/017, § 15; Krister Andersson, Comments on document CCCTB\WP\042 (2006) 1 *et seq.*; *CCCTB Proposal*, *supra* note 1, art. 11(4); Wassermeyer, in *DOPPELBESTEUERUNG — OECD-MUSTERABKOMMEN DBA ÖSTERREICH — DEUTSCHLAND, KOMMENTAR*, art. 11, ¶ 71 (Wassermeyer, Lang & Schuch eds., 2010).

40. Based on the proposal of the Danish Presidency, however, this argument ceases to apply as Article 82 should be deleted. The “interest limitation rule,” which is meant to replace Article 81, does no longer provide for a definition of interest.



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, Article 72 provides that for determining the tax rate applicable to a taxpayer, without prejudice to Article 75, revenue that is exempt from taxation pursuant to Article 11(c), (d), or (e) may be taken into account. This 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 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.

### C. 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.<sup>41</sup> The nonresident then forms a group together with that permanent establishment and the other qualified subsidiaries.

Pursuant to Article 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 be carried out in respect of companies established under the laws of a third country. This provision hence differs from that applicable to EU-resident companies, although it does not specify the relevant parameters needed to make a comparison. Presumably, this 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. This 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, leaving broader scope for discretion: the Commission is supposed “to take

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41. CCCTB Working Group, The Territorial Scope of the CCCTB, 9 March 2006, CCCTB/WP/026/, § 30.

account of changes to the laws.” This gives 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; rather the company must be subject to one of the corporate taxes listed in Annex II. This is presumably an editorial error since it is difficult 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. In view of the non-discrimination of permanent establishments enshrined in existing DTCs with third countries, this discrimination could raise concerns.

Pursuant to Article 3(1) of the proposal, the Commission shall annually adopt a list of third-country company forms. This list shall meet the requirements laid down in Article 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 Article 5 of Regulation Number 182/2011,<sup>42</sup> the committee shall deliver its opinion by the majority laid down in Article 16(4) and (5) of the Treaty on European Union and, where applicable, Article 238(3) of the TFEU<sup>43</sup> 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 national legislators, just like the Commission, cannot always keep track of all changes in legislation worldwide, national legislators might content themselves 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 Article 3(2). The company forms referred to in that list must be regarded as similar in any case, although the fact that a company

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42. 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, O.J. L 55/13.

43. Consolidated Version of the Treaty on the Functioning of the European Union, 2008 O.J. C 115/47 [hereinafter TFEU].

form is not included in the list does not preclude the application of this Directive to that form.

In view of the tax base, Article 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 or even a third country. Consequently, if a US-resident company has a permanent establishment in the European Union to which interest from the United States is attributable, that permanent establishment is taxable under the CCCTB regime.

Pursuant to Article 6(2) of the proposal, a company that 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 a permanent establishment exists again depends on the definition set forth in Article 5 of the proposal. As discussed above, this definition is largely modeled after the OECD Model Convention.

As a consequence, the question arises whether the numerous exemptions discussed above are applicable to nonresident companies as well. This would be the case under EU law only if the freedom of establishment applied. Besides situations involving European Economic Area (“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 that prohibit discrimination of permanent establishments.

The wording of the relevant exemptions as such is regularly not confined to resident companies. Article 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 Article 11(c), (d) and (e) are applicable as well.

Consequently, if the dividends are attributed to the permanent establishment, profit distributions are also exempt at the level of the permanent establishment. The same applies to proceeds from a disposal of shares that are part of the business assets of that permanent establishment. Based on the proposal of the Danish presidency, however, one would have to keep the added restrictions in mind, especially the required minimum holding of 10 percent.

The exemption of a permanent establishment’s income in a third country could be relevant as well. For example, 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 Article 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 State.<sup>44</sup> 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 Article 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. The version of the definition of a permanent establishment which was proposed by the Danish presidency would lead to similar issues. According to this version, the word order "in which its central management and control is located" shall be replaced by "in which it is resident for tax purposes."<sup>45</sup> This wording would not include cases in which the state of residence and the PE state are identical. This result is obviously dubious.

Another question is whether the exemption with progression referred to in Article 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. Hence, there is 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.<sup>46</sup> Against this backdrop, nothing speaks against applying Article 72 in this situation.

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44. On the DTC problems of "sub permanent establishment," see Klaus D. Buciek, "*Unterbetriebsstätte*" und *Außensteuerrecht*, in *UNTERNEHMEN, STEUERN — FESTSCHRIFT FLICK 647* (Klein, Stihl, Wassermeyer, Piltz & Schaumburg eds., 1997); Gassner & Hofbauer, *Die Unterbetriebstätte*, in *Gassner/Lang/Lechner/Schuch/Staringer (eds), Die beschränkte Steuerpflicht im Einkommen — und Körperschaftsteuerrecht* 83, 85 *et seq.* (Wolfgang Gassner, Michael Lang, Eduard Lechner, Josef Schuch & Claus Staringer eds., 2004); Lang, *Die Unterbetriebstätte im Abkommensrecht*, in *KÖRPERSCHAFTSTEUER, INTERNATIONALES STEUERRECHT, DOPPELBESTEUERUNG — FESTSCHRIFT WASSERMEYER 709, 715 et seq.* (Rudolf Gock, Dietmar Gosch & Michael Lang eds., 2005).

45. See *supra* note 29.

46. Peter Haunold, Michael Tumpel & Christian Widhalm, *EuGH: Negativer Progressionsvorbehalt bei beschränkter Steuerpflicht geboten*, 17 *SWI* 486 (2007); E. Marschner, *Die Steuerpflicht nach § 1 Abs. 4 EStG und das Gemeinschaftsrecht*, 82 *SWK* S-692–94 (2007).

### III. DEROGATION TO THE PRINCIPLE OF TERRITORIALITY

#### A. *Taxation of Interest and Royalties*

The CCCTB concept is characterized by the principle of territoriality. Initially, the authors of the proposal have assumed a comprehensive concept of income that is not confined to EU sources and have then restricted that taxation of worldwide income through the exemptions discussed above.<sup>47</sup> As a consequence, however, any income subject to that concept is taxable and not exempt. Business profits generated outside the European Union that are not attributable to a permanent establishment located outside the European Union are therefore taxable pursuant to the CCCTB rules.

The same applies to other non-exempt income — particularly interest and royalties. The authors of the proposal have emphasized the taxable nature of that income by incorporating a credit for foreign taxes in Article 76. This provision requires income to be included in the tax base, making it taxable in the European Union.

#### B. *The Switch-Over Clause*

Under certain circumstances, a switch-over from the exemption method to the credit method is possible with respect to the exemptions referred to in paragraphs (c) and (d) of Article 11. This switch-over is possible if the company that made the profit distributions — or the entity whose shares are disposed of — were subject to tax at a rate which was too low in the company's country of residence.<sup>48</sup> This fact will revive the tax liability, while the exemptions referred to in paragraphs (c) and (d) of Article 11, are eliminated with the aim of avoiding double non-taxation, or taxation under the general regime in a country. In contrast to the proposal of the Danish presidency, the proposal of the Commission envisages to extend this regime also to permanent establishments.

The switch-over pursuant to Article 73 shall apply if, “under the general regime in that third country,” the entity that 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.” The

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47. *See supra* Part II.A.

48. CCCTB Working Group, *CCCTB: Possible Elements of a Technical Outline*, § 120, CCCTB/WP/057, 26 July 2007.

European Parliament, however, prefers to apply the switch-over clause in case profits are taxable at a statutory corporate tax rate lower than 70 percent of the average statutory corporate tax rate applicable in the Member States.

Alternatively, that provision shall apply if the company 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 Article 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.” Only the normal tax rate is relevant 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.

Here is an example: A company resident in a Member State has a permanent establishment in a third country that generates profits of 100,000 determined according to CCCTB rules. Due to other tax base rules in that state, the permanent establishment’s profit amounts to 500,000 according to the domestic law of the third country. At a nominal tax rate of 8 percent, the corporate tax burden amounts to 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 percent.

On the other hand, Article 73(a) does not apply if the nominal tax rate exceeds the threshold, even 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 Article 73(b) are fulfilled. For purposes of Article 73(a) the question arises as to 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. Article 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 Article 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.” For example, if the corporate tax rate is generally 40 percent in the third country, a company may take advantage of a 20 percent special tax rate because 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.” Article 73(b) also requires this tax rate to be “substantially” lower than the general regime. There is no identifiable standard to measure substantiality. Assume that a tax rate which is 20 percent lower than the general regime qualifies as a substantially lower rate. This example shows that a 20 percent special tax rate may trigger a switch-over,

while a 15 percent regular tax rate will not regularly do so as long as the average applicable statutory corporate tax rate is lower than 15 percent.

Aside from paragraph (a), paragraph (b) of Article 73 does not refer to the “statutory corporate tax rate applicable in the Member States,” but only to the “level of taxation.” Paragraph (b) does not appear to refer to the nominal tax rate but simply compares 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.

Consider this example: The corporate tax rate is generally 40 percent 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 is 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 percent tax rate, but only 200,000 of tax is payable under the special regime. The taxpayer reduced its tax burden to 20 percent in relation to the general regime. The requirements for the application of Article 73(b) are fulfilled.<sup>49</sup>

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, Article 73(b) of the proposal leads to unjustified differentiation. If the tax rate under the general regime and the tax rate allowed under a special regime do not amount to 40 percent and 20 percent respectively, but to 11 percent and 9 percent, the latter will presumably not be regarded as substantially lower as required under Article 73(b). If the average rate of taxation relevant under Article 73(a) is 10 percent, it will not trigger a switch-over even though the tax rate under the special regime is lower. Furthermore, a third country that 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 provisions of Article 73. These differentiations are undoubtedly dubious.

The legal uncertainty that this regime creates is alarming. The applicable average corporate tax rate pursuant to Article 73(a) of the proposal is easily determinable and will be notified by the Commission in advance. Still, the proposal does not clearly define a standard upon which the “substantiality” Article 73(b) calls for must be determined. The 40 percent threshold defined by Article 73(a) can at best be an indication, but in a

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

different context. If one nevertheless relied upon that threshold, the above examples involving a 20 percent tax rate under a special regime would not be substantially lower and, therefore, would not trigger the applicability of Article 73(b) — the 20 percent would merely represent 50 percent of the regular tax rate.

The Danish presidency has proposed to delete the requirement of “substantiality” in Article 73(b). This would resolve several unclaritys previously discussed. However, it would be questionable if every special rule that leads to a lower taxation would trigger a switch-over. A slightly lower tax burden, compared to the normal level of taxation, for certain types of income in a high tax country may still be higher than the tax burden in most of the other states. 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 Article 73 of the proposal is titled “Switch-Over clause,” the clause as such merely provides for an exception from the exemptions referred to in Article 11(c), (d), and, in the version of the Commission proposal, (e) and triggers a revival of the tax liability with respect to that income. The clause does not provide for a credit as such. Still, Article 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 only make sense 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 Article 73 nor Article 74 of the proposal provides for an obligation to credit. This might be the reason why the Danish presidency has proposed to completely abolish Article 74 of the Commission proposal.

A credit obligation can, however, be derived from Article 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 with respect to income that is exempt pursuant to paragraphs (c), (d), and (e) of Article 11. The text of these provisions does not mention as requirements the terms “interest” and “royalties” that 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, Article 76 of the proposal can be relied on 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 Article 11(c) and (d) does not apply because it is precluded by Article 73.<sup>50</sup>

It is questionable whether the scope of application of Article 76 is so broad to procure also an *indirect* credit of corporate tax imposed upon the third-country entity in the cases in which Article 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 Article 11(c). The Parent-Subsidiary Directive maps out that option as an alternative to an exemption.<sup>51</sup> 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 wording of Article 76. Article 76(5) of the proposal, which was deleted in the compromise proposal of the Danish presidency, 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

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50. According to the Commission proposal, Article 73 also excludes the exemption according to Article 11(e). *See also* Matthijs Vogel, *Withholding Taxes and Relief for Double Taxation*, in CCCTB: SELECTED ISSUES 191, 197 n.18 (Dennis Weber ed., 2012)

[I]n my view the Proposal clearly provides that if the (income) exemption of Art. 11 (c), (d) or (e) is denied pursuant to Art. 73, a tax credit is still available according to Art. 76. If Art. 73 applies, the respective income is not exempt under Art. 11 (c), (d) or (e). . . . As a result, the door is open for a tax credit under Article 76 as that article states that a tax credit is available for “income which has been taxed in another Member State or in a third country, *other than income which is exempt under Art. 11 (c), (d) or (e).*”

51. *See generally* Parent-Subsidiary Directive, *supra* note 18. Article 4 reads:

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.

*Id*; *see also* GEORG KOFLER, MUTTER-TOCHTER-RICHTLINIE, art. 4, ¶ 23 *et seq.* (2011).

and an indirect credit. It does not expressly regulate the criteria according to which the corporate tax of the distributing company shall be determined.

Whoever considers it necessary that “received profit distributions” be credited indirectly pursuant to Article 76 need not necessarily defend that view also with respect to capital gains, which Article 73 precludes from the exemption of Article 11(d) and that 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 a 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 the case of sales.

However, assuming that the more convincing arguments speak against an indirect credit in the case of a sale, there is indeed doubt as to whether that form of crediting foreign tax is permissible in the 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 Article 76 of the proposal can be viewed as a legal basis for an indirect credit because its wording is open. A broad interpretation of Article 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 have intended that consequence. 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 Article 76, which refers to taxes “at source,” seems to point in the same direction. The lacking option of an indirect credit, however, is not convincing in terms of legal policy.

### *C. Controlled Foreign Companies (“CFC”s)*

A mere switch-over is not always the only option. In select situations the proposal also considers it acceptable to look through the entity resident outside the European Union. Article 82 of the proposal contains such a CFC clause.<sup>52</sup> The tax base shall include the non-distributed income of an entity

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52. For a discussion on CFC rules in the CCCTB system, see Georg Kofler, *CFC Rules*, in *THE COMMON CONSOLIDATED CORPORATE TAX BASE 725, 725–49* (Michael Lang et al. eds., 2008) [hereinafter Kofler, *CFC Rules*].

resident in a third country where certain conditions are met.<sup>53</sup> The Commission has opted for such a rule, although certainly not all Member States have adopted CFC rules in their national tax systems.<sup>54</sup> It has preferably adopted a provision that 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 Article 82(2) of the proposal, companies with residency in an EEA state, with which there is an agreement on the exchange of information under international law, are exempt as well.

According to the proposal of the Danish presidency, the scope of the CFC-rule should be extended in various ways. The exemption for companies, whose principal class of shares is regularly traded on one or more recognized stock exchanges, shall be deleted again.<sup>55</sup> Furthermore, companies that are resident in a third country party to the European Economic Area Agreement and with which there is an agreement on the exchange of information comparable to the exchange of information on request provided for in Directive 2011/16/EU can, according to this Danish proposal, fall within the scope of the CFC-rule.<sup>56</sup> Permanent establishments in third countries, which were taken out of the scope for the switch-over clause, fall, according to the proposal of the Danish presidency, within the scope of the CFC-rule.

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 Article 6(2) and (3) of the proposal

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53. See Mario Tenore, *CFC Rule*, in CCCTB: SELECTED ISSUES 299, 306 (Daniel Weber ed., 2012) [hereinafter Tenore, *CFC Rule*].

54. Jaroslav Dado & Milan Sedmihradsky, *National Report Czech Republic*, in CFC LEGISLATION, TAX TREATIES AND EC LAW 125, 127 (Michael Lang et al. eds. 2004); Eric von Frenckell, *National Report Belgium*, in CFC LEGISLATION, TAX TREATIES AND EC LAW 97, 99 (Michael Lang et al. eds., 2004); Katharina Haslinger, *National Report Austria*, in CFC LEGISLATION, TAX TREATIES AND EC LAW 73, 75 (Michael Lang et al. eds., 2004); Georgios Matsos, *National Report Greece*, in CFC LEGISLATION, TAX TREATIES AND EC LAW 281, 283 (Michael Lang et al. eds. 2004); Lionel Noguera & Allen Steichen, *National Report Luxembourg*, in CFC LEGISLATION, TAX TREATIES AND EC LAW 409, 411 (Michael Lang et al. eds., 2004); Martine J. Peters, *National Report Netherlands*, in CFC LEGISLATION, TAX TREATIES AND EC LAW 433, 435 (Michael Lang et al. eds., 2004). For information on Bulgaria, Ireland, Latvia, Malta, Poland, Romania, Slovakia, Slovenia, and Cyprus, see *CFC Key Features Comparison*, IBFD TAX RESEARCH PLATFORM, [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](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).

55. Presidency Note, *supra* note 11, art. 82(1)(d).

56. See *id.* art. 82(2).

are not applicable because they govern only the residency of *companies*, not that of *entities*. The fact that Article 6(3) and (4) do not only simply refer to *companies* but state that the criteria laid down in Article 6(3) are relevant “for purposes of paragraphs 1 and 2” suggests that an analogous application of these rules is impossible.

Moreover, an application of Article 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,” “owns more than 50% of the capital,” or “is entitled to receive more than 50% of the profits of that entity.” In turn, there must be a participation of more than half of the voting rights, of the capital, or of the profits of the enterprise. At least with respect to voting rights, an indirect participation is sufficient. Furthermore, the rule also applies if the 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. This prompts the following question: to which of these enterprises will the CFC rule apply?<sup>57</sup> According to its wording, several enterprises subject to the CCCTB regime could have to apply Article 83 of the proposal with respect to the same foreign entity. If the proposal of the Danish presidency would be adopted, Article 82 would also be applicable to taxpayers who

hold[] because of an agreement with other investors more than 50% of the voting rights, or [have] because of an agreement the full control over the financial and operating policies of the entity, or [have] the authority to appoint or dismiss members of the board of directors jointly holding more than 50% of the voting rights in the board of directors, or power to cast more than 50% of the votes in the board of directors,<sup>58</sup>

then these possibilities seem to multiply. Article 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 Article 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 percent of the average statutory rate of corporate tax applicable in the Member State or if the entity can rely on a special regime that allows for a substantially lower

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57. See Tenore, *CFC Rule*, *supra* note 53, at 311.

58. Presidency Note, *supra* note 11, art. 82(1)(a).

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 with respect to the enterprise. Consequently, Article 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.<sup>59</sup>

The Danish presidency has questioned the 40 percent limit and proposed deleting the requirement of substantiality, as it had also done in the switch-over clause.<sup>60</sup> The European Parliament has decided to include profits into the tax base which, “under the general regime in the third country, are taxable at a statutory corporate tax rate lower than 70% of the average statutory corporate tax rate applicable in the Member States.”<sup>61</sup>

Furthermore, according to the Commission proposal, more than 30 percent of the entity’s income must fall under one or several of the categories referred to in paragraph (3). Those categories are (1) interest or any other income generated by financial assets (paragraph 3(a)); (2) royalties or any other income generated by intellectual property (paragraph 3(b)); (3) dividends and income from the disposal of shares (paragraph 3(c)); (4) income from movable property (paragraph 3(d)); (5) 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 (6) income from insurance, banking and other financial activities (paragraph 3(f)). The provision of Article 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 Article 82(1)(c) is that more than 30 percent 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 Article 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 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 Article 82(1)(c), “category” is taken into account for the purpose of computing the 30 percent threshold only if more than 50 percent 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.

Here is an example: A company resident in a low-tax country derives 60 percent of its profits from trading goods of any kind with independent

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59. CCCTB Working Group, *Anti-Abuse Rules*, §§ 26 *et seq.* CCCTB/WP/065/, 26 March 2008.

60. See Presidency Note, *supra* note 11, art. 82(1)(b).

61. European Parliament Resolution, *supra* note 10, amend. 29.

third parties, and 20 percent each from interest and royalties. Forty percent of interest and 80 percent of royalties come from transactions with the shareholder. In that case, Article 82 is not applicable, since only royalties are harmful income, and these represent only 20 percent of total profits. However, if 60 percent of interest and 60 percent of royalties come from transactions with the shareholder, Article 82 will be applicable to the entire profit because interest and royalties are then considered harmful and together represent 40 percent and thus more than 30 percent. It is difficult to see the meaning behind this regime. The proposal of the Danish presidency to forgo the requirement that more than 50 percent of the category of the entity's income comes from transactions with the taxpayer or its associated enterprises, would lead to more appropriate results.

Similarly, it is not understandable why, according to the Commission proposal, income from immovable property (Article 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 that also exempt certain categories of interest in the state of residence.<sup>62</sup> There is no reason why different rules should apply here. The proposal of the Danish presidency to abolish this exception is therefore, in this case, equally convincing.

The consequences of an application of Article 82 are governed in Article 83 of the Commission proposal, which provides that income to be included in the tax base shall be calculated according to the rules of Articles 9 through 15. Thus, rather than directly relying upon the tax base of the company in the third country, the tax base is recalculated clearly based on the assumption that companies in third countries are residents in the European Union. As a result, dividends or proceeds from a disposal of shares must be exempt pursuant to Article 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. Article 11 itself does not distinguish whether the income is then taxed in that other third country. However, if the company is actually a resident in the European Union, Article 73 orders an exception from the exemptions provided in paragraphs (c), (d), and (e) of Article 11. According to its spirit, the exception laid down in Article 73, thereby triggering a switch-over, should also be applicable in these situations. Yet it is not applicable according to its wording because Article 83(1) simply refers to Articles 9 to 15 of the proposal. That provision differs from the last sentence of Article 84(1), which is applicable to transparent entities and provides that “the income shall be computed under

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62. Michael Lang, *Überlegungen zur österreichischen DBA-Politik*, 22 SWI 108, 111–27 (2012).

the rules of this Directive,” and it also differs from Article 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.”

Consider this example: A company subject to the CCCTB regime holds a 100 percent participation in a company resident in the low-tax country A. That company exclusively derives income from dividends that 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 percent on those profits. Provided that Article 82 is applicable to the company resident in A, the income shall be calculated pursuant to Articles 9 through 15. The dividends from B would have to be exempt, which is why the CFC rule would eventually not apply. However, if Article 73 is likewise applied, the dividends must be included in the tax base, and the CFC rule becomes effective.

With this in mind, it is a welcoming proposal of the Danish presidency to replace the reference to Articles 9 through 15 for the wording “the rules of this directive.” This would resolve the discussed questions and would furthermore lead to appropriate and clearly attainable results.

The legal consequence of Article 83 of the proposal does not consist of a full “look-through approach.” Pursuant to the second sentence of Article 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 Article 82 in subsequent years.<sup>63</sup> According to the proposal of the Danish presidency, the same should hold for losses of a permanent establishment.

Article 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 Article 82 is deducted again when the entity’s profits are distributed or when its shares are disposed of. Article 83(4) and (5) apparently presupposes that the otherwise relevant exemption of Article 11(c) and (d) does not apply because the application of Article 82 also triggers a switch-over pursuant to Article 73. Based on the proposal of the Danish presidency, this argumentation proves to be problematic. According to the changed wording, Article 73 will obtain a counter-exception and the deletion of the exemptions provided for in Articles 11(c) and (d) shall not be applied for holdings according to Article 82(1)(a). The exemptions would thus be applicable again.

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63. For a discussion on the treatment of losses in the CCCTB system, see Moreno González & J. A. Sanz Díaz-Palacios, *Treatment of Losses, in THE COMMON CONSOLIDATED CORPORATE TAX BASE* (Michael Lang et al. eds., 2009).

#### IV. TRANSPARENT ENTITIES

##### A. *Qualification of Entities in Third Countries*

The proposal also contains rules on transparent entities.<sup>64</sup> 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 the taxpayer's own tax base. For purposes 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 Article 84(1), for entities with residency 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 Article 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 paragraphs (1) and (2).

Pursuant to Article 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."

Article 85 of the proposal does not provide for independent legal consequences in the case of shares in third-country entities. These can be inferred from Article 84 of the proposal. The income of the transparent entity is considered to be a proportion to the shareholder's tax base. Pursuant to Article 84(3), the taxpayer shall be entitled to relief from double taxation in accordance with Article 76(1), (2), (3), and (5).<sup>65</sup> 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 on 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 Article 76, the treatment might be different if the provisions of

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64. CCCTB Working Group, *Personal Scope of the CCCTB*, §§ 17 *et seq.*, CCCTB/WP/040/, 26 July 2006.

65. The Danish presidency accepted Articles 84 and 85 without any amendments and has thus also accepted the reference to Article 76(5), even though the presidency itself chose to delete this provision in its compromise proposal.



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

If the entity that is treated as transparent has a permanent establishment in the third country that fulfills the requirements laid out in Article 5, the entity's assumed transparency will lead to the permanent establishment being regarded proportionally as that of the taxpayer. Consequently, the exemption of Article 11(e) of the proposal would apply, and the income must then 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 Article 11(c), and proceeds from a disposal of shares are exempt pursuant to Article 11(d). Against that backdrop, it makes little difference whether a third-country entity is treated as transparent since the profits generated there from that entity are obviously exempt anyway.

This would, however, be different based on the proposal of the Danish presidency concerning minor holdings. If the holding is below 10 percent, the exemption of Articles 11(c) and (d) will not apply. The profit distributions of a non-transparent company resident in a third country will then be liable to tax. The appropriateness of this result can be questioned.

However, if the third-country entity is treated as transparent, it is exempt within the European Union 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, Article 85 of the proposal will tax the interest received by the third-country entity at the level of its shareholders in the European Union. If the 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 European Union.

In a similar 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 Article 85 of the proposal, income will not be attributed to the EU-resident shareholder for purposes 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 Article 11(c) of the proposal. A tax liability could at best be inferred from Article 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 Article 73 is opposed by the

fact that the tax exemption is the result of its transparent treatment 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” that could also trigger the application of Article 73.

A “dividend” paid by the third-country entity to the EU shareholder cannot be taxed. In the case of transparent entities, it is more difficult to derive that tax exemption from Article 11(c) of the proposal because a look-through approach is applied to the “distributing” entity pursuant to Article 84 *et seq.* 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 out in Article 84 *et seq.* This result would not change if the proposal of the Danish presidency would be adopted and the exemptions of Articles 11(c) and (d) were made dependent on the existence of a minimum holding of 10 percent.

#### *B. EU Permanent Establishments of Third-Country Entities and Transparency*

In any event, the criteria that may be relied upon pursuant to Article 85 of the proposal for third-country entities differ from those that are relevant pursuant to Article 2(2) for the companies established according to the law of a third country. Pursuant to Article 85, the only criterion is the qualification according to the national law of the shareholder’s state of residency in the European Union. Pursuant to Article 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 that are listed in Annex I for the relevant state of the permanent establishment, the criteria need not be the same as those that 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 Article 85 and Article 2(2) of the proposal.<sup>66</sup>

The following is an example: A company resident in EU-Member State A holds a 50 percent share in a subsidiary in a third country. The third-

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66. See Matthijs Vogel et al., *Initial Comments on COMMON CONSOLIDATED CORPORATE TAX BASE: PROPOSAL FOR A COUNCIL DIRECTIVE*, in 4 HIGHLIGHTS & INSIGHTS ON EUR. TAX’N 5, 60 (2011) [hereinafter HIGHLIGHTS & INSIGHTS].

country entity has a permanent establishment in EU-Member State B. The third country regards the company resident in that state as the taxpayer while the national tax law of State A treats the company as transparent. If State B applies the examination procedure required in Article 2(2) of the proposal with respect to the permanent establishment located in its territory, the entity of the third country qualifies as a “company” according to the proposal.

In this event, the subsidiary’s income shall be included proportionally in the tax base of the company that is a resident in A pursuant to Article 85. The same is true for the profits attributable to the third-country entity’s permanent establishment in the European Union. After all, the permanent establishment is not an independent enterprise and, therefore, cannot be qualified pursuant to Article 84. The permanent establishment’s income cannot be exempt, since Article 11(e) applies only to permanent establishments in a third country. The third-country entity itself, however, is regarded as the taxpayer in Member State B. Pursuant to Article 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 State A, because the share amounts to only and not more than 50 percent. 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 State A and also at the level of the third-country entity itself and are thus taxable in State B where the permanent establishment is located. In this case, the application of the Directive leads to double taxation in the European Union. The tax imposed in B can at best be credited in State A if the reference in Article 84(3) to Article 76 of the proposal is interpreted as to also allow an indirect credit.

### *C. Controlled Foreign Companies and Transparency*

Another question is the relationship between the rules in Article 84(f) on transparent entities and those in Article 82 *et seq.* on controlled foreign companies. This question seems unimportant at least at first sight since 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, in turn, seem to be the same. This result is called into question, however, if one considers 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 Article 85. However, distributions are taxable if the CFC rules of Article 82 *et seq.* are applicable. Due to the exception laid out in Article 73, the exemption of Article 11(c) does not apply. Article 83(4) indirectly confirms that tax liability, stipulating that the amounts of income previously included in the tax base shall be deducted from the tax base. At least the last mentioned argument remains valid against the backdrop of Article 73, which

would in its proposed amendment by the Danish presidency, keep the exemption of Article 11(c) intact.

In case the CFC rules and those rules concerning transparent entities provide for different legal consequences, 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 that, as evidenced 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, then there is no need to bring the anti-abuse rules into play.

## V. DOUBLE TAXATION CONVENTIONS

### A. Priority of DTCs with Third Countries

The relationship between the Directive and the double tax conventions (DTCs) is complex.<sup>67</sup> 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,<sup>68</sup> this principle is repeated in Article 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 European Union, certainly this is not always the case. For example, Article 76 of the proposal regulates the credit of those taxes that were already paid in another Member State or even in a third country. Accordingly, subject to Article 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 that prevents the other Member State

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67. CCCTB Working Group, *International Aspects in the CCCTB*, §§ 17 *et seq.*, CCCTB/WP/019/, 18 November 2005; *Analysis and Comment*, *supra* note 20, at 518; HIGHLIGHTS & INSIGHTS, *supra* note 66, at 60.

68. See Georg Kofler, DOPPELBESTEUERUNGSABKOMMEN UND EUROPÄISCHES GEMEINSCHAFTSRECHT 265–1196 (2007) [hereinafter DOPPELBESTEUERUNGSABKOMMEN]; J. Schuch & A. Stieglitz, DBA- und EU-Diskriminierungsverbote und Verfahrensrecht, in DIE DISKRIMINIERUNGSVERBOTE IM RECHT DER DOPPELBESTEUERUNGSABKOMMEN 407, 417–33 (Michael Lang et al. eds., 2006); Marco Laudacher, *Rechtsfindung nationaler Richter im Fall der unionsrechtskonformen Auslegung und des Anwendungsvorrangs*, UFSJOURNAL 164 (2012); see also T. Schindler, *Vorrang für Menschenrechte oder Marktfreiheiten?*, 27 RdW 807 (2009).

from imposing withholding tax. Accordingly, the DTC continues to be applicable after all.

The CCCTB proposal does not contain general rules with respect to third countries. Article 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.<sup>69</sup> Based on *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.<sup>70</sup> According to the — albeit controversial — opinion of Advocate General Kokott,<sup>71</sup> an analogous application of Article 351(1) TFEU<sup>72</sup> is conceivable “where an international obligation on the part of a Member State conflicts with a subsequently agreed measure of secondary law.”<sup>73</sup> 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, Article 351 TFEU regulates only conflicts between DTCs and the Directive. Such a conflict does not exist if a DTC allows dividends to

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69. DOPPELBESTEUERUNGSABKOMMEN, *supra* note 68, at 432–1196.

70. *See supra* Part II.A.

71. The opinion which rejects an analogous application relies upon the Member States’ obligation not to impair the Community’s later exercise of competence. *See* Pietro Manzini, *The Priority of Pre-Existing Treaties of EC Member States within the Framework of International Law*, 12 *ejil*. 781, 785–92 (2001).

72. TFEU, *supra* note 43; *see also* Consolidated Version of the Treaty Establishing the European Community, art. 307, 2006 O.J. (C321) E/37 [hereinafter EC Treaty].

73. Case C-188/07, *Commune de Mesquer v. Total France SA and Total Int’l Ltd.*, 2008 E.C.R. I-4501 (Op. Of Advocate Gen Kokott). The analogous application of EC Treaty Article 307 — which corresponds to Article 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* Lorenzmeier, *Verhältnis zu früheren Verträgen der Mitgliedstaaten (Nizza-Fassung)*, in *DAS RECHT DER EUROPÄISCHEN UNION* 40, at EGV art. 307 (Eberhard Grabitz & Meinhard Hilf eds., 2009); Kirsten Schmalenbach, *Verhängen zu früheren der Mitgliedstaaten*, in *EUV/AEUV — DAS VERFASSUNGSRECHT DER EUROPÄISCHEN UNION MIT EUROPÄISCHER GRUNDRECHTECHARTA* 4, AVEU art. 351 (ex-art. 307 EGV) (Christian Calliess et al. eds., 2011); Von Eckhard Pache & Joachim Bielitz, *Das Verhältnis der EG zu den völkerrechtlichen Verträgen ihrer Mitgliedstaaten*, *EuR* 316 (2006).

be credited and if those dividends must be exempt under the Directive. An exemption within the European Union is not incompatible with the DTC as the latter does not impose a tax liability. In that event, the credit may eventually be meaningless, especially 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 residency, while Article 6(6) and Article 76 of the CCCTB proposal subject that interest to tax. In such a case, the DTC exemption has priority within the scope of the application of Article 351 TFEU — possibly extended by way of analogy. Similarly, if the DTC exempts income from a permanent establishment in the third country, and a permanent establishment for purposes of treaty law has already existed for six months in case of construction projects, a conflict exists that must be resolved in favor 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 nonresident needs fifteen 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 with respect to its permanent establishment, while the DTC prevents that state's taxation right so that the Directive will prevail subject to Article 351 TFEU.

Finally, some Articles of the CCCTB proposal directly address DTC rules. For example, Article 76(5) of the proposal — which should be deleted according to the compromise proposal of the Danish presidency — 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 represents the obligation to refund a withholding tax imposed by a third country similar to what the European Court of Justice had in mind in the *Amurta* case.<sup>74</sup> 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 Article 351(2) TFEU.

#### *B. DTCs and Foreign Controlled Companies*

Against that backdrop, the question now becomes whether DTCs preclude the application of the CFC rules. Article 82 of the CCCTB proposal addresses bilateral agreements twice. Pursuant to Article 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

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74. Case C-379/05, *Amurta SGPS v. Inspecteur van de Belastingdienst/Amsterdam*, 2007 E.C.R. I-09569.

information comparable to the exchange of information on request provided for in Directive 2011/16/EU.”<sup>75</sup> Article 82(3) also lists as one of the categories of potentially harmful income as that 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 — which should be deleted according to the compromise proposal of the Danish presidency — do not provide any indication to clarify the relationship between Article 82 *et seq.* and the DTCs generally.

DTC rules that — possibly by way of analogy — fall within the ambit of Article 351 TFEU can preclude the application of Article 82 *et seq.* only if the provisions of the Directive are incompatible with them. The decisive question is whether there is such a conflict. Courts that have had to address the relationship between national CFC rules and DTCs have provided completely different answers to this question. Here are two different examples: First, the Finnish Supreme Court held the application of the Finnish CFC rule compatible with the DTC.<sup>76</sup> The judgment was primarily based on the objective and purpose of the DTC and the OECD Commentary. Second, the French Conseil d’Etat adopted an entirely different stance in its judgment on 28 June 2002 that concerned *Schneider SA*.<sup>77</sup> The Court held that the 1966 DTC between France and Switzerland, modified in 1969 and modeled after Article 7(1) OECD-MC, required the exemption of income that may be taxed in Switzerland pursuant to Article 7(1) of the DTC because the Swiss subsidiary had its place of management in Switzerland and did not have a permanent establishment in France. The Court maintained 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.<sup>78</sup> Although DTCs are intended to prevent double taxation, they can only do so only within their scope of application.<sup>79</sup> As a result of CFC rules, the two states will attribute the income to different persons, and the DTCs usually will not focus on ensuring protection against such economic double

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75. HIGHLIGHTS & INSIGHTS, *supra* note 66, at 59.

76. *Re A Oyj Abp*, 20 March 2002, KHO 596/2002/26, 4 INT’L TAX L. REP., 1009 (2002) (Belgium-Finland Tax Treaty) [Fin.]; *see also* Marjaana Helminen, *National Report Finland*, in 8 CFC REGULATIONS, TAX TREATIES AND EC LAW 191 204–20 (Michael Lang et al eds., 2004).

77. *Re Societé Schneider Electric*, 28 June 2002, Conseil d’Etat [Supreme Administrative Court] No. 232276, 4 INT’L TAX L. REP. 1077 (2002) [Fr.]; *see also* P. Douvier & D. Bouzora, *France: Court of Appeals Confirms Incompatibility of CFC Rules with Tax Treaties*, 41 EUR. TAX’N 184 (2001).

78. Michael Lang, *Die Besteuerung von Einkünften bei unterschiedlichen Personen aus dem Blickwinkel des DBA-Rechts*, 10 SWI 527, 527–35 (2000).

79. *Id.* at 533–35.

taxation.<sup>80</sup> The Model-Commentary does not offer a solution either. It is the treaty rule that is decisive, and its content must be interpreted in reliance on the Commentary. Based on an appropriate view, however, this applies only if the version of the Commentary that addresses the issue had already been available when the relevant DTC was concluded.<sup>81</sup>

In the case of those DTCs that are modeled after the OECD Model, Article 7 is one possible distributive rule. Pursuant to Article 7 OECD-MC, the profits of an enterprise of a Contracting 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 residency 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 of 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 Article 7 OECD-MC.<sup>82</sup> Article 7 OECD-MC is, however, applicable only if Article 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 Article 10 OECD-MC are fulfilled, as the share is causal for the tax liability pursuant to Article 82 *et seq.*<sup>83</sup> This applies not only to the distribution of profits but also to the profit itself. However, the application of Article 10 OECD-MC is occasionally doubtful; for example, because there is no payment.<sup>84</sup> In my opinion, however, the term “pay” must not be construed so restrictively and should cover any event

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80. See OECD-MC, *supra* note 20, art. 23A (Commentary); *id.* art. 23A–B (Commentary), ¶ 2.

81. Verwaltungsgerichtshof [VwGH] [Supreme Administrative Court] 31 July 1996, docket No. 92/13/0172, 21 May 1997, 96/14/0084; see also Michael Lang, *Das OECD-Musterabkommen 2001 und darüber hinaus: welche Bedeutung haben die nach Abschluss eines Doppelbesteuerungsabkommens erfolgten Änderungen des OECD-Kommentars?*, 10 ISTR 538 (2001); Avery Jones, *The Effect of Changes in the OECD Commentaries After a Treaty is Concluded*, 56 BULL. INT’L FISCAL DOCUMENTATION 102 (2002).

82. Michael Lang, *CFC-Regelungen und Doppelbesteuerungsabkommen*, 11 ISTR 717, 718–23 (2002); Michael Lang, *Personengesellschaften im DBA-Recht*, 10 SWI 60, 65 (2000).

83. Michael Lang, *CFC Regelungen und Doppelbesteuerungsabkommen*, 11 ISTR 717, 721 (2002).

84. Kofler, *CFC Rules*, *supra* note 52, at 738–49.



that triggers a tax liability within the scope of Art 10 OECD-MC.<sup>85</sup> Whoever considers Article 10 OECD-MC applicable will conclude that the EU Member State is not prevented from applying Article 82(f).

### C. DTCs and Transparency

The same considerations could apply with respect to participations in those companies that are qualified as taxpayers in the third country, while being treated as transparent in the EU-Member State in which the shareholder is a resident. Foreign controlled companies are only one special case of those scenarios. As a result, these cases must 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 Article 84(f), either pursuant to Article 10 or 7 of the OECD-MC, if the third-country entity’s permanent establishment is not regarded as the permanent establishment of the shareholder.

Distributions undoubtedly fall under Article 10 OECD-MC. The fact that they are exempt in the Member State under Article 11(c)<sup>86</sup> of the CCCTB 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 Article 76(1) of the proposal prevents a credit of the remaining withholding tax that is lawfully imposed.

## VI. CONCLUSION AND OUTLOOK

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

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85. H.J. Aigner, *CFC-Gesetzgebung und DBA-Recht*, 12 SWI 407, 411–14 (2002); see also KLAUS VOGEL, KLAUS VOGEL ON DOUBLE TAXATION CONVENTIONS, art. 10, ¶ 22 (3d ed. 1997); Michael Lang, *CFC Regulations & Double Taxation Treaties*, BULL. INT’L FISCAL DOCUMENTATION 51, 56–58 (2003).

86. Again, attention should be paid to the fact that the Danish presidency wishes to make this exemption dependent on a minimum holding of 10 percent.

Aside from detailed suggestions, there are several legal improvements that could be made to the proposal.

When regulating certain questions, the authors of the OECD-MC and of other Directives, such as the Parent-Subsidiary Directive and the Interest and Royalties Directive, encountered similar challenges. Having recognized this, the authors of the CCCTB proposal have followed those rules in many respects. That makes sense, as it would be a waste of resources to re-invent the wheel, so to speak. Incorporating existing provisions by reference rather than allowing practitioners to rely upon scholarly legal writing and case law issued with respect to 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 interpretational difficulties. 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; the transparency rules, for example, 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 also an example of what the Directive regulates a single question — namely, how to classify foreign entities for the purpose of the Directive — in a different manner. Many problems of interpretation could be avoided if those questions were resolved according to uniform criteria.