Chapter 1
Introduction

In the European Union, freedom of capital transactions is one of the fundamental freedoms. Regulation of such transactions concerns capital movements as defined by EU legislation and the case law of the Court of Justice of the European Union (the European Court of Justice or the Court) on the free movement of capital, the freedom of establishment and the freedom to provide services. In addition to its liberalization aspect, regulation of capital transactions inevitably concerns taxation. Direct taxation,\(^1\) only partly harmonized at the EU level, is of a great relevance to capital regulation due to its potential to encroach upon the freedom of capital transactions.

The basic premise of this discussion is the existence of the EU regime for capital transactions, which also concerns direct taxation. The regime consists of capital transactions regulation within the European Union as well as harmonized and non-harmonized regulation of direct taxation. In particular, regulation of direct taxation at the EU level is inseparable from regulation of the EU fundamental freedoms and the freedom of capital transactions specifically and thus aspects of each of them, should one want to appreciate them properly, must be contextualized with regard to characteristics of the resulting merger. This regime has developed over the years in legislation and case law of the European Court of Justice and is endemic.

The European Court of Justice examines direct taxation at the EU level by using criteria and guidelines primarily developed for promoting trade policy and freedom of movement. Indeed, the concepts that have forged throughout the years in this subject area are a specific combination of commercial and non-commercial elements. In commercial terms, the freedom of capital transactions is promoted either because such transactions represent

\(^1\) Direct taxation is levied in accordance with a taxpayer’s ability to pay. Examples of direct taxation are tax on income and tax on capital, the tax payable being calculated on the basis of the assets owned by the taxpayer when it accrues. However, tax on capital is different from tax on income because only some of the Member States apply it. See, among other sources, DE: Opinion of Advocate General Mengozzi, 29 Mar. 2007, Case C-298/05 Columbus Container Services [2007] ECR I-10451, paras. 99-100. In contrast, indirect taxation affects the EU trade of goods and provision of services through value added tax (VAT). See N. Maydell, The Services Sirective and Existing Community Law, in Services Liberalisation in the Internal Market, European Community Studies Association of Austria (ECSA Austria) Publication Series Vol. 6, pp. 21-124 (F. Breuss, G. Fink & S. Griller (eds.), Springer, 2008), at p. 77, at footnote 230.
payments parallel to trade in goods and services or because they concern trading in financial markets. In terms of capital regulation, such commercial approach to capital, depending on the exact definition of capital and specific policy orientation, is associated with regulator’s objective of liberalization of capital transactions or maintaining of capital value. In contrast, taxation perspective on capital is non-commercial and focuses on the value of capital transactions in a given jurisdiction and given time period for the purpose of calculating tax portions. While capital policy focuses on liberalization of capital and economic efficacy, fiscal policy is concentrated on the redistribution of resources; the latter is done in accordance with Member States’ jurisdiction in taxation matters. Since a state may tax its residents or income paid on its territory in accordance with its fiscal sovereignty, exercise in parallel of such sovereignty of two or more states may result in double taxation. Thus, fiscal policy regulates international transactions in light of the exercise of taxation powers of two or more fiscal sovereigns. In terms of freedom of capital transactions this means that while capital liberalization policy is focused on elimination of barriers to such movement, tax policy focuses on the achievement of this objective primarily through elimination of double taxation.

The idea of the parallel existence of liberalization and taxation policies that requires a common appreciation has not been commented in depth; commentators of Community (now EU) regulation have focused on separate


aspects of capital transactions and direct taxation. Certain authors note the coexistence at the EU level of fundamental freedoms and taxation but comment it only in the context of interpretation of case law of the Court. Such an approach to the issue is of necessity flawed if one wants to properly assess current EU policy and its principles taking also in account the fact that Court’s reasoning is of casuistic nature, let alone to build policy elements on the basis of the existing legislation and premises developed in the case law of the Court.

Therefore, a parallel analysis of the freedom of capital transactions and direct taxation as coexisting parts of a single phenomenon especially with regard to areas of direct taxation addressed by the European Court of Justice but non-harmonized at the EU level, is necessary since its sets ground for future policy development specifically tailored to the European Union.


6. C. HJI Panayi, Double Taxation, Tax Treaties, Treaty-Shopping and the European Community (EUCOTAX Series on European Taxation Vol. 15, Kluwer Law International, 2007), ch. 4, pp. 131-175, 143-169 & 173-175, commenting on the European Court of Justice case law in comparison with the US regulation in (direct) tax matters, notes, at p. 173, that there are no tax specific tests in the case law of the European Court of Justice and that the provisions of Community (now EU) law are applied in general to the area of taxation.

7. According to Panayi (2007), supra n. 6, at p. 169, decisions of the European Court of Justice concerning allocation of taxation powers in terms of Community (now EU) law seem to be “a matter of impression”.

8. On anti-treaty shopping provisions see Panayi (2007), supra n. 6, pp. 231-250. Panayi also mentions recommendations of the Commission of the European Union (European
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it the Common Consolidated Corporate Tax Base (CCCTB), the Common Corporate Tax Base (CCTB), or, for purposes of an academic debate, the EU Tax Treaty Model, Community (now EU) multilateral tax treaty.
“fractional taxation”,12 enactment of additional direct tax directives and other instruments,13 a potential international expansion of the EU models and policies14 or fiscal surveillance measures enacted at the EU level in response to the Organisation for Economic Co-operation and Development (OECD) initiative on Base Erosion and Profit Shifting (BEPS).15 With exception of the CCCTB, the CCTB and the BEPS, the present discussion will not concentrate specifically on these policy proposals or on the idea of tax harmonization and/or approximation of laws at the EU level.16 It will


13. Panayi (2007), supra n. 6, pp. 245-246. Such instruments should, according to the author, gradually cause tax treaties to become obsolete. According to this approach, not only the state of residence of a taxpayer (the residence state) but also the state of source of taxable income (the source state) should calculate the taxpayer’s worldwide income and the resulting tax, and restrict the tax they effectively levy to the fraction thereof that corresponds with the fraction that the source state income represents of the worldwide income.

14. In this sense, see E. Raingeard de la Blétière, Les relations entre le droit communautaire et le droit fiscal international: nouvelles perspectives, PhD thesis under supervision of Daniel Gutmann, Université Panthéon-Sorbonne Paris, Paris 1 (2008), who advocates tailoring of international tax law according to the Community (now EU) regulation of taxation, i.e. harmonization at a supranational level paralleled by a tax network at international level.


16. This position is undertaken in view of a vast literature and academic writing existing on the subject of the Community (now the Union) tax harmonization as well as the current political configuration of the European Union. In that sense, I agree with authors
focus on capital and fiscal policy elements as may be discerned from current law of the European Union; notably, one may not speak of fully developed EU policies in the area where the analysis of capital transactions coincides with concepts of direct taxation. These elements can be identified from legal premises found in the case law of the Court and from certain pieces of EU legislation.

One may discern clear policy elements from the current regulation of capital movements and the Court’s examination of Member States’ direct

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taxation, in particular, the balance of powers between Member States and the European Union when it comes to direct taxation, the EU concept of discrimination between residents of different Member States and a certain concern for the protection of assets in capital transactions. Certain premises of these policy elements form part of the core of the EU law, obligatory for the Member States, and represent the foundations of what may possibly become a specific EU tax model or at least a more coherent tax policy in the future. Such a model would possibly include an eventual adoption of the CCCTB or the CCTB and potential EU-level measures against fiscal abuse, coupled with measures of fiscal surveillance.

This discussion builds on the existing legislation of the European Union and case law of the European Court of Justice and defines the basic character of the EU regulation of capital transactions and its approach to direct taxation. It defines and discusses the most important policy elements and points to difficulties of the EU regulation that need to be addressed independently of any steps towards future tax policy or tax harmonization. Such difficulties arise from the current definition of the balance of powers between Member States and the European Union in direct taxation matters as well as the interplay between commercial and non-commercial aspects of capital transaction liberalization, in the sense that these may contradict international standards and international obligations of the European Union or are non-sustainable in light of the possible future development of the EU markets.

For this reason, the book proposes certain policy reorientations, clarifications concerning interpretation of homonymous terms such as discrimination in terms of transaction policy and in the context of taxation, and policy build-ups particularly with regard to premises of non-discrimination and anti-abuse. Policy build-ups will be commented in the sense of future use of current policy elements in a CCCTB or CCTB-policy environment, implying a harmonized system of taxation for companies opting for the CCCTB or the CCTB, as well as a non-harmonized status quo environment. Since the coexistence of harmonized and non-harmonized environments implies coordination between EU and Member States’ jurisdictions, such a dual system will require strong coordination measures in addition to harmonization of substantive law. Proposed changes to anti-abuse measures also take note of the status quo and potential developments at Member State or EU level in response to the BEPS. The policy development propositions take currently exist in EU capital and taxation regulation, I use the term “policy elements” for regulatory premises I discern from EU regulation and case law of the European Court of Justice. For this reason, the term “EU capital and/or taxation policy” is used only with regard to suggested alternatives and innovations I propose in later chapters.
into account the fact that whatever the changes in the area of direct taxation may be, they will affect the current balance of powers between the Member States and the European Union.

Several prominent academics (Martín Jiménez, Pistone, Wattel, as referred to later in this book) and practitioners have proposed solutions for the future EU policy building on separate aspects of the combined appreciation of the fundamental freedoms and direct taxation. They have tested background concepts of both sides of this liberalization-taxation regime such as discrimination (Birk, Banks, Gribnau, Lang, Meussen, Peters, Santafé, Bárbbara Rupérez, Saddiki, Van den Berge, Vanistendael, Van Raad and Wattel, as referred to later in this book), and commented on the influence of Community (now EU) law on direct taxation, tax treaties and avoidance of double taxation (Cordewener, Decoq, Farmer, Hofstätter, Hohenwarter, Kofler, Lang, Le Gall, Lehner, Loukota, Lyal, Panayi, Pistone, Sánchez Jiménez, Schneeweiss, Schuch, Soler Roch, Staringer, Teixeira, Van Thiel, Wattel and Whitehead, as referred to later in this book). However, there is no coherent examination in the literature of certain underlying elements of the current EU liberalization-taxation regime and their use in a future EU policy. This thesis is intended to fill this gap, following up on the existing groundwork made by legal practice and academia. Proposed developments respect the logic of existing policy elements as far as possible, but take inspiration also from sources external to the European Union.

In view of the many legal and non-legal obstacles within the European Union which define its less-than-optimal approach to all-EU taxation solutions – first, political unwillingness of Member States to proceed towards decisive tax harmonization, second, lacunae remaining in European regulation of direct tax matters meaning there is no possibility to bridge obstacles in the sense of juridical double taxation by reference to EU fundamental freedoms and finally, the nature of legal interpretation by the European Court of Justice –, it is important to consider a wider context in terms of EU potential future policy, i.e. the context of current and potential future activities within the OECD.

Recently, the OECD’s activities with regard to occurrences of gaps exploited by companies that avoid taxation in their home countries by shifting their activities abroad to low or no tax jurisdictions increased dramatically.19 The OECD activities resulted in the Action Plan on Base Erosion and Profit

19. BEPS Action Plan, supra n. 15.
Sharing (the BEPS Action Plan), the organization’s reply to “… a concern [of a number of countries] about how international standards on which bilateral tax treaties are based allocate taxing rights between source and residence States”. The BEPS Action Plan promises that the actions defined in its context “… will restore both source and residence taxation in a number of cases where cross-border income would otherwise go untaxed or would be taxed at very low rates, [whereas] these actions are not directly aimed at changing the existing international standards on the allocation of taxing rights on cross-border income”. The BEPS Action Plan addresses the need for new standards of international taxation, realignment of substance and form in international taxation and promises to build on transparency, certainty and predictability.

In view of the above, discussions and implementation proposals of the BEPS prove that OECD member countries, and among them EU Member States that are members thereof, are willing to draw rules for the exercise of their tax sovereignty in cross-border situations, which is noteworthy in view of their reticence within the cadre of the European Union. On the example of hybrid mismatches it may be implied that one jurisdiction will have to take notice of tax treatment applied in another jurisdiction for the purpose of determining the tax treatment applicable to a given cross-border situation at the level of each jurisdiction concerned. Independent of the fact that the BEPS are intended to address cases of international tax abuse originating mostly from disparities in international taxation, the BEPS methodology may lead to jurisdictions no longer exercising their powers in isolation. In this sense, the BEPS introduce novel methodology on how jurisdictions may exercise their tax powers in the context of obligatory international anti-tax abuse coordination. In view of this very modern approach to the exercise of taxation powers, I also analyse possible application of the BEPS methodology in light of the current European law as well with regard to currently proposed amendments of applicable EU regulations.

Three areas of focus

After a note on its methodology and premises, this book concentrates on three issues.

Since one is more likely to understand a system and provide for its improvements if one studies its separate elements statically and their interactions
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dynamically, this account will start off by examining the basic characteristics of capital movements in the European Union (chapter 2), and then comment on basic and complex contradictions between such characteristics and regulation of taxation in EU law (chapter 3). This should help understand the basic elements and contradiction of the coexistence, at the EU level, of fundamental freedoms and taxation in terms of a future consolidated capital policy and development in terms of anti-abuse policy (chapter 4).

In particular, chapter 2 starts by exposing the current EU capital liberalization regime, its objectives and effects, focusing specifically on the concept of capital, assets and liabilities. Interpretations (definitions) and policy elements identified are compared to concepts of the International Accounting Standards and International Financial Reporting Standards including related interpretations (IAS and IFRS, together referred to as IAS, unless specified otherwise), adopted also at the EU level. This is necessary due to the fact that the IAS represent a harmonized regulation of capital transactions at the EU level in the sense that they provide for uniform definition of capital in terms of its value as well as methods for evaluation of assets and liabilities. Therefore, the IAS may be an important element of future EU capital policy.

Next, the EU regime so defined is compared and contrasted with capital regimes established by the OECD and the World Trade Organization (WTO). This part builds on the analysis of EU legislation, case law of the European Court of Justice, and international regulation as elaborated by the OECD and the WTO, by employing teleological and historical methods of interpretation.

Chapter 3 analyses case law of the European Court of Justice in order to discern policy elements of the EU taxation regime. These include premises developed in the Court’s case law concerning, among others, jurisdiction of Member States in direct taxation matters, fiscal territoriality, taxation symmetry, equal treatment in taxation matters, and effective fiscal surveillance. The chapter underlines contradictions between different premises. In particular, because the Court interprets national taxation regulation by means of EU law and EU fundamental freedoms, certain policy elements are shared by both capital liberalization and taxation policies. However, they may have different effects in the area of capital liberalization as compared to taxation, due to their different nature.

Having examined the principles that the European Court of Justice uses to analyse both capital transactions and taxation as defined in earlier chapters, chapter 4 tests how certain of the common features of the EU regulation
of capital and taxation are applicable in terms of a future EU policy in the area of capital transactions and direct taxation. Such a future policy will be defined by the coexistence of CCCTB or CCTB-harmonized and non-harmonized environments. The coexistence will have to imply both harmonization measures for balancing out transaction costs occasioned because of such coexistence and strong coordination tools for securing cooperation and exchange of information between EU and Member States’ jurisdictions.23

Features of the current EU substantive regulation of capital and taxation that will be most important in the future are non-restriction and non-discrimination. These two principles will be decisive as substantive legal elements in the future EU policy because, first, certain tax areas will remain under Member State regulation (which corresponds to the status quo in terms of taxation regulation), while other matters will possibly be harmonized by a future EU taxation policy in terms of the CCCTB or the CCTB, and, second, eventual tax harmonization will necessarily be limited. The principles of non-restriction and non-discrimination will need to be complemented by a coordination mechanism and a system of prevention of double taxation, the latter including measures for prevention of discrimination as well as abuse and tax evasion, both in relations between Member States and between those and third countries. Measures of coordination and prevention of double taxation in the context of the CCCTB or the CCTB will need to be enacted by the EU legislator on the basis of currently existing coordination mechanism but will need to take into consideration intricacies of the CCCTB or the CCTB system.

Once the possible framework of an EU policy is defined, chapter 4 looks towards the BEPS context. The BEPS initiative is discussed in terms of its methodological value for the interpretation of balances of taxation powers of Member States and the premises of coordination, non-discrimination and abuse, defined in chapter 3 as interpretative pillars of future EU taxation policy. It is important to note that the BEPS actions may define actual terms of future international (and thus also EU) taxation policy, whereas the European Union may develop its own anti-abuse regulation in parallel. Introducing the BEPS methodology into interpretation of the European Court of Justice may lead to a change in paradigm as to the exercise of tax

23. Tax harmonization would inevitably be of a limited extent. Generally, on the limited nature of tax harmonization, see J.M. de la Villa, La Armonización Comunitaria en el Ámbito de la Imposición Directa, Su Problemática Jurídico-Contable y Su Incidencia en España, (Instituto de Planificación Contable, Fábrica Nacional de Moneda y Timbre, 1988), at para. 2, at p. 11. Coordination mechanism will need to be adopted in line with current EU regulation on information exchange, commented in later chapters.
jurisdiction of EU Member States and help provide for an alternative to the Court’s appreciation of tax matters through lens of EU fundamental freedoms and entitlement to such freedoms in particular.

1.1. Sphere of EU capital transactions

1.1.1. Scope of the study

Interaction of the EU freedom of capital transactions and direct taxation can be described by referring to the case law of the European Court of Justice, interpreting articles 43, 56, 58 and 49 of the Consolidated version of the Treaty establishing the European Community (Treaty), now (without substantial modifications) articles 49, 63, 65 and 56 of the Consolidated version of the Treaty on the Functioning of the European Union (TFEU), EU legislation in the area of direct taxation, the EU-adopted IAS and proposals of the European Commission for a future CCCTB regime, or, alternatively, proposals for a CCTB regime. In order to describe this body of law, I use the term the “EU capital transactions regime”. To this, one must also add proposals for directive amendments and future regulation in the area of fight against fiscal fraud, which are specifically referred to throughout this account.

The most important source to establish such a capital transactions regime is the case law of the European Court of Justice which, due to the lack of EU

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legislation with regard to direct taxation, interprets the subject area by analysing interactions between the EU freedoms and direct taxation. It is only to the extent to which exercise, by Member States, of (non-harmonized) direct taxation rules may have an impact on the EU fundamental freedoms that they come within the scope of law of the European Union. The Court’s case law contains references to capital movements, establishment, services and taxation, where of interest to this discussion are in particular elements of EU capital transactions regime and direct taxation as discernible through the Court’s interpretation of the freedom of establishment and the free movement of capital.

This discussion concentrates on corporate (non-personal) capital transactions including dividends.

1.1.2. Methodology of the study

The European Court of Justice examines capital movements and taxation from the sole perspective of EU law in general and EU fundamental freedoms in particular, which means that the Court discusses the freedoms and their inhibitions due to taxation. Therefore, a conglomerate vision of capital liberalization and taxation as it currently exists will be taken in the examination of both the EU capital regime and premises developed in the case law of the Court concerning direct taxation. Such an approach is best presented graphically.


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From a graphical perspective, rights that include the freedom of capital transactions as a concept would most appropriately be represented in the form of a sphere. Such a sphere on its own would represent the freedom of capital transactions in its purest state, that is, the unimpaired freedom of capital movements as may exist in modern economic societies.

There are obstacles to such a freedom, graphically presented by section of the sphere with other spheres. The section of spheres vital for this discussion is the interaction of the freedom of capital transactions and (direct) taxation. In this sense, a graphical representation of the section of the sphere of capital transactions with the sphere of taxation would correspond to a sphere of lighter and darker areas (figure 1). Lighter tones indicate the resulting sphere’s features promoting capital transactions. Darker tones of the sphere correspond to features (partly or fully) inhibiting such transactions.

Figure 1 Sphere of capital transactions

Such a graphical presentation is essential to understanding the premise of this discussion, namely that the reality of the freedom of capital movements at the level of the European Union is to be found in its essential connection

to taxation. However, in order to analyse the capital and taxation phenomena existing in the EU market and the underlying policies they imply, it is crucial to understand both the genesis of the resulting collision as well as characteristic of the respective spheres prior to such collision. Therefore, after examining the characteristics of the primary spheres, the resulting system, this light-dark sphere, will be taken as a whole as a subject of this study.

1.1.3. Spheres of capital transactions and taxation – The concept of capital and policies revolving around it

An important terminological premise of this thesis that allows for the parallel approach to capital liberalization and taxation is the concept of “capital” as defined in law of the European Union.

In particular, it is possible to discuss the capital-taxation overlap in law of the European Union as a whole because its poles, capital movements and taxation and their policy elements, revolve around this concept. Graphically speaking, the concept of capital is the core of the black-and-white sphere as presented above. Other two key concepts are (non-)discrimination and (non-)restriction, which will be commented on with direct reference to the European Court of Justice’s interpretation of these terms.

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The concept of capital is put forward in Directives 2009/133 (repealing Directive 90/434), 2003/48 and 2003/49 in the context of direct corporate taxation, as well as substantive law defining a system for tax authority coordination, while Directive 2011/96 (repealing Directive 90/435) and Convention 90/436 concern coordination on the subject of double taxation with regard to direct taxation in the sense of designation of Member States’ jurisdictions. In the context of indirect taxation, capital is discussed, most significantly for this discussion, in Directives 69/335 and 77/388. This regulation is complemented by interpretation of the concept of capital and capital movements in the case law of the European Court of Justice.

1.1.4. The concept of capital

Generally speaking, the concept of capital may be defined in different manners. It can be analysed from economic (market), regulatory or tax perspectives, each of which differ with regard to goals they promote.

The market and regulatory perspectives on capital define it according to various forms of securities, assets and liabilities in financial markets, thus


32. Second Council Directive 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second para. of Art. 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent, OJ L 26 (1977), EU Law IBFD, and its amendments, concern capital indirectly; they regulate public limited liability companies by means of a corporate statutory law approach.


35. For capital in financial markets, for instance, see B. Porteous & P. Tapadar, Economic Capital and Financial Risk Management for Financial Services Firms and Conglomerates
promoting the *commercial* aspect of capital, which is associated with the objective of *liberalization of capital transactions or maintaining of capital value*. If market and regulatory perspectives on capital follow the same basic idea, the tax perspective on capital is different. It focuses on the *value of capital transactions* in a particular jurisdiction and during given time periods for the purposes of tax calculation. Here, the concept of capital depends on whether the relevant taxation is levied directly on the entities paying or receiving capital (direct taxation) such as in case of corporate tax or capital gains tax, or if taxes are collected by an intermediary from the entity who bears the ultimate economic burden of the tax (indirect taxation) such as sales tax or value added tax. One may thus describe the concept of capital for purposes of taxation as looking at taxable value occurring or resulting from (taxable or tax-relevant) transactions. The concept thus combines the transaction-based approach to taxable or tax-relevant transactions with the focus on taxable *values*. This makes the concept of capital for tax purposes straightforward in comparison to its many definitions within capital policy, which is explained by the straightforward economic character of taxes.

Since this account comments also on the accounting standards, it is useful to underline that in terms of *financial reporting*, capital can be divided into physical or financial capital. There are two consequential concepts of capital that an entity may adopt according to its needs and for purposes of balance sheet compilations. Under the financial concept, capital “such as invested money or invested purchasing power” is “synonymous with the net assets or equity of the entity”. Under the physical concept, capital “such as operating capability, … is regarded as productivity capacity of the entity based on, for example, units of output per day”.

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36. Id.


40. IFRS, supra n. 39, paras. F-102-F-103.


42. Id.
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concepts depends on the need of the user of financial statements, the financial concept of capital will be adopted if the users of financial statements are primarily concerned with maintenance of nominal invested capital or the purchasing power of invested capital. Of interest to this discussion is the financial concept of capital.

Furthermore, the value and activity measures for capital movements for the purposes of liberalization and capital for purposes of taxation may not be the same. Should financial reporting and capital evaluation be made for purposes of screening capital movements (sphere of capital policy), such reports will be commercially based, engulfing a large spectre of capital movements. However, financial reporting for purposes of taxation will focus on the selection of taxable transactions, its value depending on complex (tax) accounting measurements.

1.1.5. Capital policy – Disparities ab initio

The EU capital transactions regime is predominantly based on promoting capital movements and the freedom of capital transactions rather than focusing on value for commercial or taxation purposes; however, elements of both such policy poles are present, the elements contradicting in certain aspects.

Such combined and somewhat contradictory approach to capital at the EU level is explained by (commercial) capital transaction and taxation rules as used at the level of the European Union having evolved quite separately, each focusing around a different perspective on the capital involved. In contrast to the multilateral nature of trade agreements encompassing capital in terms of transactions and capital as a factor of production within international and EU trade, rules on direct taxation are decided either unilaterally or negotiated bilaterally.

In addition, while having similar goals and underlying principles such as reciprocity and non-discrimination, trade agreements are said to be useful to escape the “Prisoner’s Dilemma”, while tax treaties should prevent

43. IFRS, supra n. 39, at para. F-103. The concept of capital maintenance links concepts of capital and profit.
44. See in this sense, CCCTB Directive Proposal 2011, supra n. 9, at p. 6.
aggressive tax planning and tax evasion.\textsuperscript{46} Thus, while policy on capital transactions and the freedom of capital is concentrated on (different concepts of) capital, its value enhancement and its efficient use (the concept of which may differ with regard to the underlying capital concept selected), taxation policy evaluates such movements by defining a value portion charged as a price for their circulation\textsuperscript{47} and redistributes monies so collected.\textsuperscript{48}

Building blocks of the EU capital transactions regime are defined in Directive 88/361, predominantly concentrated around the idea of promotion and liberalization of capital transactions. However, this predominantly transactions-based system contains a reference to assets and liabilities underlying capital transactions, which urges a reading in combination with IAS and its concepts of assets and liabilities. The baseline capital policy if one may call it so thus contains a combination of two very different approaches to capital which may lead to logical and interpretative inconsistencies.

In addition, definitions of capital and capital transactions contained in different EU legislative sources may vary, which mostly corresponds to different perspectives from which capital is regulated.

While the EU capital transaction legislation may have enrooted inconsistency and various approaches to capital regulation, the European Court of Justice will use the very same terminology for purposes of approaching (very different) questions of (direct) taxation. This makes capital policy at the EU level quite endemic and very complex.

Such a variety of approaches to capital policy may cause differentiation between similar types of capital and capital movements, which may result in different levels of their legal protection. This not only represents a practical problem in transactions involving third-country elements, but also

\textsuperscript{46} Daly (2005), supra, at p. 17 & footnote 49. Inter alia J. Gowa, Bipolarity, Multipolarity, and Free Trade, 83 American Political Science Review 4, pp. 1245-1256 (1989), also available at: http://www.jstor.org/pss/1961667, argues that the prisoner's dilemma representation does not reflect the most critical aspect of free trade agreements in an anarchic international system, i.e. security externalities.

\textsuperscript{47} Ardy & El-Agraa (2004), supra n. 37, pp. 238-255.

\textsuperscript{48} According to J. Snell, Non-Discriminatory Tax Obstacles in Community Law, 56 International and Comparative Law Quarterly, pp. 339-370 (2007), at p. 357, the concepts of the EU freedom of movement and taxation are essentially different; the former conceptualized to ensure economic efficiency while the latter concentrated on the idea of distribution.
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inconsistency with the EU principle of equal treatment in circulation as well as in tax matters.\(^49\) In the words of Handoll (2006, at page 11, paragraph 73), “categorisation of a given movement as ‘capital’, ‘payments’, ‘goods’ or ‘services’ is no mere academic exercise”, since a different classification results in a “distinct regime with its own personal and substantive spheres of operation, including possible derogations”,\(^50\) even though within the European Union, the test of whether a national measure is restrictive and justified will essentially be the same regardless of the freedom that the European Court of Justice deems to be predominantly concerned.\(^51\) Clarification of basic terms and premises in relation to EU capital policy is necessary also for another reason: certain authors believe that international tax standards are or should be influenced by the EU law.\(^52\) If serious developments were to be undertaken in that direction, a clear understanding and a strong systematization within the EU system is essential.

In addition to the contradiction regarding capital policy’s building blocks, there is a difference, at the EU level, between the two sets of rules also with regard to jurisdiction in terms of power over the subject matter. Currently, if policies concerning freedom of capital movements and establishment are within the jurisdiction of the European Union and interpreted by the European Court of Justice, jurisdiction with regard to taxation is bifurcated. While indirect taxation is harmonized at the EU level,\(^53\) direct taxation in

\(^{49}\) Capital transactions not categorized under the concepts regulated by EU law will not benefit from the EU regime. Similarly, should transactions involving third states and their residents be classified under the freedom of establishment and the free provision of services, such transactions cannot benefit from the protection under those fundamental freedoms, strictly reserved for intra-European Union transactions. Classification under the freedom of establishment or the free movement of capital is thus very important both for circulation and taxation contexts. See, inter alia, M. Dahlberg, Direct Taxation in Relation to the Freedom of Establishment and the Free Movement of Capital (EUCOTAX Series on European Taxation Vol. 9, Kluwer Law International, 2005).

\(^{50}\) J. Handoll, Capital, Payments and Money Laundering in the European Union (Richmond Law & Tax Ltd, 2006), at p. 11, at para. 73.


\(^{52}\) For instance, see Raingeard de la Blétière (2008), supra n. 14. Clarification is of great importance in terms of definition of non-discrimination between residents and non-residents; in this sense, M. Lang, Non-Discrimination, What Does History Teach Us?, in Fiscalité et entreprise: Politiques et pratiques, Mélanges en l’honneur de Jean-Pierre Le Gall, pp. 103-108 (Dalloz, 2007) (2007a), at p. 103, believes certain ideas developed throughout the European Court of Justice’s interpretation of Community (now EU) freedoms may influence the interpretation of non-discrimination as per Art. 24 of the OECD Model (2010), supra n. 10, and the arm’s length rule.

\(^{53}\) See supra n. 33.
principle remains within the jurisdiction of Member States. A future adoption of the CCCTB, the CCTB or EU anti-abuse measures may cause a shift in or at least provide for a new perspective on taxation jurisdiction.

Currently, the Member States have in principle full tax sovereignty in the field of direct taxation; the principle of subsidiarity concerning direct taxation helps establish the most appropriate level for regulation. In terms of the relationship between capital-transaction and taxation regimes, taxation and the tax jurisdiction of Member States is a certain relaxation of full market liberalization of capital, which is understandable in light of the arrangement of EU direct taxation powers. At the EU level, article 58 of the Treaty (now article 65 of the TFEU), by tolerating diversity in national tax laws and systems while capital markets experience functional inflexibility, even allows to a certain extent for tax competition, which may be seen as a particular expression of the Member States’ sovereignty in the direct taxation field. However, forum shopping, which can be perceived as a market behaviour counterpart of such a policy choice, may be considered to be an abusive use of the EU freedom of establishment and capital movement since it may create evasion of pertinent national tax

54. Supra n. 27, for EU-harmonized subject matters.
55. On empirically studied impact of the European Court of Justice’s rulings in various Member States see, inter alia, Brokelind (2007), supra n. 17.
laws. In the future, amendments to EU secondary regulation in terms of anti-abuse and BEPS-inspired regulation may possibly set the definition of abuse as well as anti-abuse policy.

Despite the above logic of taxation power distribution, from an economic perspective, taxes are considered a non-tariff distortion of trade, having an equivalent effect to tariffs, which may impede free movement of persons, services and capital. Market anomalies caused by the operation of tax systems and diversities thereof result in distorted consumer and producer choices, reduced market efficiency and impaired mobility of capital.

Considering all of the above, the basic relationship between opposite poles of the capital movement-taxation policy may be summarized by the following premise of the European Court of Justice: once a Member State has exercised its taxation power which lies in its jurisdiction, the exercise triggers the application of Community law. Therefore, with regard to regulation of areas which are a matter for Member States, such as direct taxation, Member States must exercise their powers in conformity with law of the European Union, namely with respect of the EU freedoms and the rules regarding equal treatment, therefore avoiding any overt or of Directive 90/434 and presumption of fraud, see the judgments DK: ECJ, 5 July 2007, Case C-321/05 Kofoed [2007] ECR I-5795, ECJ Case Law IBFD, paras. 37-47, and DE: ECJ, 11 Dec. 2008, Case C-285/07 A.T. [2008] ECR I-9329, ECJ Case Law IBFD, paras. 31-32, and NL: Opinion of Advocate General Kokott, 16 July 2009, Case C-352/08 Zwijnenburg [2010] ECR I-4303, paras. 44-46. R.S. Avi-Yonah & C. HJI Panayi, Rethinking Treaty-Shopping: Lessons for the European Union, University of Michigan Law School, Empirical Legal Studies Center, Paper No. 7 (2010), also available at: http://law.bepress.com/cgi/viewcontent.cgi?article=1113&context=umichlwps, pp. 24-28, discuss treaty shopping in EU law.

60. A similar idea is also expressed in Directives 2009/133 (repealing Directive 90/434), 2011/96 (repealing Directive 90/435) and 2003/49.
61. Ardy & El-Agraa (2004), supra n. 37, at p. 238.
62. Id.
63. Ardy & El-Agraa (2004), supra n. 37, at p. 239.
covert discrimination on grounds of nationality, as well as respecting the principle of proportionality. The general principle of equal treatment, or non-discrimination, requires that comparable situations must not be treated differently and that different situations must not be treated in the same way.

The principles used to examine such interaction between the freedom of capital movements and direct taxation, in particular non-discrimination and non-restriction form an important part of the foundations of the current and eventual EU capital transactions regime; these principles will be given special attention in chapter 3, and in terms of an eventual future regime, in chapter 4.

1.2. EU capital transactions regime concretely – Commercial and non-commercial components

As underlined, one may describe the EU capital transactions regime by its commercial and non-commercial aspects in view of a direct application of the EU freedom of movements to direct tax matters. Commercial components share the nature of the freedom of movement, whereas non-commercial components take inspiration from international taxation policy as discernible from international tax law.

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1.2.1. Commercial components of capital transactions regime
      – A capital policy framework

Generally speaking, a capital policy can be attached to the definition of capital through either assets, transactions or the position of the relevant enterprise. Only those capital transactions included in the definition of capital will benefit from the protective regime of the corresponding capital policy.

An asset-based approach focuses on capital as the financial wealth used to start or maintain a business and as resources for investment intended to generate revenue. A transaction-based approach to capital focuses on capital transactions as such and promotes their liberalization. In contrast, an enterprise-based approach to capital as defined in the Canada-United States Free Trade Agreement (1988) qualifies as capital all types of corporate investments among entities and from them to other entities. While capital definition according to the transaction-based approach to capital may include payments, financial services including financial market services and financial retail services, and an enterprise-based approach to capital qualifies capital transactions and relations within (a group of) companies, capital according to the asset-based approach defines resources in terms of net assets and corresponding liabilities.

The principal difference between these three approaches is in their objectives. In particular, capital policy that is premised on an asset-based, transaction-based or enterprise-based concept of capital may have its objectives focused either on the protection of value of capital involved (in the case of

73. See the OECD Code of Liberalisation of Capital Movements (2013).
74. The Canada-United States Free Trade Agreement, supra n. 71.
75. Supra n. 71, n. 72 and n. 73.
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an asset and enterprise-based definition of capital) or promoting transac-
tional freedom (in the case of a transaction-based definition of capital).76

In this sense, an asset-based approach to capital focuses on imposing non-
discrimination with regard to every asset or liability a transaction involves.77
Such a regime focuses on the protection of value of assets regardless of
their origin.78

In contrast to the asset-based approach, a transaction-based capital policy
qualifies as capital entire transactions,79 regardless of accounting premises
such as assets and liabilities. A transaction-based concept of capital focuses
on their liberalization, regardless, for this purpose, of whether net capital
assets, financial services or transfers necessary for capital transactions are
in fact concerned. This distinguishes the scope of protection of the trans-
action-based regime from the asset-based regime, since the former liberal-
izes all capital movements selected by the legislator even though some of
the transactions concerned cannot be interpreted as affecting net capital in
terms of assets and liabilities. The selected capital movements benefit from
the capital regime and the prohibition of discrimination between similar
transactions regardless of their origin or content.

Lastly, an enterprise-based approach establishes a balance between the
asset-based and transaction-based capital policies by focusing on the pro-
tection of the value of assets involved in corporate capital transactions and
less on the freedom to transact in general.80

It will be shown that the primary approach to EU capital definition is a par-
ticular combination of the asset and transaction-based definition, the latter
being similar to that of the OECD, while developments of the case law of
the European Court of Justice show also a specific variant of the enterprise-
based approach.

76. Flynn (2002), supra n. 72, at p. 776.
77. Id.
78. See in this sense, WTO Working Group on the Relationship between Trade and
Investment, supra n. 70.
79. See WTO Working Group on the Relationship between Trade and Investment, supra
n. 70, at p. 2. For the transaction-based approach, see the OECD Code of Liberalisation
80. See in this sense, the Canada-United States Free Trade Agreement, supra n. 71.
1.2.2. Non-commercial elements – Elements of international tax law

Keeping in mind the double (commercial and non-commercial) nature of the EU current capital transactions regime, it is important to identify certain mechanisms of (international) tax law undertaken or referred to by EU regulation and/or the European Court of Justice. The most important features for purposes of this discussion relate to the concepts of tax jurisdiction, discrimination between residents and non-residents and avoiding of double taxation; their interpretation at the EU level is discussed in chapter 3. Specific policy developments with regard to anti-abuse and the BEPS are discussed in chapter 4.

In order to address principles of international tax law, I refer to the OECD Model (2010), in the area of international tax, OECD is the most objective global organization. Other international tax standards are those established by the UN Model (2011), the provisions of which are virtually the same as in the OECD Model (2010). The UN Model (2011) is not discussed in this account.

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83. OECD Model (2010), supra n. 10.


85. UN United Nations Model Double Taxation Convention between Developed and Developing Countries (1 Jan. 2011), Models IBFD.

86. In drafting of the UN Model, supra, the United Nations Secretariat prepared a draft model convention (ST/SG/AC.8/L.29) consisting of articles reproducing guidelines formulated by the Group of Experts, together with Commentaries thereon incorporating the views of members of the Group and also reproducing, where appropriate, the
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The value of the OECD standards underlined in this discussion can be described by the words the European Court of Justice habitually uses to refer to them – namely, they are an indication of international tax rules, used by the Court as gap filler in certain cases.87

There is an important similarity between the OECD regime established by the OECD Model (2010) and the EU direct taxation treatment that enables such a gap filling function of the OECD Model (2010). Namely, both the OECD Model (2010) and the body of EU law discussed in the European Court of Justice’s case law establish a regime of coordination between sovereign national systems of direct taxation as set by their respective Member States.89 In addition, the OECD Model (2010) and its Commentary can

87. See case law of the European Court of Justice cited supra n. 82. Although admitting the thesis itself is contradictory, R.S. Avi-Yonah, International Tax as International Law: An Analysis of the International Tax Regime (Cambridge Tax Law Series, Cambridge University Press, 2007) (2007a), believes that a coherent international tax regime exists, that is embodied in both the tax treaty network and in domestic laws, forming a significant part of international law (both treaty based and customary). As a consequence, countries are not free to adopt any international tax rules; country may not violate basic norms of the regime, which are the single tax principle (i.e. that income should be taxed once – not more and not less) and the benefits principle (i.e. that active business income should be taxed primarily at source, and passive investment income primarily at residence). This discussion starts from noting that the EU system is singular within the international context and obligatory in relation to the Member States and takes note of international standards and principles in order to draw a parallel between them and the EU internal system.
89. Member States are free to set up their taxation systems and determine tax base, tax rate, connecting factors for the allocation of fiscal jurisdiction and the general tax treatment of income subject to tax. Inter alia in the judgments in Kerckhaert and Morres (C-513/04), paras. 15 & 19; in C-374/04 Test Claimants in Class IV of the ACT Group Litigation, at para. 50; C-446/04 Test Claimants in the FII Group Litigation, at para. 47; NL: ECJ, 20 May 2008, Case C-194/06 Orange European Smallcap Fund [2008] ECR I-3747, ECJ Case Law IBFD, at para. 30 and references therein; in Damseaux (C-128/08), at para. 25, and BE: ECJ, 11 Sept. 2014, Case C-489/13 Verest and Gerards, ECLI:EU:C:2014:2210, ECJ Case Law IBFD, at para. 18. See also W. Hellerstein, G.W. Kofler & R. Mason,
contribute to the interpretation of Member States’ tax treaties, which also form a background to this discussion, since Member States have concluded many bilateral conventions based, in particular, on the model conventions on income and wealth tax drawn up by the OECD.

It must be underlined, however, that even though the objectives of the European Union and the OECD show similarities, there is no equivalence between “EU tax language” and “international tax language”. This is indicated in view of the fact that the European Court of Justice’s interpretation of EU fundamental freedoms is transplanted to national direct tax concepts; the Court sets a type of EU tax policy by interpreting national (direct) tax rules via EU fundamental freedoms.

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91. On the necessity to change the current network of bilateral Member State treaties with positive integration and multilateralism at Community (now EU) level, see Panayi (2007), supra n. 6, at p. 245.


1.2.3. The value of the OECD Model as an external source and benchmark for EU tax policy elements

The OECD Model (2010) deals, as its name states, with taxes on income and on capital and includes all taxes levied on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation. Even though OECD member countries have entered reservations to the majority of the below commented articles of the OECD Model (2010),\footnote{OECD Model (2010), Reservations of certain member countries on some provisions of the Convention, \textit{supra} n. 10, at para. 31, pp. 14-15.} the latter nevertheless represents a codification of international tax law and can thus be taken as a reference for the current and future EU tax regime. The OECD Model (2010) does not define the precise meaning of the terms it employs to refer to the income covered by a particular provision,\footnote{K. van Raad, \textit{Application of Tax Treaties to Items of Income that Are Covered by More Than One Distributive Provision}, in \textit{A Vision of Taxes within and outside European Borders}, Festschrift in honour of Prof. Dr Frans Vanistendael, pp. 729-736 (L. Hinnekens & P. Hinnekens (eds.), Kluwer Law International, 2008), at p. 730. On tax policy being based on concept of income, see J. Waincymer, \textit{International Tax and International Trade Policy Objectives}, in \textit{A Vision of Taxes within and outside European Borders}, Festschrift in honour of Prof. Dr Frans Vanistendael, pp. 877-904 (L. Hinnekens & P. Hinnekens (eds.), Kluwer Law International, 2008), at p. 882.} which leaves considerable room for flexibility with regard to the OECD regime for taxation of income.

In addition to the below commented concepts, a major preoccupation of the OECD and the regulation of international taxation in general, is the allocation of tax jurisdiction,\footnote{According to Panayi (2007), \textit{supra} n. 6, pp. 29 & 83, allocation of tax jurisdiction is the primary objective of tax treaties and the OECD Model (2010); alleviation of double taxation is in fact incidental to or a corollary to allocation. In this sense, Vogel speaks of classification and assignment rules and distributive rules of a double taxation convention; K. Vogel et al., \textit{Klaus Vogel on Double Taxation Conventions: A Commentary to the OECD, UN and U.S. Model Conventions for the Avoidance of Double Taxation of Income and Capital, with Particular Reference to German Treaty Practice}, 3rd ed. (Kluwer Law International, 1997), Introduction, at para. 45d, at p. 27.} international tax evasion\footnote{Baker (1994), \textit{supra} n. 86, at B-07, pp. 10-11, mentions avoiding double taxation and international tax evasion as purposes of the OECD Model (2010).} and improper use of tax conventions (such as tax abuse and certain forms of tax avoidance).\footnote{On the increasing importance of tax avoidance and tax evasion in the context of tax treaties, see Panayi (2007), \textit{supra} n. 6, at p. 31. Panayi, id., at p. 47, also mentions that the High Court in the United Kingdom held that the object and purposes of the OECD Model (2010) are avoidance of double taxation and the prevention of fiscal evasion and}
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to exchange information to combat these abuses. Specific attention to the BEPS Actions is given in chapter 4 of this book.

While the basic premise of tax jurisdiction in the European Union is that in the absence of unifying or harmonizing EU measures, the Member States are competent to determine criteria for taxation on income and wealth with a view to eliminating double taxation by treaty or unilaterally, there are certain international tax premises and principles that will generally be the same throughout the Member States and will thus be included in the terminology and reasoning of the European Court of Justice. It is thus crucial to represent such basic premises of international tax law to be able to contrast them with certain premises of EU law.

Presented below are the concepts of “subject to tax”, “discrimination between residents and non-residents” and “avoidance of double taxation”.  

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101. Apart from Directive 2011/96 (repealing Directive 90/435), Convention 90/436 and Directive 2003/48, no uniform or harmonization measure designed to eliminate double taxation has as yet been adopted at Community (now EU) level, nor have Member States concluded any multilateral convention to that effect under the second indent of article 220 of the EC Treaty (art. 293 of the Treaty, repealed by the TFEU).
102. Inter alia in Verest and Gerards (C-489/13), at para. 18. See also UK: Opinion of Advocate General Geelhoed, 29 June 2006, Case C-524/04 Test Claimants in the Thin Cap Group Litigation [2007] ECR I-2107, at para. 53; the Advocate General established that “… the necessity to divide tax jurisdiction over the income of cross-border economic operators between Member States (dislocation of tax base) is an inevitable consequence of the fact that direct tax systems are national …”.
104. For a general comment on the entire list of concepts see, inter alia, Vogel et al. (1997), supra n. 96, and Baker (1994), supra n. 86.
Since European law in principle “borrows” these concepts from international tax terminology, their primary source is to be found in international tax law.

1.2.3.1. Transactions and entities subject to tax

A person or entity subject to tax in a particular state is an individual or an entity levied in that state.

The OECD Model (2010) links power to tax to the residence of a person or a company or a permanent establishment (PE) of a company in a state, and defines three classes of income and capital, depending on the treatment applicable to each class in the state of source or situs (location). These are income and capital that may be taxed without any limitation in the state of source or situs; income that may be subjected to limited taxation in the state of source, and income and capital that may not be taxed in the state of source or situs.

In this context, one can distinguish residence-based and source-based taxation. While residence-based taxation is linked to the concept of tax residence and worldwide taxation, according to the OECD Model Convention, the source state has a taxing right if the income is sourced in its jurisdiction or if the person carries on a business through a PE in this state. But these are not the only situations where the source state has a taxing right.

In this sense, the concepts of residence and PE are crucial for defining transactions subject to tax in terms of the corporate taxation. The OECD Model (2010) defines the persons covered in its article 1; it applies to all persons who are residents of one or both of the contracting states. The OECD Model (2010) defines in its article 4 “resident of a Contracting State” as “any

106. OECD Model (2010), supra n. 10, Introduction, at para. 21, lists classes of income and capital that may be taxed without any limitation in the state of source or situs.
107. Examples of items of income or capital which may not be taxed in the state of source or situs, which are, as a rule, taxable only in the state of residence of the taxpayer, are commented in OECD Model (2010), supra n. 10, Introduction, at para. 23.
person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein”.

Article 5 of the OECD Model (2010) defines PE; the term “PE” defines a fixed place of business through which the business of an enterprise is wholly or partly carried on; a PE may also be constituted by dependent or independent agent activity.108

It is by applying the criteria of residence and the source of income or capital that the state of taxation will be identified.109 This corresponds to a requirement of a “genuine link” or a sufficient connection with the taxing state.110

In terms of division of tax jurisdiction between contracting states according to a tax treaty modelled on the OECD Model (2010), there are, according to the Model, two types of income that are of a particular interest to this discussion and that may be subject to limited taxation in the state of source, namely, dividends, provided the holding in respect of which the dividends are paid is not effectively connected with a PE in the state of source;111 and interest, subject to the same proviso as in the case of dividends.112 These two categories demonstrate the importance of connection of income or capital with the state of source.

108. On the term PE including a place of management, see OECD Model (2010), Commentary on Article 5, supra n. 10.
110. Inter alia, see Hohenwarter (2007), supra n. 5, at p. 85.
111. According to art. 10 of the OECD Model (2010), supra n. 10, in such a case the state with limited tax jurisdiction must limit its tax to 5% of the gross amount of the dividends, where the beneficial owner is a company that holds directly at least 25% of the capital of the company paying the dividends, and to 15% of their gross amount in other cases.
112. According to art. 11 of the OECD Model (2010), supra n. 10, in such a case the state with limited tax jurisdiction must limit its tax to 10% of the gross amount of the interest, except for any interest in excess of a normal amount. Applying this principle ensures that, in general, that the profit is connected to the activity of such a PE will be taxed in the state of source rather than in the state of establishment of the parent company.
1.2.3.2. Discrimination between residents and non-residents

In its article 24, the OECD Model (2010) defines **non-discrimination of nationals** and company’s PEs of one contracting state in the other contracting state;\(^{113}\) the regime protects nationals of one contracting state who are residents in the other contracting state.

Paragraph 1 of the said article states that “[n]ationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or **more burdensome** than the taxation and connected requirements to which nationals of that other State **in the same circumstances**, in particular with respect to **residence**\(^{114}\), are or may be subjected” (emphasis added). According to the Commentary to this provision, all nationals of a contracting state are entitled to invoke the benefit of this provision as against the other contracting state.

This provision **supplements**, in general, **non-discrimination rules and equal treatment precepts already existing under domestic or international law**\(^{115}\) and it is also aimed at the protection of nationals of the contracting states who are not residents of either of them but of a third state. However, protection of nationals who are residents of a third state is contextualized. In particular, discrimination against **foreign persons** prevented by this international regime concerns different tax treatment solely based on nationality but only with respect to persons or entities “in the same circumstances, in

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113. For a general comment on art. 24 of the OECD Model (2010), *supra* n. 10, see Baker (1994), *supra* n. 86, 24-01; 24-47, pp. 383-413.
114. According to Vogel et al. (1996), *supra* n. 90, art. 24, para. 1, of the OECD Model (2010) prohibits discrimination on grounds of nationality. Such ground is, however, mostly invoked in cases involving legal entities since in case of individuals, the distinction between domestic and foreign is based on residence; *supra* n. 90, art. 24, at para. 28, pp. 1289-1290. A case of discrimination on grounds of nationality can be taken to exist only where nationality is the decisive criterion for the taxpayer’s being treated less favourably under domestic tax law; *supra* n. 90, at para. 29, at p. 1290.
115. Vogel et al. (1996), *supra* n. 90, art. 24, at para. 5, at p. 1281. The same authors note however, that for the EU Member States, a rule which is applicable to tax law is derived from the EC Treaty; *supra* n. 90, at para. 5b, at p. 1282. Nevertheless, it is underlined that several reasons speak against applying the European Court of Justice’s interpretation of discrimination to the interpretation of article 24 of the OECD Model (2010); *supra* n. 90, art. 24, at para. 5e, at p. 1283 and references within. In this sense, *see also* Lang (2007a), *supra* n. 52, at p. 103, discussing problematic features of such convergence of interpretations.
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particular with respect to residence“,116 and requires that all other relevant factors, including the residence of the entity, be the same.117

In this context, it is necessary to underline that different treatment of residents and non-residents is a crucial feature of domestic tax systems and tax treaties.118 In fact, residents and non-residents are usually not considered to be in the same circumstances,119 the residence of the taxpayer being one of the factors that are relevant in determining whether taxpayers are placed in similar circumstances.120 Differences in the circumstances of residents and non-residents will not be established where residence has no relevance with respect to the different treatment under consideration.121

In addition, entities including PEs must be in comparable circumstances. The expressions “the same circumstances”, “the same activities” pursuant to article 24, paragraph 3, of the OECD Model (2010), and “similar enterprises” pursuant to article 24, paragraph 5, of the Model, refer to taxpayers placed, from the point of view of the application of taxation laws and regulations, in substantially similar circumstances both in law and in fact.122

One has to distinguish between the different paragraphs of article 24 of the Model Convention.

Article 24, paragraph 3, of the OECD Model (2010) establishes an obligation to apply similar conditions for the taxation on a PE in a contracting

116. Because of the formulation of art. 24, para. 1, of OECD Model (2010), supra n. 10, a different treatment that is solely based on nationality must be differentiated from a different treatment that relates to other circumstances and, in particular, residence; supra n. 10, Commentary on Article 24, Concerning Non-Discrimination, at para. 17.
117. OECD Model (2010), supra n. 10, Commentary on Article 24, Concerning Non-Discrimination, at para. 17.
118. Id.
121. OECD Model (2010), supra n. 10, Commentary on Article 24, Concerning Non-Discrimination, at para. 18.
122. For commentary on the expression “in the same circumstances”, see OECD Model (2010), supra n. 10, Commentary on Article 24, Concerning Non-Discrimination, at para. 7.
state of an enterprise of another contracting state in comparison to an enterprise of the latter state carrying on the same activities.\textsuperscript{123} The PE of an enterprise of the other contracting state should be compared to that of an enterprise of the first-mentioned state that has a legal structure that is similar to that of the enterprise to which the PE belongs.\textsuperscript{124} The discrimination targeted in this paragraph is discrimination based not on nationality but on the location of an enterprise. It thus affects all residents of a contracting state who have a PE in the other contracting state irrespective of their nationality,\textsuperscript{125} with the purpose to “end all discrimination in the treatment of PEs as compared with resident enterprises belonging to the same sector of activities, as regards taxes based on business activities, and especially taxes on business profits”.\textsuperscript{126} Article 24, paragraph 3, of the OECD Model (2010) only prohibits a more burdensome taxation in form of a higher tax liability, differences in the assessment of taxes not being covered.

The provisions of article 24, paragraph 5, of the OECD Model (2010) require that \textit{enterprises}\textsuperscript{127} of a contracting state, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other contracting state, are not subjected in the first-mentioned state to any taxation or a connected requirement which is different or more burdensome than the taxation and connected requirements to which other similar enterprises\textsuperscript{128} of the first-mentioned state are or may be subjected. The provisions thus ensure equal treatment for taxpayers residing

\textsuperscript{123} The rule is not applicable when an enterprise operates in other states through a separate independent enterprise. In Vogel et al. (1996), supra n. 90, art. 24, at para. 120, at p. 1313.
\textsuperscript{124} OECD Model (2010), supra n. 10, Commentary on Article 24, Concerning Non-Discrimination, at para. 37.
\textsuperscript{125} OECD Model (2010), supra n. 10, Commentary on Article 24, Concerning Non-Discrimination, at para. 33.
\textsuperscript{126} OECD Model (2010), supra n. 10, Commentary on Article 24, Concerning Non-Discrimination, at para. 35. This test requires a hypothetical comparison with an enterprise engaged in the same activities and located in the state in which the PE is situated. Such a comparison is based on the fictitious assumption that the PE is placed on equal footing for tax purposes with a legally independent enterprise of the state in which the PE is situated. In Vogel et al. (1996), supra n. 90, art. 24, at para. 122, at p. 1314.
\textsuperscript{127} The protection is aimed at enterprises and does not extend to shareholders or partners resident in other contracting states. Therefore, income accruing to such shareholdings can be taxed differently to corresponding income accruing to shareholders or partners resident in the same state as the enterprise. In Vogel et al. (1996), supra n. 90, art. 24, at para. 164, pp. 1330-1331. The provision does not protect against discrimination enterprises in which non-residents participate, when there is no connection between the discrimination and the ownership of capital by foreigners; supra n. 90, art. 24, at para. 165, at p. 1331.
\textsuperscript{128} “Similar enterprises” describes enterprises primarily operating in the same or comparable legal form as the enterprise concerned; in Vogel et al. (1996), supra n. 90, art. 24, at para. 166, at p. 1332.
in the same state, subjecting foreign capital, in the hands of the partners or shareholders, to identical treatment to that applied to domestic capital.\textsuperscript{129}

In view of the above, the provisions of article 24 of the OECD Model (2010) do not cover “indirect” discrimination,\textsuperscript{130} neither can the provisions be interpreted to require \textit{most-favoured-nation treatment} (MFN treatment).\textsuperscript{131} Nationals or residents of a third state that is not a contracting state of the treaty may not claim benefits from a bilateral or a multilateral agreement, by reason of a similar non-discrimination provision in double tax conventions (DTCs) between the third state and the first-mentioned state.\textsuperscript{132} This is because tax conventions are based on the principle of \textit{reciprocity}, therefore “a tax treatment that is granted by one Contracting State under a bilateral or a multilateral agreement to a resident or national of another Contracting State party to that agreement by reason of the specific economic relationship between those Contracting States may not be extended to a resident or national of a third State under the non-discrimination provision of the tax convention between the first State and the third State”.\textsuperscript{133}

According to its Commentary, the obligation of equal treatment according to article 24 the OECD Model (2010), with limitations as stated with regard to paragraph 3, is good also for the assessment of tax, the \textit{structure and rate of tax}, withholding tax on dividends, interest and royalties received by a

\begin{itemize}
\item \textsuperscript{129} OECD Model (2010), \textit{supra} n. 10, Commentary on Article 24, Concerning Non-Discrimination, at para. 76. On interest to resident or non-resident creditors, \textit{see} Commentary on Article 24, \textit{supra} n. 10, Concerning Non-Discrimination, at para. 79. In contrast to art. 24, para. 3, of the OECD Model (2010) concerning PEs, art. 24, para. 5, of the OECD Model (2010), like the rule against discrimination based on nationality of art. 24, para. 1, of the OECD Model (2010), refers to the entire relationship between state and taxpayer. Regulation of transfer pricing is, however, specific. In Vogel et al. (1996), \textit{supra} n. 90, art. 24, at para. 162, at p. 1330.
\item \textsuperscript{130} OECD Model (2010), \textit{supra} n. 10, Commentary on Article 24, Concerning Non-Discrimination, at para. 1.
\item \textsuperscript{132} OECD Model (2010), \textit{supra} n. 10, Commentary on Article 24, Concerning Non-Discrimination, at para. 2.
\item \textsuperscript{133} Id.
\end{itemize}
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PE, credit for foreign tax, and the extension to PEs of the benefit of DTCs concluded with third states, with exception of cases of abuse.134

1.2.3.3. Avoiding double taxation

Receiving income or possessing capital taxable in different territories or states raises the problem of double taxation. Generally speaking, there are two types of double taxation that may arise.

International juridical double taxation can generally be defined as the imposition of comparable taxes in two (or more) states on the same taxpayer in respect of the same subject matter and for identical periods.135 A second type of double taxation is economic double taxation, where two different persons are taxable in respect of the same income or capital. Contracting states solve problems of double taxation in bilateral negotiations.136

In the system of the OECD Model (2010), in case of double taxation, where income or capital may be taxed with or without limitation in the state of source or situs, it is for the state of residence to eliminate double taxation.137 In general, this can be accomplished by one of the following two methods.138 One is the exemption method, where income or capital that is taxable in the state of source or situs is exempted in the state of residence, but may be taken into account in determining the rate of tax applicable to the taxpayer’s remaining income or capital.139 The other method is the credit method, where income or capital that is taxable in the state of source or situs

134. OECD Model (2010), supra n. 10, Commentary on Article 24, Concerning Non-Discrimination, paras. 40-72.
135. OECD Model (2010), supra n. 10, Introduction, at para. 1. For occasions giving rise to juridical double taxation, see OECD Model (2010), supra n. 10, Commentary on Articles 23 A and 23 B, Preliminary Remarks, paras. 3-5.
137. Customary international tax law does not forbid double taxation as long as each (individual) legislation is consistent with international law. In Vogel et al. (1996), supra n. 90, Introduction, at para. 8, at p. 12; referring to K. Vogel, Der räumliche Anwendungsbereich der Verwaltungsrechtsnorm (Metzner, 1965), at p. 351.
is subject to tax in the state of residence, but the tax levied in the state of source or situs is credited against the tax levied by the state of residence on such income or capital. The deduction that the state of residence allows is restricted to that part of the income tax that is appropriate to the income derived from the other state (the so-called “maximum deduction”). Credit is allowed for income tax only against income tax and for capital tax only against capital tax.

The OECD Model (2010) establishes the rules for eliminating double taxation by the methods listed in its articles 23 A and 23 B, the difference between the methods being that the exemption methods look at income, while the credit methods look at tax. The methods proposed by the two articles of the OECD Model (2010) are the exemption method with progression (article 23 A), and the ordinary credit method (article 23 B).

Specific cases of eliminating double taxation pertain to corporate income, in particular to dividends, interest and losses.

Concerning dividend taxation, the combined effect of article 10 and article 23 of the OECD Model (2010) (articles 23 A and 23 B as appropriate) is

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142. OECD Model (2010), supra n. 10, Commentary on Articles 23 A and 23 B, at para. 70.
143. OECD Model (2010), supra n. 10, Commentary on Articles 23 A and 23 B, at para. 17.
144. OECD Model (2010), supra n. 10, Commentary on Articles 23 A and 23 B, at para. 29. Art. 23A of the OECD Model Convention provides for exemption and credit, see art. 23A, para. 2.
145. Applying the exemption method of art. 23A of the OECD Model (2010) in terms of treatment of losses in the context of avoiding double taxation, several states treat losses incurred in the other state in the same manner as they treat income arising in that state; however, as the state of residence, they do not allow deduction of a loss incurred from immovable property or a PE situated in the other state. In any event, the solution to the problem depends primarily on the domestic laws of the contracting states and bilateral clarifications. No solution is proposed in the OECD Model (2010) itself, it being left to the individual contracting state. OECD Model (2010), supra n. 10, Commentary on Articles 23 A and 23 B, at para. 44. According to the credit method in general, a loss in a given state will be set off against other income from the same state. See also OECD Model (2010), supra n. 10, Commentary on Articles 23 A and 23 B, paras. 65-66, in terms of losses in terms of domestic law and as to excess foreign tax credit carry-over. See also Vogel et al. (1996), supra n. 90, paras. 70-75, pp. 1181-1185.
that the state of residence of the shareholder is allowed to tax dividends arising in the other state but must give relief concerning such dividends for the tax which has been collected by the state where the dividends arise. The regime applies also in case the recipient of a dividend is a parent company and the dividend is paid by its subsidiary; in this case, the regime prevents juridical double taxation.\textsuperscript{146}

In the context of \textit{taxation of interest payments}, anti-abuse rules connect concepts of interest payments and dividend taxation. In fact, \textit{thin capitalization} describes loan relationships between connected companies that consist of financing a company by way of a loan in preference to equity capital, in order to benefit from a more advantageous tax treatment.\textsuperscript{147} The OECD Model (2010) allows the state of the borrower company, under certain conditions, to treat an interest payment as a distribution of dividends in accordance with its domestic legislation, the essential condition being that the contributor of the loan effectively shares the risks run by the borrower company. This results in taxation at source of the “interest” at the rate of dividends and the inclusion of such interest in the taxable profits of the lender company.\textsuperscript{148} If the relevant conditions are met, the state of residence of the lender is in principle obliged to give relief for juridical or economic double taxation of the interest as though the payment were in fact a dividend.\textsuperscript{149}

\textit{Losses taxation} will be discussed with regard to case law of the European Court of Justice.

\subsection*{1.2.4. Recapitulation}

Capital movements and taxation, like underlined above, although concentrated around the concept of capital, have very different purposes and orientation. Outside of the concept of capital’s net worth, their building blocks and terminology are distinct and should not be mistaken for one another even though they may be referred to by similar terms.

\begin{flushleft}
\textsuperscript{146} OECD Model (2010), \textit{supra} n. 10, Commentary on Articles 23 A and 23 B, paras. 49-50.
\textsuperscript{147} Among other sources, see Advocate General Geelhoed in \textit{Test Claimants in the Thin Cap Group Litigation} (C-524/04), paras. 3-5; and the judgments in DE: ECJ, 12 Dec. 2002, Case C-324/00 \textit{Lankhorst-Hohorst} [2002] ECR I-11779, ECJ Case Law IBFD, and in \textit{Test Claimants in the Thin Cap Group Litigation} (C-524/04).
\textsuperscript{148} OECD Model (2010), \textit{supra} n. 10, Commentary on Articles 23 A and 23 B, at para. 67.
\textsuperscript{149} OECD Model (2010), \textit{supra} n. 10, Commentary on Articles 23 A and 23 B, at para. 68.
\end{flushleft}
This is all the more relevant if one defines taxation policy in terms of criteria used to define a capital policy. In this sense, while a position may be taken that taxation has a transaction-based underlying idea, this does not correspond to the transaction-based orientation of a capital policy. In particular, while taxation may be considered to focus and intervene when transactions take place, this has little to do with a capital policy orientation toward liberalization of capital movements.

Therefore, for purposes of this account, taxation policy is not classified as transaction-based in the sense of a transaction-based capital policy, nor, for that matter, in the sense of an asset-based capital policy. What is, however, a premise of this discussion is that a combination of capital policy and taxation at the EU level must look to the capital worth (net value) of the underlying transactions subject of liberalization. In the sense of a capital policy, this idea is closer to an asset-based policy looking at the value of underlying assets, while in terms of a future EU taxation policy, it means solely that when arbitrating between taxation regimes of Member States or, in case of harmonization, when operating at the level of the European Union, a taxation policy should, in view of the nature of the EU conglomeration, pursue an idea of maintenance of capital’s worth regardless of moving cross-border.

The baseline of this account is thus to look beyond terminology of both capital liberalization and national taxation laws in order to define the actual building blocks of the EU capital transactions regime; this will be done with an ambition of respecting terminological standards and the underlying philosophies of capital liberalization and (international or national) taxation laws.