

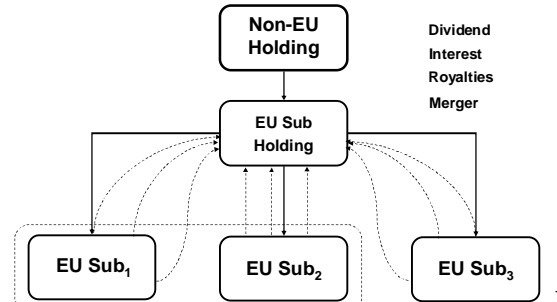
Mumbai, 30 November 2007



Investing in the European Union — Some international tax issues

Prof. Guglielmo Maisto
Maisto e Associati

Establishment of an European sub-holding



7

Uniform holding company regime



- Up to 1990 ⇒ no EU corporate tax rule
- ✓ Dividends (1990)
- ✓ Mergers (1990)
- ✓ Transfer pricing (2002)
- ✓ Interest (2003)
- ✓ Royalties (2003)
- ? Consolidated tax base (under discussion)
- NO Capital gains

8

EU law applicable to companies established in the European Union

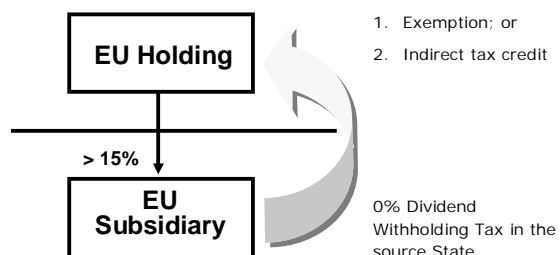


- Art. 48 EC Treaty

« 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 Community shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member State »

9

Parent-Subsidiary Directive



10

Parent-Subsidiary Directive: anti-abuse provision



- Domestic or agreement-based provisions required for the prevention of fraud or abuse (Article 1(2), Directive)
- Spain, France, Italy, Ireland: parent company directly or indirectly controlled by non-EU residents unless
 - Italy, France: exclusive or primary purpose to obtain exemption
 - Spain: business purpose
 - Ireland: bona fide commercial reasons

11

Extension to third countries



- Belgium, Ireland on dividends paid to companies resident in States that have entered into a DTA
- United Kingdom: domestic full exemption from withholding tax on outbound dividend distributions

12

Extension to third countries



- Art. 15 of the Agreement between Switzerland and the EC:
 - exemption from withholding tax on dividend distributions
 - minimum holding: 25%
 - 2 year holding period
 - agreement directly applicable in Member States

13

European law and third countries: fundamental freedoms



- Art. 56 EC Treaty: free movement of capital
« ... restrictions on the movement of capital between member States and between Member States and third countries shall be prohibited »
- Art. 43 EC Treaty: freedom of establishment
« ... restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited »

14

ECJ and dividend distributions



- ECJ Case C-170/05, *Denkavit Internationaal BV*:
 - French withholding tax on outbound dividend distributions; and
 - domestic dividend distributions almost exemptdiscriminatory restriction on freedom of establishment (Art. 43 and 48, EC Treaty)
- Legislations of Belgium, Spain, Italy, the Netherlands and Portugal referred to the ECJ by the European Commission
- Companies resident in third countries do not benefit from freedom of establishment

15

ECJ and dividend distributions



- ECJ Case C-379/05, *Amurta SGPS*: dividends distributed by a Dutch resident company to a Portuguese parent company in a situation where the minimum holding requirement of the Parent-Subsidiary Directive is not met
- Art. 56 and 58 EC Treaty precludes a legislation of a Member State providing
 - for a withholding tax on dividends distributed to a company established in another Member State
 - for an exemption regime on domestic dividend distributions
- Restrictions on movement of capital shall be prohibited also between Member States and third countries

16

EU Fundamental freedoms and third countries



- Art. 56 EC Treaty not applicable
 - to situations primarily affecting another freedom
 - if the restriction to the free movement of capital is an unavoidable consequence of such other restriction
- Restrictions deriving from provisions that apply to controlling shareholders fall in the scope of Art. 43 EC Treaty (C-251/98, *Baars*)
- Thin capitalization rules legitimate vs. non-EU States (C-524/04, *Test Claimants in the the Thin Cap Group Litigation*; C-492/04, *Lasertec*)
- Art. 56 EC Treaty only applicable on dividends from “portfolio” investments?

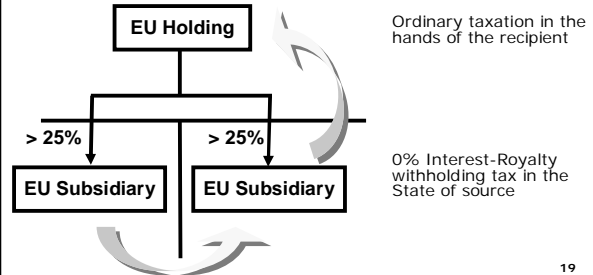
17

EU Fundamental freedoms and third countries

- ECJ Case C-379/05 (*Manninen*):
 - exclusion of dividend tax credit to foreign companies precluded by Art. 56 and 58 EC Treaty if the credit is granted to resident companies
 - AG Kokott Opinion:
 - *Particular problems may arise when third countries are involved. The principle of the free movement of capital between Member States and third countries ... does not ... lay down a binding requirement that corporation tax paid in third countries be offset in the same way as in situations involving two Member States. Here too, the rule is that equal treatment is required only if the situation is comparable*

18

Interest & Royalty Directive



19

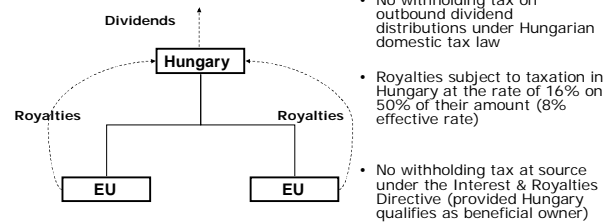
Company of a Member State Subject-to-tax requirement

- Reference to the general tax liability of the company and not to the income covered by the Directive
- Communication COM(2003)841 final
 - *1. Interest or royalty payments arising in a Member State shall be exempt from any taxes imposed on those payments in that State, whether by deduction at source or by assessment, provided that the beneficial owner of the interest or royalties (...) **is effectively subject to tax on the interest or royalty payments in that other Member State.**
- Subject to tax requirement in the implementing legislation of certain States (e.g., Italy)

20

Company of a Member State Subject-to-tax requirement

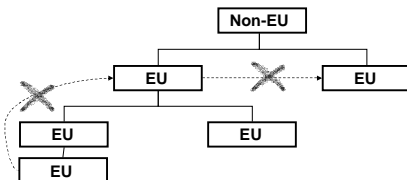
- No reference to a minimal level of taxation of the income in the current version of the Directive



21

Interest-Royalty Directive: associated companies

- Minimum 25% direct holding requirement: no application to indirect holdings
- Holding must involve only companies resident in Community territory



22

EU Joint Transfer Pricing Forum

- Forum established by EU Council of March 11, 2002
- Member of the Forum
 - Members States representatives
 - experts from the business community
- Aim of the Forum
 - pragmatic, non-legislative solutions to practical problems
 - improvements to the application of transfer pricing rules in the Internal Market
 - consistency and implementation of OECD guidelines

23

EU Joint Transfer Pricing Forum: achievements



- Effective implementation of the "Arbitration Convention"
- Transfer pricing documentation (EU TPD)
 - standardized information
 - optional use, unless arbitrarily opt in and out
 - no documentation related penalties if EU TPD adopted
 - entitlement of Member States to require more information by specific request or during a tax audit
- Dispute avoidance and resolution procedures
 - advance pricing agreements

24

EU JTPF: further extension



- Second extension of the mandate for 2 further years granted by the Commission on December 2006
- Program:
 1. monitoring effective implementation of previously adopted Code of Conducts
 2. further improvement in Arbitration Convention functioning
 3. group services: management and HQ expenses, central services, shareholder costs, stewardship expenses
 4. small and medium sized enterprises
 5. common approach on Cost Contribution Agreements

25

Transfer pricing: documentary requirements



- Balance between documentation and compliance costs
- Lack of consistency among Asian States as opposed to:
 - EU Transfer Pricing Documentation,
 - PATA Transfer Pricing Documentation Package
- Periodical filing of detailed reports (South Korea, Taiwan)
- Translation of the documentation (Korea, Taiwan)

26

Anti-abuse provisions against "tax havens"



- Disallowance of expenses (Belgium, France, Italy, Spain)
- Definition of tax havens:
 - Low tax rate (Belgium, France)
 - Treaty providing for adequate exchange of information (Spain and, possibly, in the future, Italy)
 - Black list (Italy, Spain)
- Asian territories included in the black list:
 - Hong Kong
 - Malaysia
 - Philippines
 - Singapore

27

Beneficial ownership requirement



- The Interest and Royalties directive applies, provided that the recipient of the payment qualifies as the beneficial owner thereof
- Autonomous definition of "beneficial owner" for the purpose of the Directive
- No consensus on a common definition of the term for double tax treaty purposes
- Domestic law meaning Vs. autonomous meaning
- Lack of definition in most civil law countries
- Autonomous definition:
 - domestic law meaning in common law countries
 - definition excluding agents or nominee
 - person to whom income is attributable for tax purposes under the law of the residence State

28

Definition of beneficial owner: OECD



- Recipient of income acting in the capacity of agent or nominee does not qualify as beneficial owner (OECD Commentary to the Model Tax Convention)
- Conduit companies that, though formal owners of certain assets, have very narrow powers which render them mere fiduciaries or administrators acting on account of the interested parties do not qualify as beneficial owners (OECD Report on Use of Conduit Companies)
- Recipient to be treated as beneficial owner if liable to tax on such income (OECD Partnership Report)

29

Definition of beneficial owner: tax treaties

- Art. 7 of the Protocol to the Germany-Australia Treaty:
"The references in Articles 10 to 12 of the Agreement to dividends, interest or royalties paid to a resident of a Contracting State refer to dividends, interest or royalties ... to which a resident of Australia is entitled ... **being economically the owner of the assets on which the dividends, interest or royalties are paid** ..."
- Art. 3(2) of the Belgium-New Zealand Treaty:
"... dividends, interest or royalties in respect of which **a trustee is subject to tax** in New Zealand shall be treated as being beneficially owned by that trustee"
- Art 4(5) of the Italy-Switzerland Treaty
"A person who, while fulfilling the conditions laid down in paragraphs 1 to 3 **is merely the seeming recipient of the income in question** whereas the person who actually receives the income - either directly or indirectly through other individuals or legal entities - is not deemed to be a resident of that State within the meaning of this Article"

30

Definition of beneficial owner: UK case law

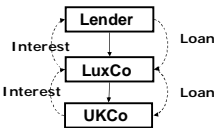
- Decision of the UK Court of Appeal on the *Indofood* case
- Issue of notes by an Indonesian company through a Dutch SPV
- The term "beneficial owner" is to be given an international fiscal meaning not derived from the domestic laws of the contracting States
- Reference to a test which requires that the recipient "enjoy the full privilege to directly benefit from the income"
- Where the recipient is bound in legal, commercial or practical terms to pass on the income, it is not the beneficial owner of the income

31

Definition of beneficial owner: UK case law

Example 7 of the HM Revenue & Customs (INTM 332050)

UK/Lux treaty not applicable



- LuxCo set up or maintained in the group specifically to deal with the intra-group loan
- LuxCo taxed on a small "turn" for administering the loan
- Lender resident in a State with no DTA with the UK
- Loan agreement between LuxCo and Lender shows that such loan was predetermined to be passed on to UKCo
- Interest paid by UKCo to LuxCo predetermined to be passed to the Lender

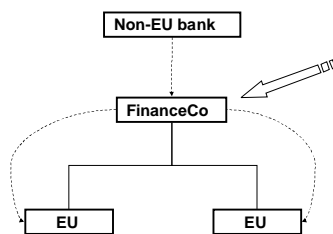
32

Definition of beneficial owner: Interest & Royalty Directive

- Different definitions for companies and permanent establishments
- A company is the beneficial owner:
"if it receives those payments for its own benefit and not as an intermediary, such as an agent, trustee or authorized signatory, for some other persons"
- Existence of an economic benefit for the recipient of the payment
- Directive not applicable in cases where the company is interposed between the payer and the economic recipient of the income

33

Definition of beneficial owner: Interest & Royalty Directive



- Spread realized by FinanceCo determined at arm's length: in accordance with functions performed and risks assumed

34

Definition of beneficial owner: Interest & Royalty Directive

- A permanent establishment is the beneficial owner if:
 - the debt-claim or right is effectively connected with the permanent establishment **and**
 - the interest or royalty payments represent income in respect of which that permanent establishment is subject to tax
- No reference to the receipt of the payment for the benefit of the permanent establishment
- Subject to tax requirement

35