Chapter 3

Corporate Tax Directives

3.1. EU Parent-Subsidiary Directive

3.1.1. Background

*Force*

A directive concerning the tax treatment of profit distributions between parent companies and subsidiaries of different Member States (the EU Parent-Subsidiary Directive) was issued on 23 July 1990.\(^{686}\) The Member States had to bring into force the laws, regulations and administrative provisions necessary for them to comply with the Directive before 1 January 1992. The Directive also binds all the new EU Member States from the date of their accession.\(^ {687}\) The scope of the original version of the Parent-Subsidiary Directive was later extended with Directive 2003/123/EC.\(^ {688}\) The Member States had to bring into force the laws, regulations and administrative provisions necessary to comply with the amendments by 1 January 2005. A recast version of the directive was issued at the end of 2011.\(^ {689}\)

*Objective*

The aim of the common tax system based on the Parent-Subsidiary Directive is to prevent tax measures of the Member States that constitute a disadvantage to cooperation between companies of different Member States compared to cooperation between companies of one Member State. The purpose is to facilitate the grouping together of companies of different Member States\(^ {690}\) and to abolish tax obstacles on profit distributions between companies of different Member States.

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\(^{687}\) A transition period applied to Estonia until 31 December 2008.


\(^{689}\) 30 Nov. 2011 (2011/96/EU).

\(^{690}\) See e.g. *Athinaiki Zythopoïta* (C-294/99), para. 25, *Test Claimants in the FII Group Litigation* (C-446/04), para. 103 and *Amurta* (C-379/05), para. 18.
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Tax-exempt distributions
The aims of the Parent-Subsidiary Directive are implemented by exempting profit distributions from the withholding tax in the state of residence of the subsidiary and by eliminating both international juridical and economical double taxation in the state of residence of the parent company. The Parent-Subsidiary Directive allows tax-exempt profit distributions between subsidiaries and parent companies of two different Member States.

3.1.2. Scope of application

3.1.2.1. Profit distributions between subsidiary and parent companies residing in different Member States

Basic situation
The scope of application of the Parent-Subsidiary Directive is determined in article 1(1) of the directive. Each Member State applies the directive to distributions of profits received by companies of that state which come from their subsidiaries of other Member States. Each Member State must also apply the directive to distributions of profits by companies of that state to companies of other Member States of which they are subsidiaries. The directive has an impact on the tax treatment of intragroup distributions both in the state of residence of the distributing subsidiary and in the state of residence of the receiving parent company. The directive applies only to cross-border situations. Internal situations concerning only one Member State and cross-border situations where one of the companies is from a non-Member State fall outside the scope of application of the Directive.\(^{691}\)

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\(^{691}\) See joined cases *KBC Bank* (C-439/07 and C-499/07), paras. 57 and 63. Because of national legislation or because of the free movement of capital principle of the TFEU or the EEA Agreement, benefits similar to the directive benefits, however, may have to be made available also in purely national situations or in situations concerning companies from non-Member States.
EU Parent-Subsidiary Directive

Picture 3.1 The EC Parent-Subsidiary Directive applies

EU State 1

Parent company

Profit distribution

EU State 2

Subsidiary

Dual-residence conflict

In a dual-residence conflict situation a distribution may come under the scope of application of the Parent-Subsidiary Directive even though the distribution would be made between a subsidiary and a parent company that are residents of the same Member State. The distribution made between the companies may come under the scope of application of the directive if one of the companies is considered to be a resident of another Member State because of a dual-residence conflict. Such a situation may emerge if the place of management of one of the companies is in another Member State.

Picture 3.2 The EC Parent-Subsidiary Directive may apply in a dual-residence conflict situation

EU State 1

Place of management

EU State 2

Parent company

Profit distribution

EU State 2

Subsidiary
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3.1.2.2. Profit distributions connected with a permanent establishment

*Rule*

Each Member State in which a permanent establishment is situated must apply the Parent-Subsidiary Directive to profit distributions received by the permanent establishments of companies of other Member States that come from their subsidiaries of a Member State other than that where the permanent establishment is situated. The directive must also be applied to distributions of profits by companies of that state to permanent establishments situated in another Member State of companies of the same Member State of which they are subsidiaries.692

*TFEU compatibility*

The freedom of establishment principle of article 49 of the TFEU requires that the cross-border situations in which the profit distribution is connected with a permanent establishment of a company of a Member State situated in another Member State come under the scope of application of the Parent-Subsidiary Directive. The permanent establishments of companies of Member States must be subject to equally beneficial tax treatment in the state in which they are situated as applies to the resident companies of that state.693

*Parent and subsidiary of the same state*

A distribution of profits may come under the scope of the Parent-Subsidiary Directive as a cross-border payment even though the parent company and the subsidiary company are from the same Member state if the profit distribution is connected with a permanent establishment situated in another Member State. In such a situation, both the state of residence of the subsidiary, which is the same state as the state of residence of the parent company, and the state in which the permanent establishment is situated must take the directive into account.

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693. See e.g. Commission v. France (avoir fiscal) (270/83) and Saint-Gobain (C-307/97). See also e.g. Zanotti 2004, pp. 493-505 and Zanotti 2004a, pp. 535-546.
The Parent-Subsidiary Directive applies to Three Member States. The state in which the permanent establishment is situated must also take the Parent-Subsidiary Directive into account if the subsidiary and the parent company are from two different Member States and the permanent establishment is situated in a third Member State. The state of residence of the subsidiary must not levy a withholding tax on the profit distribution and the state in which the permanent establishment is situated must exempt the distribution or tax the distribution but grant an indirect foreign tax credit. The state of residence of the parent company must also take the directive into account.

Three Member States

The state in which the permanent establishment is situated must also take the Parent-Subsidiary Directive into account if the subsidiary and the parent company are from two different Member States and the permanent establishment is situated in a third Member State. The state of residence of the subsidiary must not levy a withholding tax on the profit distribution and the state in which the permanent establishment is situated must exempt the distribution or tax the distribution but grant an indirect foreign tax credit. The state of residence of the parent company must also take the directive into account.

694. The indirect foreign tax credit means granting a credit to the dividend recipient for the corporate taxes paid by the dividend distributing company on the profits distributed to the recipient.
695. See sec. 3.1.3.
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Picture 3.4 The Parent-Subsidiary Directive applies

EU State 1

Parent company

EU State 2

Permanent establishment

EU State 3

Subsidiary

Profit distribution

Permanent establishment in the subsidiary state

It is somewhat unclear as to whether the Parent-Subsidiary Directive covers a situation in which a resident subsidiary of one Member State makes a distribution to its parent company, which is a resident of another Member State, but the distribution is connected with a permanent establishment of the parent company in the state of residence of the subsidiary.

It may be argued that the distribution in the situation described is an internal distribution in one Member State and not a cross-border distribution, even though the parent company is a resident of another Member State. In any case, the state of residence of the parent company must comply with the directive because from the perspective of that state there is a cross-border situation. From the perspective of the state of residence of the subsidiary and the state in which the permanent establishment is situated, which is the same state, it is an internal situation of that state and not a cross-border situation. This state may consider that, because there is no cross-border situation, the state is allowed to tax the distribution as an internal distribution irrespective of the existence of the Parent-Subsidiary Directive. The freedom of establishment principle of the TFEU, however, requires that the taxes levied in the case of the permanent establishment are not more burdensome than the taxes levied in the case of resident companies.
The Parent-Subsidiary Directive applies partially to Permanent establishment in a non-Member State.

A profit distribution made between a subsidiary and a parent company of two different Member States comes under the scope of the Parent-Subsidiary Directive even if the distribution would be connected with a permanent establishment that the parent company has in a non-Member State. The state of residence of the subsidiary and the state of residence of the parent company must comply with the directive. However, the Parent-Subsidiary Directive does not oblige the state in which the permanent establishment is situated in any way.

696. Compare to the Interest-Royalty Directive, which has a different scope of application in this respect. See sec. 3.2.2.
3.1.2.3. Company of a Member State

Definition

Article 2(1) of the Parent-Subsidiary Directive defines what is meant by the term “company of a Member State”, i.e. which entities come under the scope of application of the directive. The entity must be a company that
- takes one of the forms listed in the Annex to the Parent-Subsidiary Directive;
- is considered to be a resident of a Member State for tax purposes according to the national laws of that state and is not considered to be a resident for tax purposes outside the European Union under the terms of a tax treaty with a non-Member State; and
- is subject to one of the taxes listed in the Parent-Subsidiary Directive or to any other tax that may be substituted for any of the expressly mentioned taxes, without the possibility of an option or of being exempt.

All three criteria mentioned must be met simultaneously; however, it is sufficient that each of the criteria is met in one Member State. It is not required that all the criteria are met in one Member State.

Entity form

Private and public companies limited by shares of different Member States typically come under the scope of application of the Parent-Subsidiary Directive. European Companies (Societas Europaea – SE) and European Cooperative Societies (SCE) also come under the scope of the directive. Otherwise, it depends on the Member State concerned which entity forms are covered.

In the case of some Member States, the Annex to the Parent-Subsidiary Directive expressly includes a list of all the national entity forms covered. This list is exhaustive. For example, the list may include national cooperative society forms of some Member States, but not of all Member States.

697. See e.g. Schoneville 1992, p. 13. See also Tenore 2010a, pp. 224-225 about the Parent-Subsidiary Directive term “company”.
698. See the Annex to the Parent-Subsidiary Directive.
700. See Gaz de France (C-247/08), para. 32. See also Boulogne & Geursen 2010, pp. 129-140 about the Gaz de France case.
701. Because of the freedom of establishment principle of the TFEU it is possible that tax benefits similar to the benefits based on the Parent-Subsidiary Directive must be made available also to entity forms not covered by the list included in the Annex to the directive. See Aberdeen Property Fininvest Alpha (C-303/07) and Gaz de France (C-247/08), para. 60.
National partnership forms are usually not included in the list and in most situations these would fall outside the scope of the directive because they are not separately taxable entities.

Some Member States have not included an express list of all possible national entity forms in the Annex to the directive but they have determined broadly that all national company forms incorporated under the law of the state concerned come under the scope of the directive provided that the other two criteria set forth in article 2 of the Parent-Subsidiary Directive are met. This type of a broad formulation is practical because it is less probable that this formulation leads to a treatment in conflict with the freedom of establishment principle than the formulation including a list of the different national entity forms covered. It is possible that an express list of national entity forms excludes an entity, which is to the extent similar to the entity forms covered, that the entity must be subject to the tax benefits similar to the benefits of the Parent-Subsidiary Directive in order for its tax treatment not to be in conflict with the freedom of establishment principle.\textsuperscript{702} However, a broad and general determination of the entities covered may be problematic in the way that it may lead to a conflict if the state of residence of the subsidiary and the state of residence of the parent company interpret the term “company” differently.\textsuperscript{703}

**Tax liability**

Even if a company would take one of the entity forms covered by the Parent-Subsidiary Directive it comes under the scope of the directive only if it is subject to one of the taxes listed in the directive (or to any other tax that may be substituted for any of the expressly mentioned taxes) without the possibility of an option or of being exempt. Tax-exempt entities do not come under the scope of the directive even if they would take a form covered by the directive. Entities that can choose whether to be treated as an exempt entity or not also fall outside of the scope of the directive.

Different partnership forms that are not treated as separately taxable entities also fall outside of the scope of the Parent-Subsidiary Directive. However, hybrid entity forms that are treated as a separately taxable entity in one

\textsuperscript{702} See Aberdeen Property Fininvest Alpha (C-303/07).

Member State but as a transparent entity in another Member State may come under the scope of the directive.

The Parent-Subsidiary Directive does not set any limit for the required tax but companies established in low-tax states also come under the scope of the directive. It is somewhat unclear, however, as to what extent partially tax-exempt entities come under the scope of application of the directive.704

Tax residence

The application of the Parent-Subsidiary Directive requires that the tax residence of the company is in a Member State according to the tax laws of that state. For example, dividends paid to the Chanel Islands, therefore, do not come under the scope of the directive.705

The tax residence of the company must not be outside the European Union according to a tax treaty concluded with a non-Member State. Such a dual-residence conflict situation may emerge, for example, if the place of management of a company established and registered under the laws of a Member State is situated in a non-Member State that treats the company as a tax resident because of the place of management. This type of dual-residence company is left outside the scope of the directive for anti-avoidance reasons.

Dual-resident companies with their tax residence in two different EU Member States come under the scope of the directive even if there would be a tax treaty between the two states concerned. Also, dual-resident companies with their tax residence in a Member State and in a non-Member State come under the scope of the directive if there is no tax treaty between the states concerned. These types of dual-residence companies are not problematic for anti-avoidance reasons because there is no tax treaty that would prevent an EU Member State from taxing the profits of the company.

From the tax treatment perspective, the scope of application of the Parent-Subsidiary Directive also covers dual-resident companies that have their state of residence in one of the EU Member States and in a non-member tax treaty state if the tax treaty resolves the dual-residence conflict in favour of the EU Member State. This type of a conflict may emerge, if the place of management of the company is in the EU Member State and the company is established and registered under the law of the other state. In such

704. See e.g. Fibbe 2006, pp. 99-102 about this problem.
a situation, the company, however, falls outside of the scope of application of the Parent-Subsidiary Directive because the foreign entity form is not covered by the directive.

3.1.2.4. Permanent establishment

Definition

Article 2(2) of the Parent-Subsidiary Directive defines the term “permanent establishment” for the purposes of the directive. The term “permanent establishment” means a fixed place of business situated in a Member State through which the business of a company of another Member State is wholly or partly carried on. The fixed place of business constitutes a permanent establishment for the purposes of the directive, however, only insofar as the profits of the place of business are subject to tax in the Member State in which it is situated by virtue of a tax treaty or, in the absence of a treaty, by virtue of national law.

In order for a fixed place of business to come under the scope of application of the directive, the place must meet similar requirements that apply to companies. The fixed place of business must be a permanent establishment of an EU resident company, it must be situated in a Member State and it must be subject to tax in the Member State in which it is situated.

Relation to the OECD Model Convention

The definition of the term “permanent establishment” included in the Parent-Subsidiary Directive corresponds to the basic definition of the same term in article 5(1) of the OECD Model Tax Convention. The definition of the Parent-Subsidiary Directive, unlike the OECD Model, however, requires that the permanent establishment is subject to taxes in the state in which it is situated. This additional requirement can be explained by the fact that the directive also covers companies only insofar as they are subject to taxes. Tax-exempt entities do not come under the scope of application of the directive.

The directive, however, does not set any minimum level on the required tax. It is sufficient that the permanent establishment in principle is subject to tax in the state in which it is situated, even though in practice no taxes would be paid for example because of a loss year or because of another reason.

It is sufficient that the taxing right of the permanent establishment state is not restricted by a tax treaty and that the state under its domestic law
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allocates dividend income to the permanent establishment. The holding on the basis of which the dividend is paid must form part of the business assets of the permanent establishment both for domestic tax law and in the case of tax treaty states for tax treaty purposes.\textsuperscript{706}

3.1.2.5. Parent and subsidiary company

Companies of different Member States

Article 3(1) of the Parent-Subsidiary Directive defines when a company that comes under the scope of application of the Directive qualifies as a parent company or as a subsidiary for the purposes of the directive. According to the article, the status of a parent company is attributed at least to any company of a Member State that comes under the scope of the directive and which has a minimum holding of 10\% in the capital of such a company of another Member State that comes under the scope of the directive. A subsidiary is then the company the capital of which includes the holding of the parent company. Only direct holdings qualify. Indirect holdings are not taken into account when determining the 10\% limit. The concept “holding in capital” also excludes mere holdings of shares in usufruct.\textsuperscript{707} The holding situation on the day of the profit distribution is decisive.

The directive sets only the minimum requirement. The Member States are free to grant tax benefits similar to the benefits based on the directive in situations in which the holding is less than 10\%.

Companies of the same Member State

A company of a Member State that has a minimum holding of 10\% in the capital of a company of the same Member State qualifies as a parent company for the purposes of the Directive, provided that the holding is held in whole or in part by a permanent establishment of the first company situated in another Member State.\textsuperscript{708} A subsidiary is then the company, the capital of which includes the holding. A parent company and a subsidiary company of the same Member State come under the scope of the directive only if the shares in the subsidiary belong to the assets of a permanent establishment situated in another Member State.

\textsuperscript{706} See also Kofler & van Thiel 2011, pp. 328-329.
\textsuperscript{707} Les Vergers du Vieux Tauves (C-48/07). See also Peeters & van de Vijver 2009, pp. 147-156 and Bundgaard 2010a, pp. 496-498 about the case. Because of the basic freedoms of the TFEU, the treatment of cross-border situations, however, must not be worse than the treatment of domestic situations.
\textsuperscript{708} Art. 3(1) Parent-Subsidiary Directive.
The directive also sets only the minimum requirement in respect of these situations. The Member States are also free to grant tax benefits similar to the benefits based on the directive in situations in which the holding is less than 10%.

**Capital or voting rights**

The Member States are free to replace the criterion of a holding in the capital by that of a holding of voting rights by means of bilateral agreements.709

**Two-year holding period**

Article 3(2) of the Parent-Subsidiary Directive includes an option for the Member States to deny the directive benefits in certain anti-avoidance situations. Member States have the option of not applying the directive to companies of that Member State that do not maintain the required holding for an uninterrupted period of at least 2 years or to companies in which a company of another Member State does not maintain the required holding for an uninterrupted period of at least 2 years.710

The Member States may require under their national laws that the required holding exists for a certain time period, which must not exceed 2 years. The time period required may be different in the case of parent companies and in the case of subsidiaries.

Even if a holding period requirement is included in the domestic law of a Member State it cannot be required that the time has already elapsed before the profit distribution took place. The time period requirement may also be met after the distribution. However, it is acceptable to first tax the distribution at the time of the distribution, if the holding requirement is then not yet met, and then afterwards to reimburse the tax.711

3.1.2.6. Profit distribution

**Broad concept**

It is clear that the Parent-Subsidiary Directive applies only in the case of intragroup profit distributions. The directive, however, does not include a

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definition of the term “profit distribution”. There is a general understanding according to which the term “profit distribution” is a somewhat broader term than the term “dividend”. For example, the Parent-Subsidiary Directive covers disguised or hidden dividend distributions. Also, a return on hybrid instruments may be considered to come under the scope of the directive if the return is classified as dividend for national tax law purposes and if the payer and the recipient are companies that qualify as companies that come under the scope of the directive.712

Hybrid mismatches, however, may create double non-taxation situations. Therefore, on 20 June 2014, the European Union’s Economic and Financial Affairs Council (ECOFIN) announced that the Parent-Subsidiary Directive will be modified to prevent double non-taxation via the use of hybrid financing arrangements. Member States are required to implement the amendments into their domestic laws by 31 December 2015. The Council adopted this amendment on 8 July 2014. The amendment includes a limitation of the exemption of payments received from hybrid financing arrangements. The state where the parent company is established must refrain from taxing profits distributed by a subsidiary in another Member State, only to the extent that such profits are not tax deductible by the subsidiary. If the profits are tax deductible by the subsidiary, the state of residence of the parent company shall tax the distribution in accordance with its domestic law.713

Capital gains

The term “profit distribution” does not cover capital gains from the sale or other alienation of the shares. The Member States are free to choose whether or not to tax capital gains of the parent company received from the sale of the subsidiary shares. Several Member States, however, have broadened their domestic law participation tax exemption to cover capital gains received by the parent company from the sale of its subsidiary shares in addition to dividends received by a parent company from its subsidiary.

Liquidation distributions

Concerning the tax treatment in the state of residence of the income recipient, article 4 of the Parent-Subsidiary Directive expressly excludes liquidation distributions paid to the parent company when the subsidiary is


liquidated. It seems, therefore, that the directive covers all situations in which the parent company or its permanent establishment receives a profit distribution from the subsidiary because of the shareholding relationship except the situation in which the subsidiary is liquidated. However, article 5 of the Parent-Subsidiary Directive (concerning the tax treatment in the state of residence of the subsidiary) does not expressly exclude liquidation distributions. Therefore, it is not completely clear whether the state of residence of the subsidiary must refrain from taxing liquidation distributions because of the directive.\footnote{Helminen 2010, pp. 226-230 and Helminen 1999, pp. 353-359.}

The EU Court, however, has confirmed that the liquidation distributions excluded from the scope of article 4 do not cover liquidation distributions made in connection with a dissolution of a company in the context of a merger by acquisition.\footnote{Punch Graphix (C-371/11).}

3.1.2.7. Other requirements

\textit{Primary rule}

The Parent-Subsidiary Directive determines exclusively the requirements that the Member States may include in their domestic law as requirements for the directive benefits to be available. For example, Member States must not require that a company conducts business in order for the directive benefits to be available. The type of the activities of the company is irrelevant as regards the application of the Parent-Subsidiary Directive.

\textit{Avoidance}

Tax benefits based on the Parent-Subsidiary Directive must be made available to companies that come under the scope of the directive except for clear tax-avoidance arrangements.\footnote{See secs. 2.3.3. and 3.1.4. about tax-avoidance situations.} Normally, the moment of the dividend distribution is decisive when determining whether the distribution comes under the scope of the directive. If a Member State applies a minimum holding period requirement, this requirement may also be met after the distribution moment. In tax-avoidance situations, a moment different from the moment when the distribution was made may be decisive.

\footnotesize
\begin{itemize}
\item \footnote{Helminen 2010, pp. 226-230 and Helminen 1999, pp. 353-359.}
\item \footnote{Punch Graphix (C-371/11).}
\item \footnote{See secs. 2.3.3. and 3.1.4. about tax-avoidance situations.}
\end{itemize}