

Agenda

INCOME FROM IMMOVABLE PROPERTY AND OTHER INCOME

- a) **ART. 6 OECD MC**
- b) **ART. 21 OECD MC**

RELIEF FROM DOUBLE TAXATION

- a) **EXEMPTION (ART 23 A OECD MC)**
- b) **CREDIT (ART. 23 B OECD MC)**

INCOME TAXATION AND EU LAW

- a) **FUNDAMENTAL FREEDOMS AND INCOME TAXATION**
- b) **EU DIRECTIVES IN THE AREA OF INCOME TAX**

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ART. 6 OECD MC

Art. 6 – Income from immovable property

- **Art. 6(1)**

"Income derived by a resident of a Contracting State from immovable property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other State"

- **Right to tax:**

- **State in which the property producing the income is situated** → Source State
- **State of residence of the recipient of the income** → elimination of the double taxation (credit method vs. exemption method)

Art. 6 – Income from immovable property

- **Art. 6(2)**

"The term "immovable property" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships, boats and aircraft shall not be regarded as immovable property"

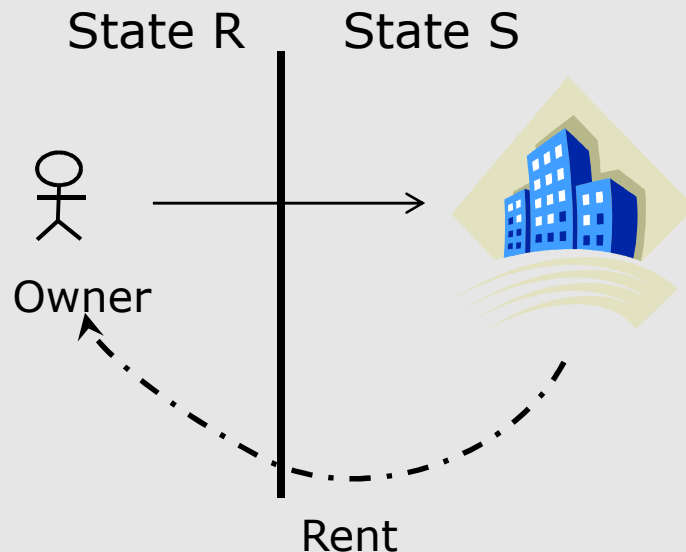
- Definition of immovable property:

- Reference to the domestic law of the contracting State in which the immovable property is located;
- Explanatory list (*"The term shall in any case include..."*);

Art. 6 – Income from immovable property

- **Commentary on Art. 6:**

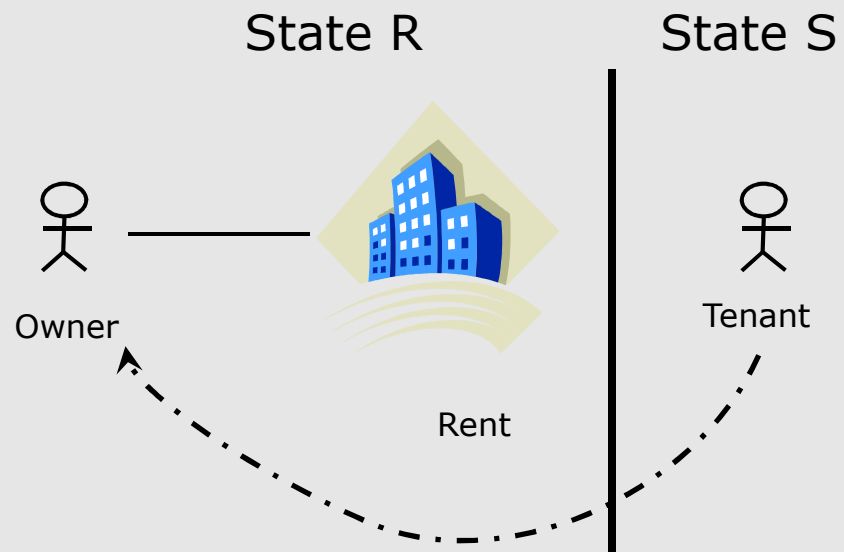
- Article 6 deals only with income which a resident of a Contracting State derives from immovable property situated in the other Contracting State;
- It does not, therefore, apply to income from immovable property situated in the Contracting State of which the recipient is a resident within the meaning of Article 4 or situated in a third State:
 - The provisions of paragraph 1 of Article 21 shall apply to such income.



R-S Treaty:

- Art. 6(1) shall apply
- State S has the right to tax
- State R has the right to tax - elimination of the double taxation

Art. 6 – Income from immovable property



R-S Treaty:

- Art. 6(1) shall not apply
- Art. 21 (*Other incomes*) applies: exclusive right to tax of State R

Art. 6 vs Art. 7 - Immovable property relevant to a PE located in the other contracting State

- **Art. 6(4):**

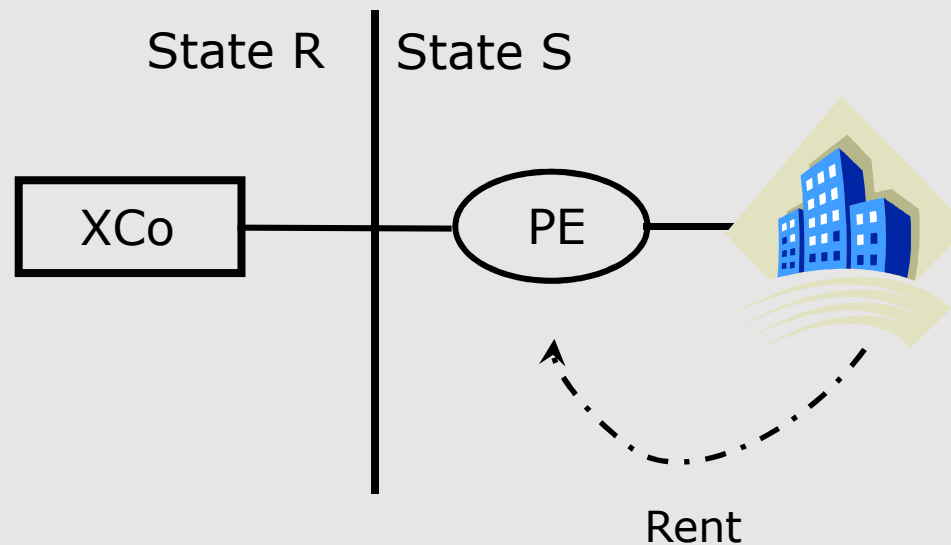
"The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise"

- **Art. 7(4) (Business profit):**

"Where profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article"

- Art. 6 prevails on Art. 7 → The State in which the immovable property is located has the right to tax

Art. 6 vs Art. 7 - Immovable property relevant to a PE located in the other contracting State



R-S Treaty:

- Art. 6(1) shall apply (and not Art. 7) even if the immovable property is relevant to the PE;
- State S has the right to tax
- State R has the right to tax - elimination of the double taxation

ART. 21 OECD MC

Art. 21 – Other income

- **Art. 21(1):**

"Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Convention shall be taxable only in that State."

- **Art. 21(2):**

"The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of Article 6, if the recipient of such income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein and the right or property in respect of which the income is paid is effectively connected with such permanent establishment. In such case the provision of Article 7 shall apply."

Art. 21 – Other income

- Amendments to the OECD MC(1977):
 - "*wherever arising*" → third States or State of Residence
 - "*not dealt with in the foregoing Articles*" → incomes not falling within other categories provided by the MC
 - Addition of Par. 2

Art. 21 – Other income

- Amendments to the OECD MC Commentary (1977):
 - Clarifications:
 - Incomes falling under Art. 21 are those incomes which (i) *category*, or (ii) *source* is not expressly considered
 - Art. 21 applies to incomes which are sourced *sia* in a third State (i.e. a State different from those which sign the relevant Treaty)

Art. 21 – Other income

- Article 21(1) of the OECD MC provides for exclusive residence taxation;
- It does not contain rules that restrict the way in which the residence state may tax such income;
- With regard to items of income derived from a right or property that is effectively connected to a PE, article 21(2) of the OECD Model refers to article 7;
- With regard to income arising from immovable property, article 21 of the OECD MC shall not apply, as article 6 prevails.

ART. 23 OECD MC

Art. 23 - Methods for elimination of double taxation

- **Different kind of double taxation:**
 - Double taxation arising when a taxpayer deemed to be resident in both the contracting States (art. 4(2) and (3) of the OECD MC);
 - Double taxation arising when a taxpayer resident in a contracting State derives incomes from the other contracting State (art. 23 of the OECD MC).

Art. 23 - Methods for elimination of double taxation

- **Art. 23 vs the so-called *distributive rules***
 - *Distributive rules* (Articles from 6 to 22 of the OECD MC):
 - i. Both the contracting State have the right to tax (e.g. Art. 16);
 - ii. Both the contracting State have the right to tax but source State's right to tax is limited (e.g. Art. 10);
 - iii. Exclusive taxation in the State of residence (e.g. Art. 12);
 - iv. Exclusive taxation in the source State (e.g. Art. 19(1)(a));
- **According to Art. 23, the State of residence shall eliminate the double taxation arising from the taxation of the income in the source State (case i. and ii.)**

Art. 23 - Methods for elimination of double taxation

- **How to eliminate double taxation?**
 - Art. 23 of the OECD MC offers a choice of relief from double taxation:
 - The **exemption method** (Art. 23A OECD MC)
 - «Full exemption»
 - «Exemption with progression»
 - The **tax credit method** (Art. 23B OECD MC)
 - «Full credit»
 - «Ordinary credit»

Art. 23A – Exemption method

1. Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first-mentioned State shall, subject to the provisions of paragraphs 2 and 3, **exempt such income or capital from tax.**
2. Where a resident of a Contracting State derives items of income which, in accordance with the provisions of Articles 10 and 11, may be taxed in the other Contracting State, the first-mentioned State **shall allow as a deduction from the tax on the income of that resident an amount equal to the tax paid in that other State.** Such deduction shall not, however, exceed that part of the tax, as computed before the deduction is given, which is attributable to such items of income derived from that other State.

Art. 23A – Exemption method

3. Where in accordance with any provision of the Convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.
4. The provisions of paragraph 1 shall not apply to income derived or capital owned by a resident of a Contracting State where the other Contracting State applies the provisions of this Convention to exempt such income or capital from tax or applies the provisions of paragraph 2 of Article 10 or 11 to such income.

Art. 23A – Exemption method

- **Full Exemption Method:**

- The whole income which is taxed in the source State is exempt i.e. not taken into account by the resident State for its tax purposes;
- In determining the tax on the rest of the income in the resident State, the income taxable in the Source country is not considered;

- **Exemption with Progression Method:**

- The whole income which is taxed in the source State is exempt i.e. not taken into account by the State of residence for its tax purposes;
- In determining the tax on rest of the income in the State of residence, the income taxable in source State is considered. Therefore, level of income in the source State matters.

Art. 23B – Credit method

1. Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first-mentioned State shall allow:
 - a) as a deduction from the tax on the income of that resident, an amount equal to the income tax paid in that other State;
 - b) as a deduction from the tax on the capital of that resident, an amount equal to the capital tax paid in that other State.

Such deduction in either case shall not, however, exceed that part of the income tax or capital tax, as computed before the deduction is given, which is attributable, as the case may be, to the income or the capital which may be taxed in that other State.

2. Where in accordance with any provision of the Convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.

Art. 23B – Credit method

1. Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first-mentioned State shall allow:
 - a) as a deduction from the tax on the income of that resident, an amount equal to the income tax paid in that other State;
 - b) as a deduction from the tax on the capital of that resident, an amount equal to the capital tax paid in that other State.

Such deduction in either case shall not, however, exceed that part of the income tax or capital tax, as computed before the deduction is given, which is attributable, as the case may be, to the income or the capital which may be taxed in that other State.

2. Where in accordance with any provision of the Convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.

Art. 23B – Credit method

- **Key features:**

- Under this method, the State of residence grants credit for the taxes paid in the Source country;
- For the State of residence, the loss of revenue is generally lower in credit method, therefore generally most double tax treaties relieve double taxation only through credit method;
- Non-refundable tax credit → In case the tax payable in Resident country is less than the credit available or the relevant income is exempt in State of residence, the resident is not entitled to refund of the excess credit for the taxes paid in Source state

Fundamental freedoms and income taxation

European Union

The Scope

Art. 26 of the TFEU:

- **Para. 1:** *“The Union shall adopt measures with the aim **of establishing or ensuring the functioning of the internal market**, in accordance with the relevant provisions of the Treaties”*
- **Para. 2:** *“The internal market shall comprise an area without internal frontiers in which the **free movement of goods, persons, services and capital** is ensured in accordance with the provisions of the Treaties”*

European Union

The Scope

- **Establishing or ensuring the functioning of the internal market means:**
 1. Eliminate obstacles to **free movement of goods, person, services and capitals** among Member states
 2. Guarantee fair competition within the internal market (*e.g. State aid rules*)

European Union

The Scope

- **Treaties of Functioning of the European Union (TFEU):**
 - **Non-discrimination** principle (art. 18)
 - **Fundamental freedoms** (art.28, 45, 49, 56 e 63)
- **Role of the Court of Justice of European Union (CJEU):**
 - To assess the compliance of EU Member States domestic law with the EU law

European Union

Non-discrimination principle

- **Art. 18 of TFEU:**

- *"Within the scope of application of the Treaties, and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality shall be prohibited"*



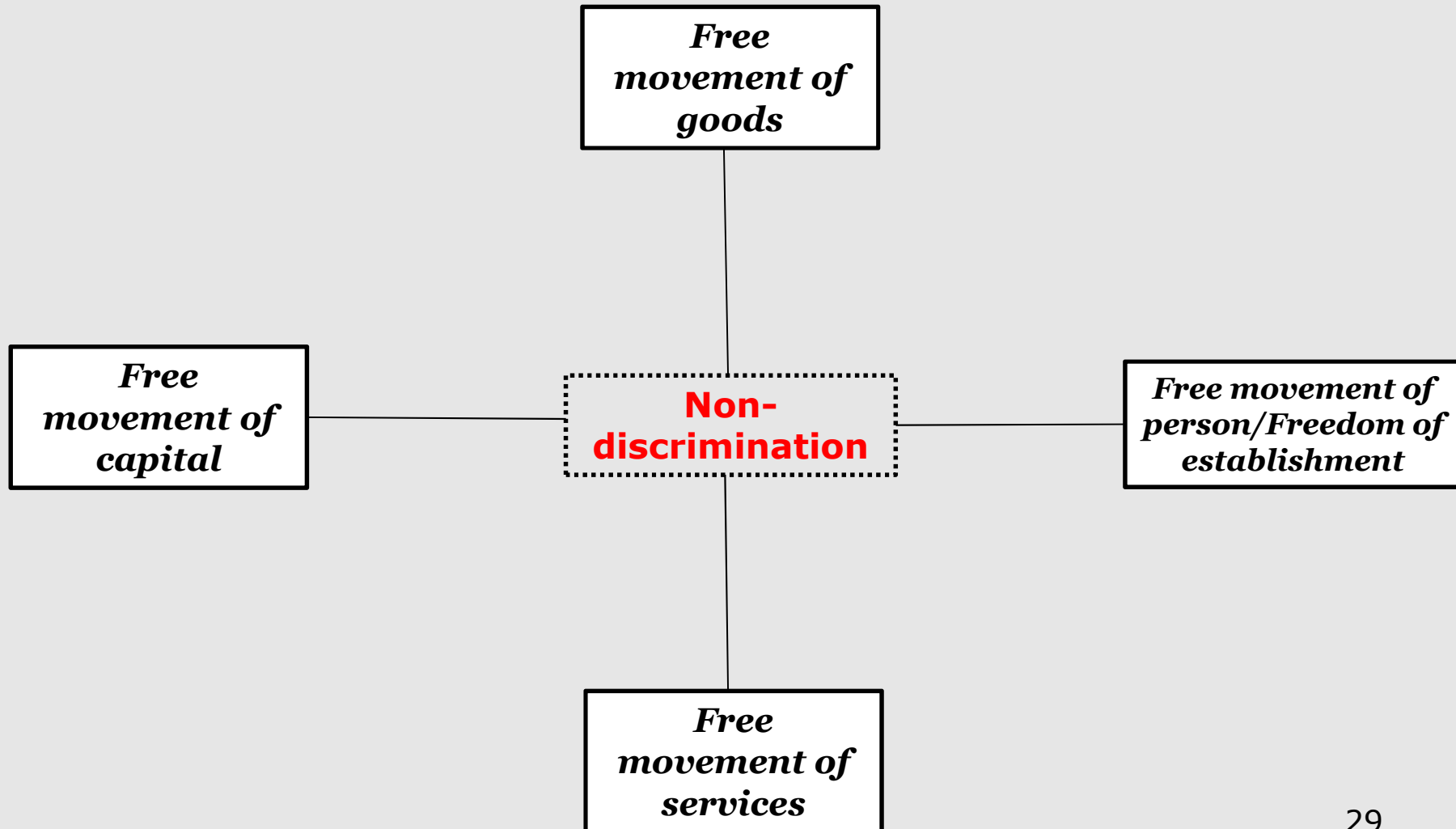
Direct/Indirect Discrimination



Arising from both (i) the **different treatment of comparable situations** and (ii) the **same treatment of different situations** (Italy vs Commission, Cause C-13/62 of 17 July 1963)

European Union

Non-discrimination and Fundamental freedoms



Fundamental freedoms

Free movement of Goods

- **Art. 28 TFEU:**

- *"The Union shall comprise a customs union which shall cover all trade in goods and which shall involve the prohibition between Member States of customs duties on imports and exports and of all charges having equivalent effect, and the adoption of a common customs tariff in their relations with third countries".*

- **Prohibition of quantitative restrictions between member states**

- **Import of goods** (art. 34 TFEU):

"Quantitative restrictions on imports and all measures having equivalent effect shall be prohibited between Member States"

- **Export of goods** (art. 35 TFEU):

"Quantitative restrictions on exports, and all measures having equivalent effect, shall be prohibited between Member States"

Fundamental freedoms

Free movement of Person and Freedom of Establishment

- **Free movement of *workers* (artt. 45–48 of the TFUE):**
 - *"Such freedom of movement shall entail the abolition of any discrimination based on nationality between workers of the Member States as regards employment, remuneration and other conditions of work and employment"*
- **Freedom of *establishment* (artt. 49–55 of the TFUE):**
 - *"Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State"*
 - It entails:
 - The Freedom to access to the market of another Member State
 - The conditions set forth by the domestic law of the Member State of establishment (applicable to its citizens) must be extended to who exercise the freedom

Fundamental freedoms

Free movement of Person and Freedom of establishment

- Scope of application:
 - **Individuals** (i.e. self-employed and individual enterprise)
 - **Companies** (according to art. 54 of the TFEU):
 - *"Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States".*
 - "Companies or firms" means companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making".*

Fundamental freedoms

Free movement of services

- **Artt. 56–62 TFEU:**

- *"Within the framework of the provisions set out below, restrictions on freedom to provide services within the Union shall be prohibited in respect of nationals of Member States who are established in a Member State other than that of the person for whom the services are intended"*
- services shall be considered as such where they are normally provided for remuneration, in so far as they are not governed by the provisions relating to freedom of movement for goods, capital and persons
- free movement of services **cover all activities of an industrial or commercial character** or of craftsmen and the activities of the professions

Fundamental freedoms

Free movement of capital

- **Artt. 63 – 66 of the TFEU:**

- *"Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between **Member States** and **third countries** shall be prohibited"*
- It enables integrated, open, competitive and efficient European financial markets and services
- Capital movements mean any one of the following when carried out on a cross-border basis:
 - **Foreign direct investment** (FDI), including investments which establish or maintain lasting links between a provider of capital (investor) and an enterprise (in effect setting up, taking-over, or acquiring an important stake in a company or institution);
 - **Real estate investments or purchases**
 - **Securities investments (e.g. in shares, bonds, bills, unit trusts)**
 - **Granting of loans and credits**
 - **Other operations with financial institutions**

Eu Directives in the area of income tax

European Union

Direct Taxation

- **The EU Treaty makes no explicit provision for legislative competences in the area of direct taxation**
 - The current EU taxation framework leaves Member States free to decide on their tax systems provided they comply with European Union (EU) rules
 - Authorizes the Union to adopt **directives** on the approximation of laws, regulations or administrative provisions of the Member States which directly affect the internal market
 - These require unanimity and the consultation procedure

European Union Direct Taxation

- Key Directives relevant to direct taxation:
 - **“Parent-Subsidiary”** Directive – 2011/96/UE;
 - **“Merger” Directive** – 2009/133/CE;
 - **“Interest-Royalty”** Directive – 2003/49/CE;

Parent-Subsidiary Directive

- Council Directive (EU) 2011/96/UE on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (P-S Directive)
 - Introduced in 1990;
 - **Exempts** dividends and other profit distributions paid by subsidiary companies to their parent companies from **withholding taxes** and eliminates double taxation of such income at the level of the parent company:
 - Exemption from withholding taxes in the source State (i.e. State of residence of the subsidiary);
 - Exemption or indirect tax credit in the State of residence (i.e. State of residence of the parent company).

Parent-Subsidiary Directive

- The P-S Directive applies to:
 - Distributions of profits received by companies of a Member State which come from their subsidiaries of other Member States
 - Distributions of profits by companies of a Member State to companies of other Member States of which they are subsidiaries
 - Distributions of profits received by permanent establishments situated in a Member State of companies of other Member States which come from their subsidiaries of a Member State other than that where the permanent establishment is situated
 - Distributions of profits by companies of that Member State to permanent establishments situated in another Member State of companies of the same Member State of which they are subsidiaries

Parent-Subsidiary Directive

- For the purposes the P-S Directive a “company of a Member State” means any company which:
 - i. Takes one of the forms listed in Annex I, Part A of the Directive
 - ii. According to the tax laws of a Member State is considered to be resident in that Member State for tax purposes and, under the terms of a double taxation agreement concluded with a third State, is not considered to be resident for tax purposes outside the EU
 - iii. Is subject to one of the taxes listed in Annex I, Part B of the Directive, without the possibility of an option or of being exempt

Parent-Subsidiary Directive

- The status of “**Parent**” shall be attributed:
 - at least to a company of a Member State which fulfils the conditions set out in Article 2 and has a **minimum holding of 10 %** in the capital of a company of another Member State fulfilling the same conditions
 - under the same conditions, to a company of a Member State which has a **minimum holding of 10 %** in the capital of a company of the same Member State, held in whole or in part by a permanent establishment of the former company situated in another Member State
- The status of “**Subsidiary**” shall be attributed to that company the capital of which includes the holding above

Interest-Royalty Directive

- Council Directive (EU) 2003/49/CE on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States (I-R Directive)
 - Introduced in 2003
 - It is designed to **eliminate withholding tax** obstacles in the area of cross-border interest and royalty payments within a group of companies by abolishing:
 - Withholding taxes on royalty payments arising in a Member State, and
 - Withholding taxes on interest payments arising in a Member State
 - These interest and royalty payments shall be exempt from any taxes in that State provided that the beneficial owner of the payment is a company or permanent establishment in another Member State

Interest-Royalty Directive

- The benefits of the I-R Directive are only granted to companies which are:
 - Subject to corporate tax in the EU;
 - Tax resident in an EU Member State; and
 - Of a type listed in the annex to the Directive.

Merger Directive

- COUNCIL DIRECTIVE 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States
 - Introduced in 1990;
 - The objective of the Directive is to remove fiscal obstacles to cross-border re-organizations involving companies situated in two or more Member States;
 - It includes a list of the legal forms to which it applies;
 - The companies must be subject to corporate tax, without being exempted, and resident for tax purposes in a Member State.

Merger Directive

- Mergers and divisions, where the transferring company transfers assets and liabilities to one or more receiving companies:
 - The Merger Directive provides for **deferral of the taxes** that could be charged on the difference between the real value of such assets and liabilities and their value for tax purposes;
 - The deferral is granted provided that the receiving company continues with their tax values and effectively connects them to its own permanent establishment in the Member State of the transferring company;
 - The assets transferred shall form a branch of activity;

Merger Directive

- Transaction where a company acquires a holding majority in the capital of the acquired company and it transfers in exchange its own shares to the shareholders of the latter company (i.e. exchange of shares):
 - the Merger Directive provides for **tax deferral** of the taxes that could be charged on the income or capital gains derived by the shareholders of the transferring or the acquired company from the exchange of such shares for shares in the receiving or the acquiring company.