

Università Carlo Cattaneo – LIUC

International Tax Law a.a.2017/2018

*Parent Subsidiary Directive and Interest  
and Royalty Directive*

Prof. Marco Cerrato

# Parent-Subsidiary Directive

# The Directive in general

- Common regime of dividend flows within the European Union
- Directive 2011/96/EU has recast and updated Directive 90/435/EEC
- State of the Subsidiary
  - Exemption in the State of the subsidiary company
- State of the Parent
  - Exemption or underlying tax credit in the State of the parent company
- Special rules for PEs and transparent entities

# Personal scope

## ***“Company of a Member State”*** (Article 2(a))

–Legal form

–Residence

–Subject to tax

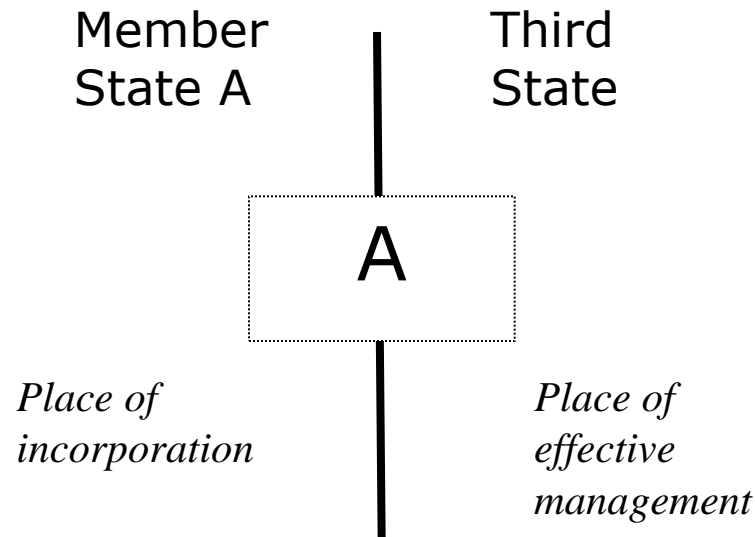
# Legal form

- The company shall take one of the forms listed in Annex I, Part A (Article 2 (a)(i))
- The list of Annex I, part A shall be considered closed (CJEU, C-247/08, *Gaz de France*) but Member States cannot discriminate

# Residence

Art. 2(a)(ii):

- The company shall be considered resident for tax purposes of a Member State; and
- Shall not be considered resident only in a third State according to the tie breaker rule of the double tax treaty between the member State of residence and the third State



# Subject to tax

## Article 2(a)(iii)

- The company shall be subject to one of the taxes listed in Annex I, Part B, without the possibility of an option or of being exempt
  - A company liable to tax but subject to tax at zero rate cannot benefit from the Directive because it cannot be considered subject to tax (*Wereldhave* (C-448/15))

# P-S Relationship

## *The participation threshold*

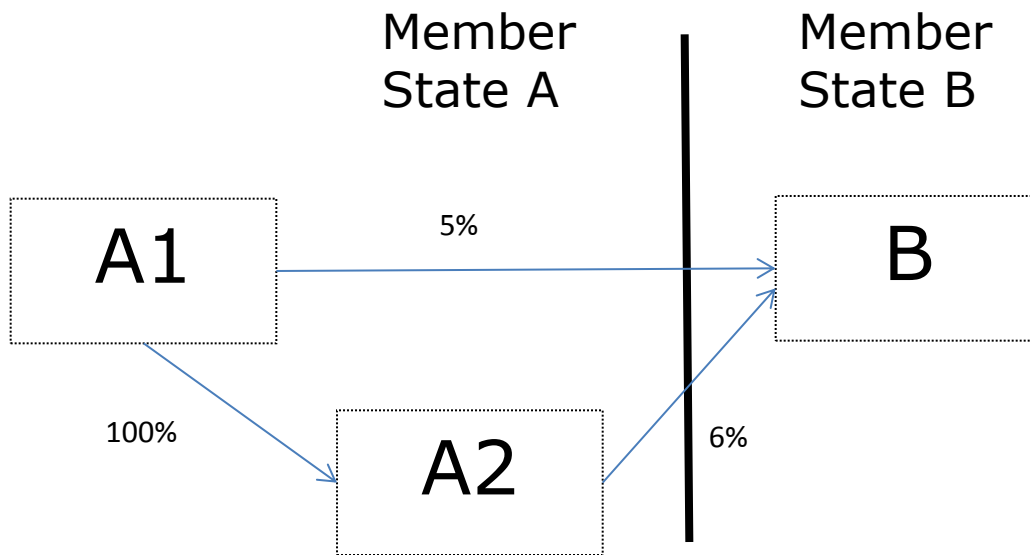
- At least 25 % of the capital (1990-2005)
- 20%, as from 2005
- 15%, as from 2007
- 10%, as from 2009
  
- More in line with conditions for domestic dividend exemptions
  
- Criterion of capital may be replaced by voting rights through bilateral agreements
- Usufruct does not allow to meet the requirement of “holding in the capital” (CJEU, Case C-48/07, *Les Vergers du Vieux Tauves*)



# P-S Relationship

## *The participation threshold*

- Reference to date of dividend distribution
- Are indirect holdings covered?



# P-S relationship

## *Holding period*

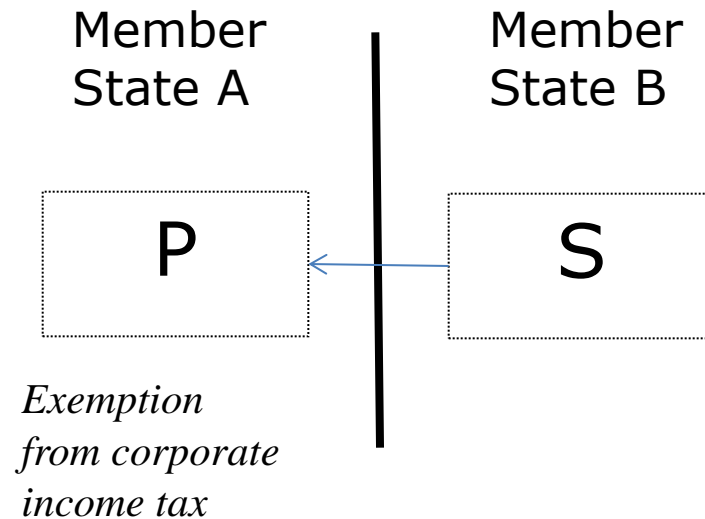
- Member States may opt to not apply the Directive in cases where the participation in the subsidiary is not maintained for a period of maximum 2 years (optional holding period)
- This condition may be met after the distribution
  - CJEU Case C-283/94 Denkavit
  - Italian tax authority in Letter ruling 109/E 2005

# Exemption or imputation credit

- Article 4: the Member State of residence of the parent company shall either:
  - a) Exempt the dividends received by the parent; or
  - b) Grant the parent company a credit for the corporate tax suffered by the subsidiary

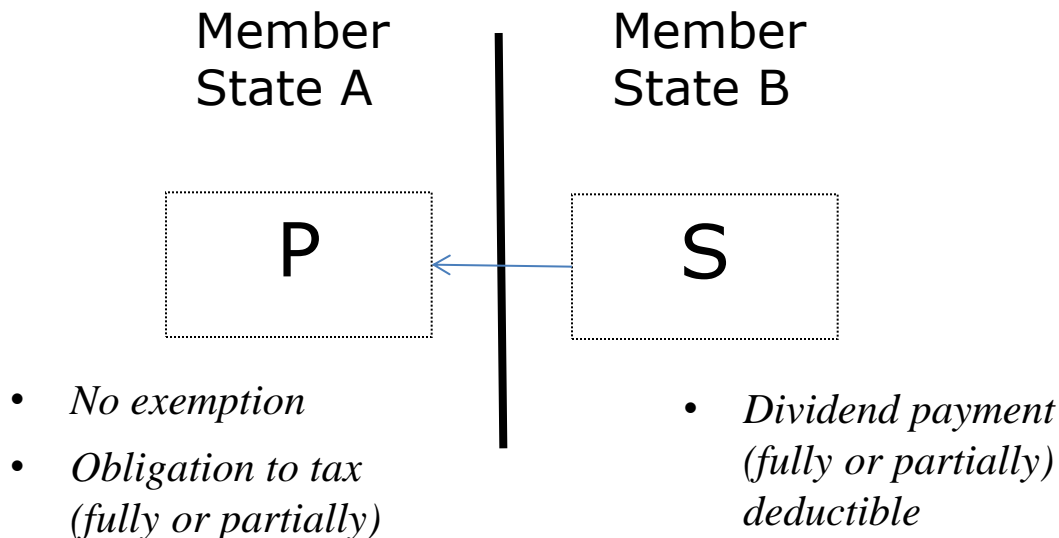
# Exemption

- Article 4: the Member State of the parent company shall exempt the dividends



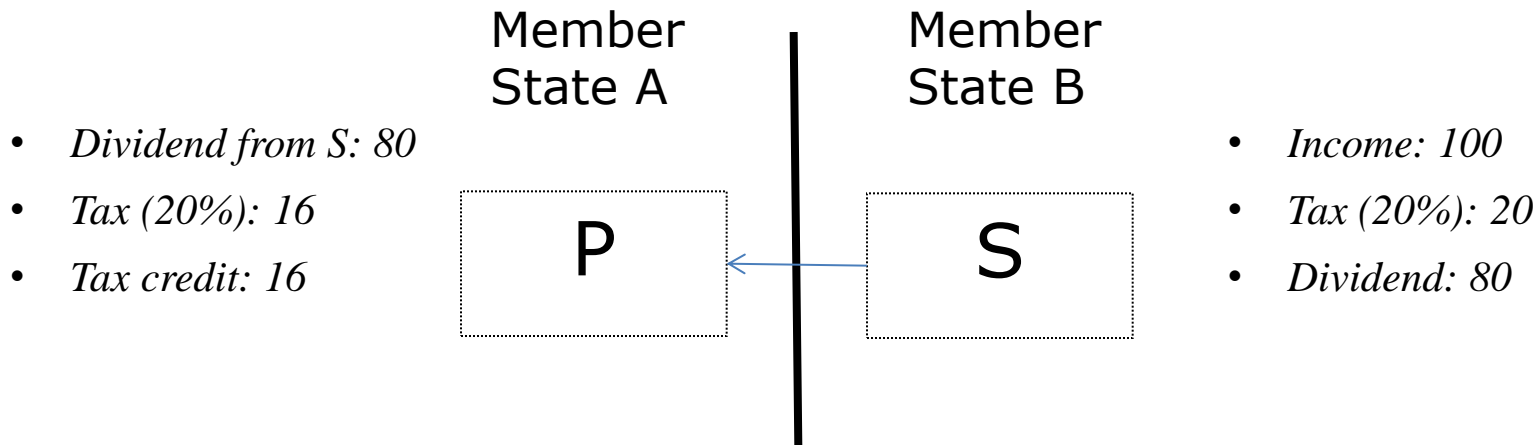
# Hybrid mismatches

- Directive 2014/86/EU limited the exemption:
  - If the payment is deductible in the Member State of the subsidiary;
  - The Member State of the parent shall not grant any exemption and shall tax the payment.



# Imputation system of further tier-subsubsidiaries

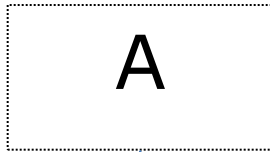
- Article 4 (1) (b)



- Credit to be granted also in respect of further-tier subsidiaries provided that at each level the companies qualify as parent and subsidiary company

# Exemption system and further tier-subsubsidiaries

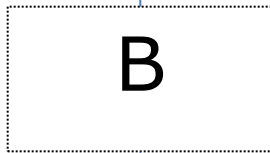
Member  
State A



*Exemption*

- *Dividend from B: 80*
- *Tax: 0*
- *Dividend after tax: 80*

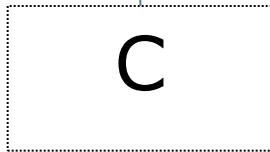
Member  
State B



*Exemption*

- *Dividend from C: 80*
- *Tax: 0*
- *Dividend after tax: 80*

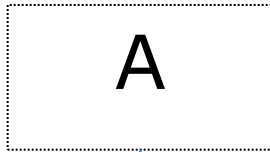
Member  
State C



- *Income: 100*
- *Tax (20%): 20*
- *Dividend: 80*

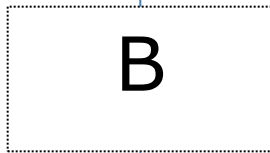
# Imputation system and further tier-subsubsidiaries

Member  
State A



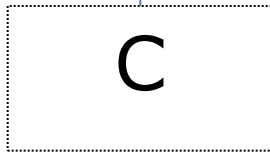
*Imputation*

Member  
State B



*Exemption*

Member  
State C



- *Dividend from B: 80*
- *Tax (20%): 16*
- *Credit for tax paid in C: 16*
- *Dividend after tax: 80*

- *Dividend from C: 80*
- *Tax: 0*
- *Dividend after tax: 80*

- *Income: 100*
- *Tax (20%): 20*
- *Dividend: 80*



# Scope of the Directive

## Original anti-abuse provision

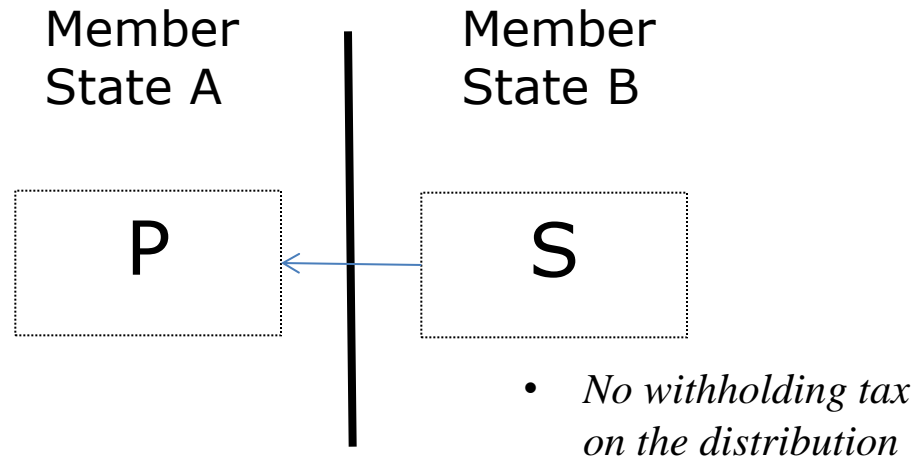
- The original Directive of 1990 (Directive 90/435/EEC) contained a provision allowing Member States to deny the directive benefits in application of their anti-abuse provision (current Article 1(4))
- Some Member States (*e.g.*, Italy, France) **automatically** denied the Directive benefits if the parent company was controlled by a non-EU company unless the taxpayer could prove that the structure was not abusive
- The CJEU (Case C-6/16, *Eqiom*) concluded that such automatic presumption was contrary to the Directive and to the freedom of establishment

# New (additional) anti-abuse clause

- In 2015 the Directive was modified to introduce a General Anti-Avoidance Rule (GAAR) that Member States are obliged to implement
- Provision similar to the many Member States GAAR (*e.g.*, Italy):
  - Benefits of the Directive to be denied if:
    - Obtained through an arrangement or series of arrangement;
    - Whose main purpose or one of the main purpose was to obtain an advantage contrary to the *ratio* of the Directive;
    - Not put in place for valid commercial reasons which reflect economic reality

# Definition of WHT

- Art. 5: *“Profits which a subsidiary distributes to its parent company shall be exempt from withholding tax”*



- No explicit definition of “withholding tax”

# Definition of WHT

- Case law of CJEU (see *C-68/15, X*): three criteria:
  1. the tax must be levied in the State in which the dividends are distributed and its chargeable event must be the payment of dividends or of any other income from shares;
  2. the taxable amount is the income from those shares;
  3. the taxable person is the holder of the shares

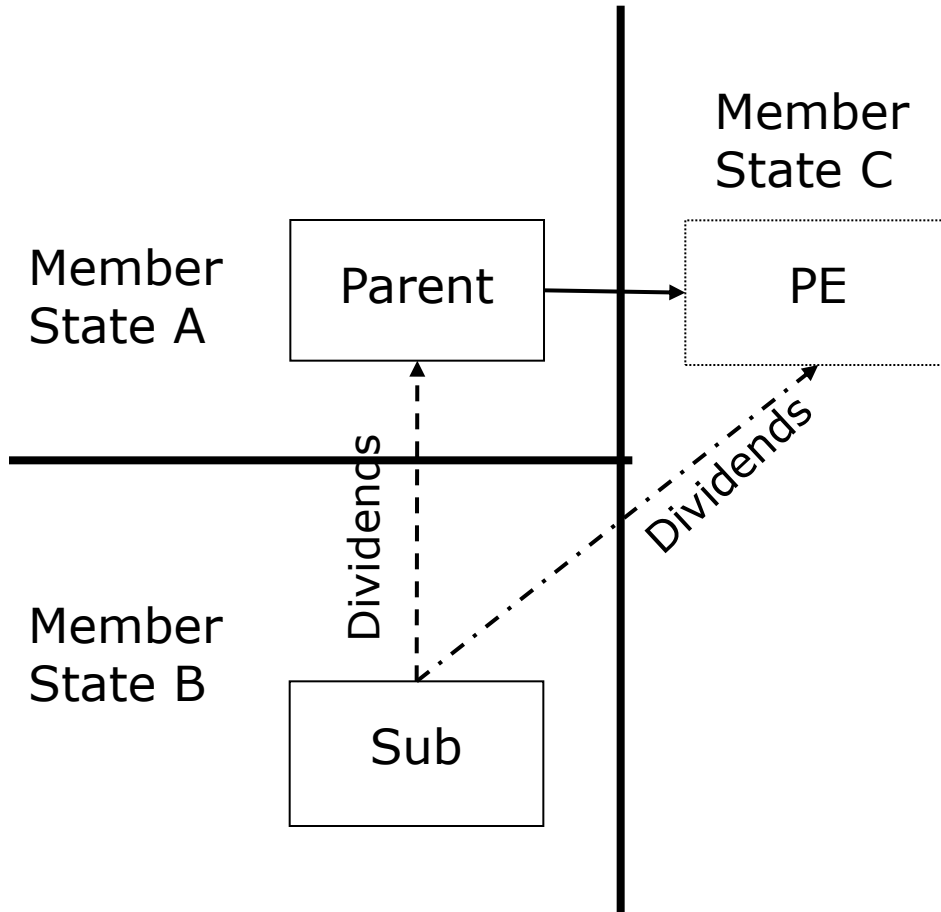
# Definition of WHT

- Case C-375/98 – *EPSON*:
  - Portugal: 5% substitute tax of inheritance and gift tax upon the payment of dividends
  - CJEU:
    - Substitute tax has the same effect of WHT
    - National qualification irrelevant

# The application to PEs

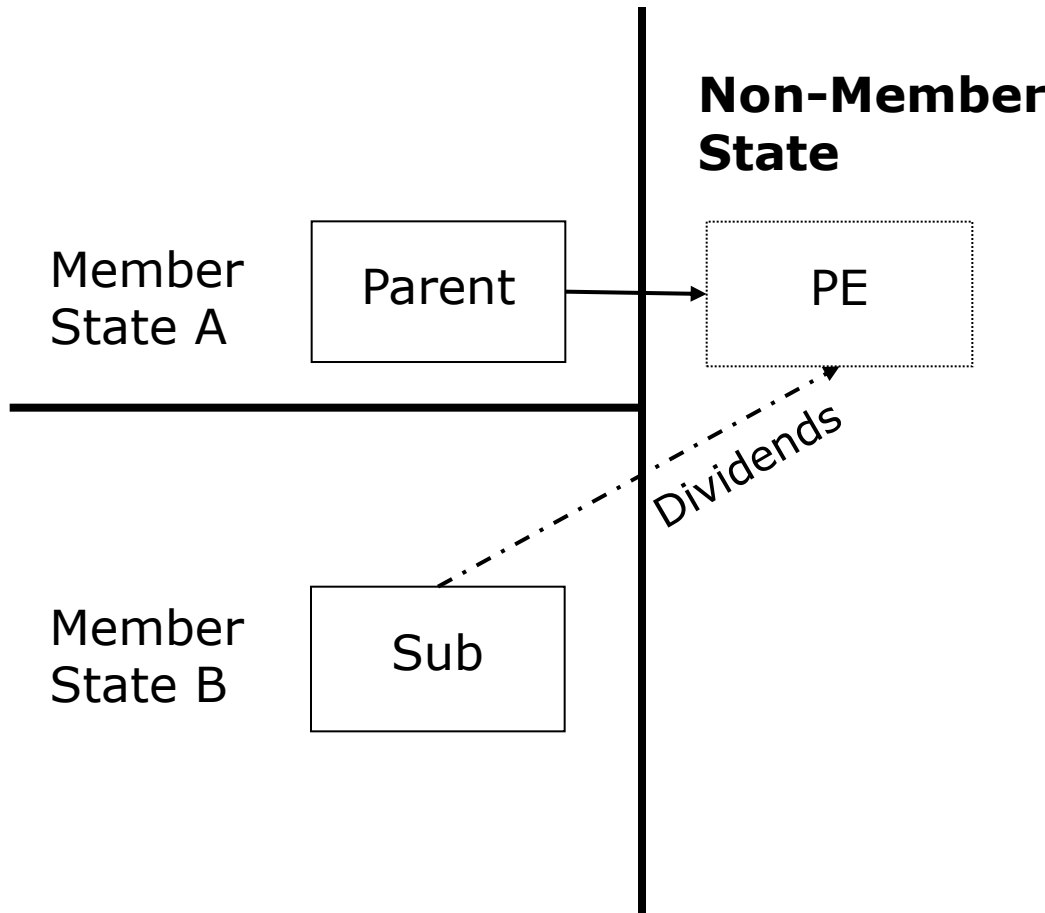
- In 2003 the Directive the scope of the Directive was widened in order to cover dividend payments received by permanent establishments (PE)
- Directive applicable only to PE located in Member States of companies of Member States
- Explicit definition of PE
  - Solely a fixed place of business; no “agency” PE
  - PE’s profits must be “subject to tax” in the State in which the PE is situated by virtue of treaty or domestic law

# The application to PEs



- Parent holds 30% of Sub (of which 5% through PE)
- The Directive applies on the dividends between sub and PE (relevance to the shares held by the parent)
- Member State C shall exempt the dividends received by the PE
- Member State A shall exempt the dividends
- Member State B shall not levy any withholding tax

# The application to PEs



- The Non-Member State is not bound by the Directive
- Member State A shall exempt the dividends
- Member State B shall not levy any withholding tax



# Interest & Royalty Directive

# The Directive in general

- Council Directive 2003/49/EC of 3 June 2003
- Elimination of:
  - Double taxation on interest and royalty (“I&R”) payments
- Ensuring that I&R payments are subject to tax once in a Member State

# Taxes covered

- Art. 1(1): obligation on the Member State of the payer to exempt the I&R payments from **any tax**
- Regimes of Member States that limit the amount of deductible interest are not equivalent to a tax on the interest payments and are not covered by the Directive (Case C-397/09 *Scheuten Solar Technology GMBH*)

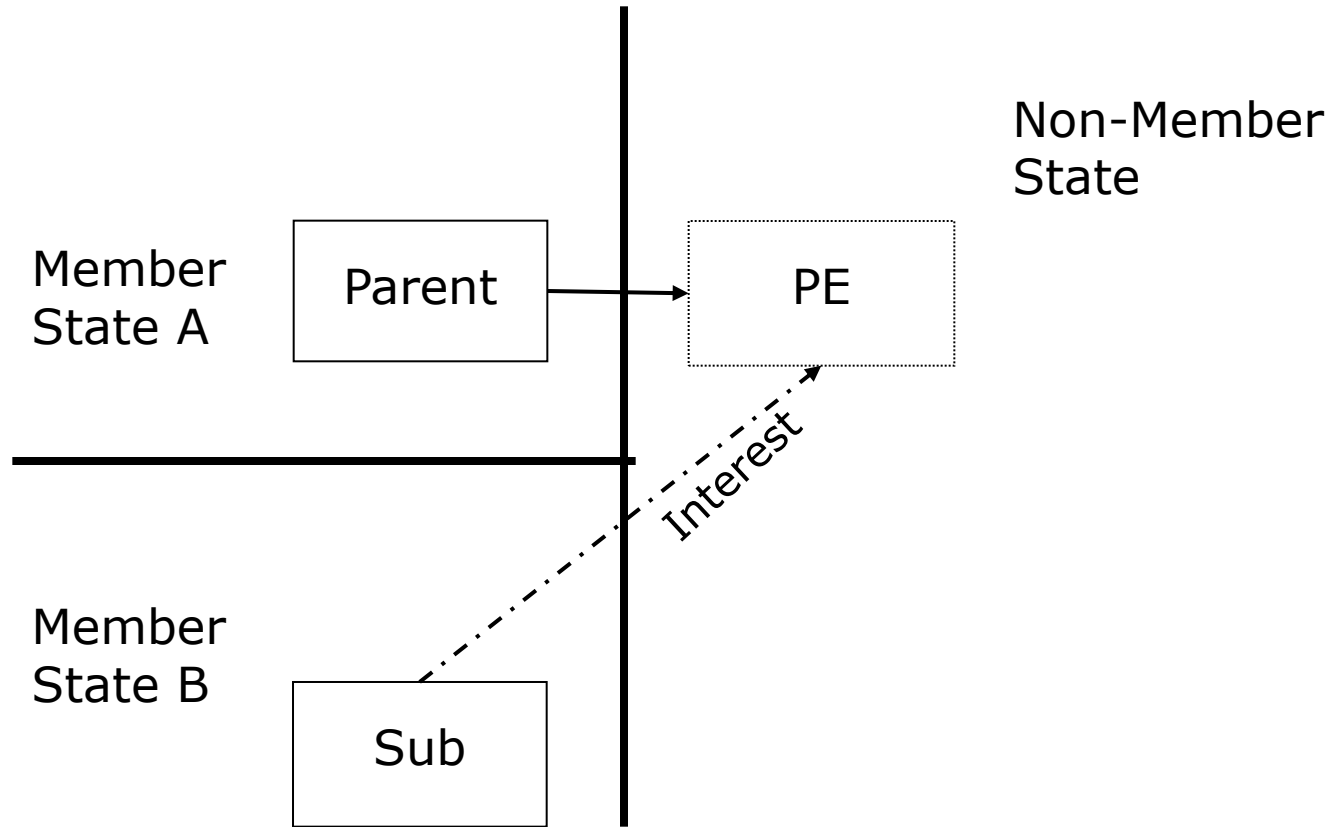
# The notion of “Interest”

- Art. 2(a): definition of interest covers income from:
  - Debts-claims of every kind, whether or not secured by mortgage and whether or not carrying out a right to participate in the debtor’s profits,
  - Securities,
  - Bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures.
- Definition similar to the definition of Article 11(3) OECD MC

# The notion of “Royalties”

- *Art. 2(b): payments of any kind received as a consideration for the use of, or the right to use:*
  - Any copyright of literary, artistic or scientific work, including cinematograph films and software,
  - Any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience;
  - Industrial, commercial or scientific equipment
- Definition similar to the definition of Article 12(2) OECD MC

# Third Countries



- Directive not applicable if payments received or made by a PE located in a Non-Member State
- Different than the Parent Subsidiary Directive

# Payments outside the scope of the Directive

- Art. 4(1): Member State of Source is not obliged to grant exemption in respect of payments that have features of dividend payments. Namely, payments that are:
  - treated as a distribution of profits or as a repayment of capital under the law of the State of source
  - from debt-claims which carry a right to participate in the debtor's profits;
  - from debt-claims which entitle the creditor to exchange his right to interest for a right to participate in the debtor's profits;
  - from debt-claims which contain no provision for repayment of the principal amount (or where the repayment is due more than 50 years after the date of issue)

# Arm's length payments

- Art. 4(2): Member State of the payer is not obliged to grant exemption in respect of payments exceeding the arm's length value
- Similar to Articles 11(6) and 12(4) OECD MC



# Article 3 (1) (a): Scope *ratione personae*

- Three cumulative conditions:
  - Legal forms (see Annex)
  - Residence in a EU Member State
  - Subject to tax in a EU Member State

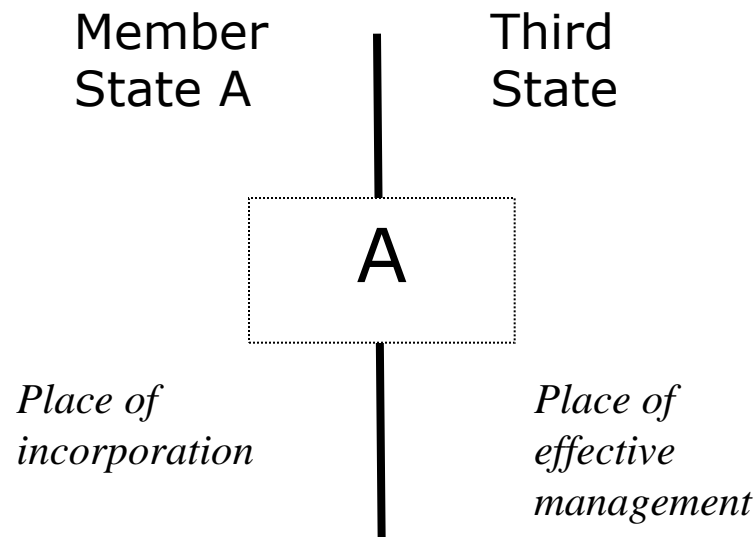
# Legal forms

- The company shall take one of the forms listed in the Annex
- Different approaches by MSs
- Closed listing (*e.g.* Romania, Greece, Italy)
- Open listing (*e.g.* UK, Lithuania)
- Closed listing and “incorporation” residual entities clause (*e.g.* Portugal)
  - Public undertakings incorporated in accordance with Portuguese law
- Closed listing and “taxation” residual entities clause (Cyprus)
  - Residual entity must be considered “as a company in accordance with the Income Tax Laws”

# Residence

Art. 3(a)(ii):

- The company shall be considered resident for tax purposes of a Member State; and
- Shall not be considered resident only in a third State according to the tie breaker rule of the double tax treaty between the member State of residence and the third State
- Similar to the Parent Subsidiary Directive



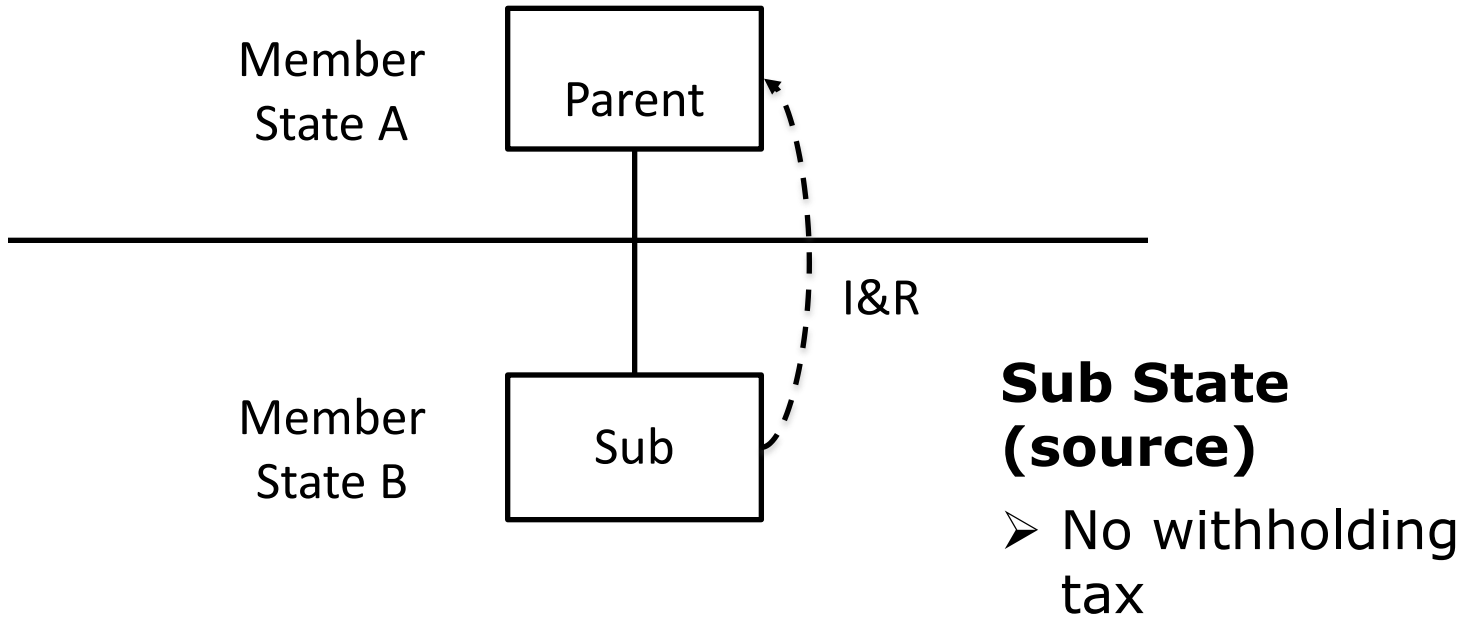
# Subject to tax

- Art. 3(a) the Company shall be subject, without being exempt, to one of the taxes listed in the Directive
  - Similar to the Parent Subsidiary Directive (See *Wereldhave* case)
  - 2011 Commission Proposal (COM(2011) 714 final) to specify that the I&R income shall be effectively subject to tax and shall not benefit from any specific exemption

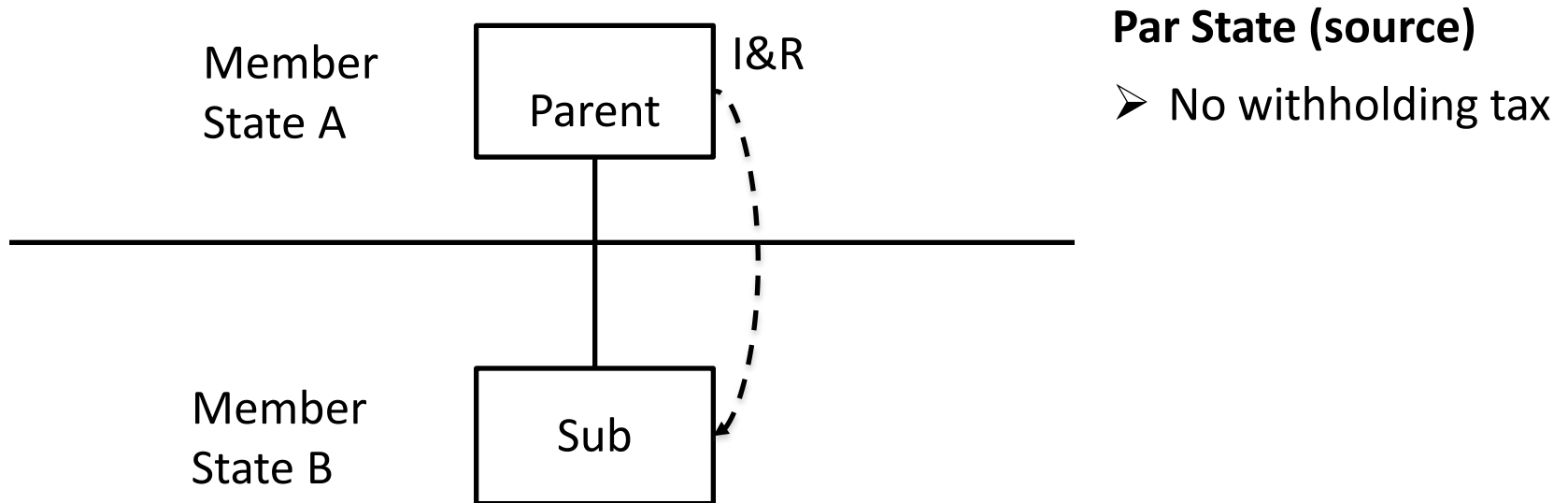
# Association requirement (Art. 3b)

- Directive applicable only in cases of direct holdings
- At least 25% per cent of the capital
  - Proposal for reduction COM 2011(714): reduction to 10%
- Member States can unilaterally replace the criterion of capital by the criterion of voting rights
  - Different than PSD
  - Lack of symmetry possible

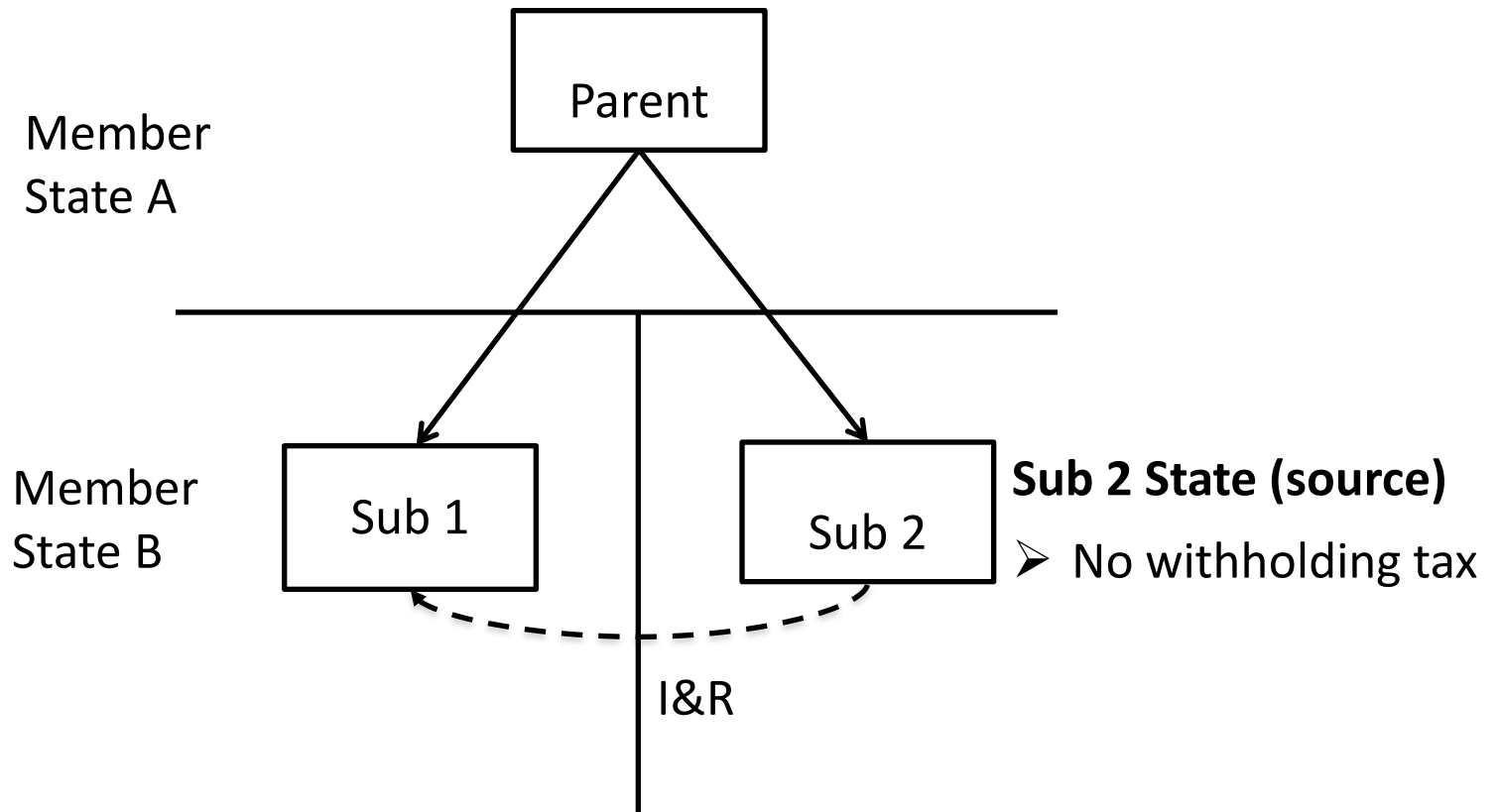
# Upstream payments



# Downstream payments



# Horizontal payments





# Holding period

- Member States may opt to not apply the Directive in cases where the participation in the subsidiary is not maintained for a period of maximum 2 years (optional holding period)
- May the requirement be met after the payment?
  - Not yet decided by the CJEU
  - Different wording *vis-à-vis* the Parent Subsidiary Directive

# Definition of PE

- Art. 3(c): the Directive provides for an explicit definition of PE
  - Similar to the definition included in the Parent Subsidiary Directive
  - Covers only a fixed place of business; no “agency” PE

# Sourcing rules

- Art. 1(1)-(2): I&R payments are deemed to arise in the Member State of the company which made such payment
- Art. 1(3): a PE can be considered as the payer of the I&R only if such payment is deductible from its tax base in the Member State in which it is located

# Beneficial ownership

- Art. 1(4): the Directive provides for an explicit definition of beneficial ownership:
  - *“A company shall be treated as the beneficial owner of the interest or royalties only if it receives those payments for its own benefit and not as an intermediary, such as an agent, trustee or authorised signatory, or for some other person”*

# Beneficial ownership (*PEs*)

- Art. 1(5): A PE shall be treated as the beneficial owner:
  - if the source of the income (debt claim or right to use the IP) is effectively connected with that PE, and
  - If the PE is subject to tax on the I&R income.