Table of Contents

Foreword v
List of abbreviations vii

Chapter 1: Introduction 3
  1.1. The problem 3
  1.2. Purpose 6
  1.3. Definitions and terminology 10
    1.3.1. The principle of territoriality (in international law), the fiscal principle of territoriality and the principle of worldwide taxation 10
    1.3.2. Capital import neutrality and capital export neutrality 11
    1.3.3. The ability-to-pay principle and the benefit principle 14
  1.4. Limitations 15
  1.5. Previous research 19
  1.6. Method 21
    1.6.1. Legal method used in the dissertation 21
    1.6.2. Links with other disciplines 23
    1.6.3. Language 24
    1.6.4. Research method applied to the dissertation 25
  1.7. Outline 26

Chapter 2: International Law and Tax Jurisdiction over Foreign Business Income 31
  2.1. Introduction 31
  2.2. Jurisdiction in international law 33
    2.2.1. Introduction 33
    2.2.2. Principles of jurisdiction to prescribe 35
      2.2.2.1. The principle of territoriality as a jurisdiction principle in international law 36
    2.2.2.2. Other jurisdiction principles 39
    2.2.2.3. Conclusion 40
    2.2.3. Does international law require a genuine or minimum connection to exercise jurisdiction? 40
    2.2.4. Is there a hierarchy between the different jurisdiction principles to avoid concurring jurisdictional claims? 42
    2.2.5. Conclusion 44
### Table of Contents

2.3. Tax jurisdiction over foreign business income 45  
2.3.1. May a state take into account foreign elements when exercising jurisdiction to prescribe in the field of tax law? 45  
2.3.1.1. Introduction 45  
2.3.1.2. Tax jurisdiction on resident taxpayers: Is it compatible with international law to tax residents on their worldwide income? 47  
2.3.1.3. Tax jurisdiction on non-resident taxpayers: Is it compatible with international law to tax non-residents on worldwide income? 52  
2.3.2. Does international law impose a minimum connection to exercise tax jurisdiction? 54  
2.3.3. Overlaps between tax claims of several states: Does international law prohibit double taxation? 61  
2.3.4. May states refuse to take into account foreign elements when exercising their taxing powers? 62  
2.4. Conclusion 63  
2.4.1. Summary of the findings and illustration of states’ tax jurisdiction in relation to different territorial connections 63  
2.4.2. Member States’ fiscal sovereignty with regard to EU law 67

### Chapter 3: Taxation of Resident Companies on Income of Foreign Group Companies 71

3.1. Introduction 71  
3.2. Application of the principle of worldwide taxation to foreign companies’ profits: The Cadbury Schweppes case 73  
3.2.1. Introduction and presentation of the Cadbury Schweppes case 73  
3.2.2. Reasoning of the ECJ and choice of a comparator 76  
3.2.2.1. Comparison between the ownership in foreign and domestic subsidiaries 76  
3.2.2.2. Comparison of CFC rules with the taxation of inbound dividends 80  
3.2.2.3. Comparison of CFC rules with the taxation of a permanent establishment 83  
3.2.2.4. Conclusion 86  
3.2.3. Consequences of Cadbury Schweppes with regard to the principle of worldwide taxation 87
<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.2.3.1</td>
<td>CFC rules and the taxation of a non-resident’s foreign income</td>
<td>87</td>
</tr>
<tr>
<td>3.2.3.2</td>
<td>May a Member State favour the principle of worldwide taxation over the fiscal principle of territoriality for the prevention of tax avoidance?</td>
<td>89</td>
</tr>
<tr>
<td>3.2.3.2.1</td>
<td>CFC taxation – A means to prevent the abuse of EU law</td>
<td>90</td>
</tr>
<tr>
<td>3.2.3.2.2</td>
<td>The prevention of tax avoidance through CFC rules: Drawing the line between abusive and non-abusive situations</td>
<td>96</td>
</tr>
<tr>
<td>3.2.3.3</td>
<td>CFC rules imply a different treatment between domestic and foreign subsidiaries for the shareholder: Can Cadbury Schweppes be reconciled with FII Group Litigation?</td>
<td>98</td>
</tr>
<tr>
<td>3.2.4</td>
<td>Conclusion on CFC rules and the application of the principle of worldwide taxation at a group level</td>
<td>100</td>
</tr>
<tr>
<td>3.3</td>
<td>Deduction of negative income incurred by foreign group companies</td>
<td>101</td>
</tr>
<tr>
<td>3.3.1</td>
<td>Introduction</td>
<td>102</td>
</tr>
<tr>
<td>3.3.2</td>
<td>Presentation of the <em>Marks &amp; Spencer, Oy AA</em> and <em>X Holding</em> cases</td>
<td>105</td>
</tr>
<tr>
<td>3.3.2.1</td>
<td>The <em>Marks and Spencer</em> case</td>
<td>105</td>
</tr>
<tr>
<td>3.3.2.2</td>
<td>The <em>Oy AA</em> case</td>
<td>107</td>
</tr>
<tr>
<td>3.3.2.3</td>
<td>The <em>X Holding</em> case</td>
<td>108</td>
</tr>
<tr>
<td>3.3.3</td>
<td>The choice of comparator</td>
<td>109</td>
</tr>
<tr>
<td>3.3.3.1</td>
<td>Comparison between domestic and foreign group companies</td>
<td>110</td>
</tr>
<tr>
<td>3.3.3.2</td>
<td>Comparison between foreign subsidiaries and permanent establishments</td>
<td>112</td>
</tr>
<tr>
<td>3.3.3.2.1</td>
<td>Comparison between foreign subsidiaries and permanent establishments in <em>Marks &amp; Spencer</em></td>
<td>113</td>
</tr>
<tr>
<td>3.3.3.2.2</td>
<td>Comparison between foreign subsidiaries and permanent establishments in <em>X Holding</em></td>
<td>115</td>
</tr>
<tr>
<td>3.3.4</td>
<td>Relief for non-final losses incurred by foreign group companies</td>
<td>117</td>
</tr>
<tr>
<td>3.3.4.1</td>
<td>The <em>Marks &amp; Spencer</em> case</td>
<td>117</td>
</tr>
<tr>
<td>3.3.4.1.1</td>
<td>The justification level</td>
<td>118</td>
</tr>
<tr>
<td>3.3.4.1.2</td>
<td>The proportionality level</td>
<td>125</td>
</tr>
<tr>
<td>3.3.4.2</td>
<td>The <em>X Holding</em> case</td>
<td>128</td>
</tr>
<tr>
<td>3.3.4.3</td>
<td>The <em>Oy AA</em> case</td>
<td>130</td>
</tr>
<tr>
<td>3.3.4.4</td>
<td>Conclusion on the relief for non-final losses incurred by foreign group companies</td>
<td>131</td>
</tr>
</tbody>
</table>
Table of Contents

3.3.5. Relief for final losses incurred by foreign group companies 133
3.3.5.1. The relevance of cross-border loss relief within the internal market 134
3.3.5.2. Defining “final” losses 135
3.3.5.3. The discrepancy between international double taxation and the double non-deduction of final losses 138
3.3.5.4. The perspective from which final losses should be computed: Capital export neutrality vs capital import neutrality 141
3.3.5.5. Which group company should be granted relief for final losses? 144
3.3.5.5.1. Should loss relief be granted only to a parent company or could it also be granted to other group companies? 145
3.3.5.5.2. Granting loss relief to the parent company: The dilemma between direct and ultimate parent companies 147
3.3.5.6. Conclusion on the relief for final losses incurred by foreign group companies 148
3.3.6. Conclusion on losses incurred by foreign group companies 150
3.4. Conclusion of Chap. 3 150

Chapter 4: Taxation of Resident Companies on Foreign Business Income Earned through Permanent Establishments 153

4.1. Introduction 153
4.2. Application of the principle of worldwide taxation in the Member State of residence 155
4.2.1. Introduction 155
4.2.2. The Columbus Container case 158
4.2.2.1. Presentation of Columbus Container 158
4.2.2.2. Discussion of Columbus Container 159
4.2.2.2.1. Columbus Container and compatibility of the principle of worldwide taxation with EU law 160
4.2.2.2.2. Columbus Container and the prevention of tax avoidance: Can Columbus Container and Cadbury Schweppes be reconciled? 162
4.2.2.2.2.1. Comparing Columbus Container and Cadbury Schweppes 162

xii
<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.2.2.2.2. The apparent incompatibility between Columbus Container and Cadbury Schweppes</td>
<td>165</td>
</tr>
<tr>
<td>4.2.2.2.3. Compatibility with EU law of the non-discriminatory taxation of foreign income: Discrimination-based analysis vs restriction-based analysis</td>
<td>168</td>
</tr>
<tr>
<td>4.2.3. The Krankenheim case</td>
<td>176</td>
</tr>
<tr>
<td>4.2.3.1. Presentation of Krankenheim</td>
<td>176</td>
</tr>
<tr>
<td>4.2.3.2. Discussion of Krankenheim with regard to the taxation of foreign profits</td>
<td>177</td>
</tr>
<tr>
<td>4.2.4. EU law and the grant of a full tax credit</td>
<td>181</td>
</tr>
<tr>
<td>4.2.4.1. Introduction</td>
<td>181</td>
</tr>
<tr>
<td>4.2.4.2. Illustration of the potential advantages of a full tax credit and presentation of the Gilly case</td>
<td>183</td>
</tr>
<tr>
<td>4.2.4.3. May the objective of achievement of the internal market require granting a full tax credit?</td>
<td>186</td>
</tr>
<tr>
<td>4.2.5. Conclusion on the taxation of the positive income of permanent establishments</td>
<td>188</td>
</tr>
<tr>
<td>4.3. Application of the fiscal principle of territoriality in the Member State of residence</td>
<td>190</td>
</tr>
<tr>
<td>4.3.1. Introduction</td>
<td>190</td>
</tr>
<tr>
<td>4.3.2. Presentation of the Deutsche Shell, Lidl Belgium and Krankenheim cases</td>
<td>192</td>
</tr>
<tr>
<td>4.3.2.1. The Deutsche Shell case</td>
<td>192</td>
</tr>
<tr>
<td>4.3.2.2. The Lidl Belgium case</td>
<td>193</td>
</tr>
<tr>
<td>4.3.2.3. The Krankenheim case</td>
<td>194</td>
</tr>
<tr>
<td>4.3.3. Discussion of the solutions reached in Deutsche Shell, Lidl Belgium and Krankenheim with regard to foreign losses</td>
<td>195</td>
</tr>
<tr>
<td>4.3.3.1. Relief for non-final losses incurred by a permanent establishment</td>
<td>196</td>
</tr>
<tr>
<td>4.3.3.1.1. Consequences of the exemption method chosen in a tax treaty</td>
<td>196</td>
</tr>
<tr>
<td>4.3.3.1.2. The justification level</td>
<td>198</td>
</tr>
<tr>
<td>4.3.3.1.3. The proportionality level</td>
<td>200</td>
</tr>
<tr>
<td>4.3.3.1.4. Conclusion on the relief for non-final losses incurred by a permanent establishment</td>
<td>202</td>
</tr>
<tr>
<td>4.3.3.2. Relief for final losses incurred by a permanent establishment</td>
<td>205</td>
</tr>
<tr>
<td>4.3.3.2.1. Analysis of Lidl Belgium with regard to final losses incurred by a permanent establishment subject to the exemption method</td>
<td>205</td>
</tr>
</tbody>
</table>
4.3.3.2.2. The tax treatment of final losses in *Krankenheim* 206
4.3.3.2.3. Arguments pleading for granting relief for final losses incurred by a permanent establishment subject to the exemption method 208
4.3.4. Conclusion on the application of the fiscal principle of territoriality to permanent establishments 213
4.4. The possible requirement of most favoured nation treatment in the Member State of residence with regard to foreign business income 214
   4.4.1. Introduction 214
   4.4.2. The absence of requirement of a most favoured nation treatment in ECJ case law 216
   4.4.3. Arguments supporting the view that EU law should not require most favoured nation treatment as far as the taxation of business income is concerned 217
   4.4.4. Conclusion 220
4.5. Conclusion on the extent of the tax jurisdiction of the Member State of residence 220

Chapter 5: Taxation of the Foreign Business Income Attributable to a Permanent Establishment by the Member State of establishment 223

5.1. Introduction 223
5.2. Taxation of foreign positive income attributable to a permanent establishment 224
   5.2.1. Introduction 224
   5.2.2. ECJ case law transposed to the taxation of foreign positive income attributable to a permanent establishment 225
   5.2.3. Taxation of foreign positive income attributable to a permanent establishment: Tax policy considerations 227
   5.2.4. Conclusion 230
5.3. The tax treatment of foreign negative income attributable to a permanent establishment 230
   5.3.1. Introduction 230
   5.3.2. ECJ case law on the tax treatment of foreign negative income in the Member State of source 231
   5.3.2.1. The *Futura* case 231
   5.3.2.2. The *Centro Equestre* case 233
5.3.2.3.  The tax treatment of foreign negative income in the Member State of source according to case law applying the *Schumacker* doctrine: The *Renneberg* case 236
5.3.3.  Discussion of *Futura* and *Centro Equestre* with regard to foreign negative income attributable to a permanent establishment 239
5.3.3.1.  Introduction 239
5.3.3.2.  Attribution to a permanent establishment of costs originally borne by a foreign entity 242
5.3.3.3.  Foreign negative income incurred when a permanent establishment carries on business activities in a third state 245
5.3.3.4.  Application of the profit split method when the enterprise is globally loss-making 248
5.3.3.5.  Final losses incurred outside the territory of the Member State of establishment 251
5.4.  Conclusion on the tax jurisdiction of the Member State of establishment 252

Chapter 6: International Double Taxation and the Objective of Achievement of the Internal Market 255

6.1.  Introduction 255
6.2.  The relation between the EU Treaties and international double taxation 258
6.2.1.  Double taxation and the concept of an internal market 258
6.2.2.  Consequences of former Art. 293 TEC and its repeal by the Treaty of Lisbon 267
6.2.3.  International double taxation and Art. 6 TEU 269
6.2.3.1.  The possible legal value in the EU legal system of the European Convention for the Protection of Human Rights and the Charter of Fundamental Rights with regard to double taxation 271
6.2.3.1.1.  The possible legal value in the EU legal system of the Charter of Fundamental Rights with regard to international double taxation 271
6.2.3.1.2.  The possible legal value in the EU legal system of the European Convention for the Protection of Human Rights with regard to double taxation 274
Table of Contents

6.2.3.2. Possible consequences of the protection of possessions and the principle of *ne bis in idem* with regard to international double taxation 276

6.2.3.2.1. Possible consequences of the protection of possessions under Art. 6 TEU with regard to international double taxation within the internal market 276

6.2.3.2.2. Possible consequences of the principle of *ne bis in idem* under Art. 6 TEU with regard to international double taxation 280

6.2.4. Conclusion on the relation between the EU Treaties and international double taxation 282

6.3. The relation between ECJ case law and international double taxation 282

6.3.1. International double taxation may be incompatible with EU law 283

6.3.1.1. Double taxation may be incompatible with EU law as a consequence of the taxing rights exercised by the Member State of source 283

6.3.1.2. Double taxation may be incompatible with EU law as a consequence of the taxing rights exercised by the Member State of residence 287

6.3.1.3. Conclusion on situations of double taxation that may be incompatible with EU law 290

6.3.2. Double taxation as a result of the non-discriminatory tax jurisdiction exercised by a Member State 290

6.3.2.1. Double burdens in direct tax cases 291

6.3.2.2. Double burdens in the field of social contributions 295

6.3.2.2.1. The perspective of the host Member State 295

6.3.2.2.2. The perspective of the home Member State 296

6.3.2.2.3. Analysis of the different outcomes for social contributions and direct taxes with regard to double burdens 297

6.3.3. The acceptance of double taxation is difficult to reconcile with case law on double non-deduction of negative income 299

6.4. Conclusions on the relation between international double taxation and the objective of achievement of the internal market 302
# Table of Contents

## Chapter 7: Reconsidering Cross-Border Loss Relief: Should Final Foreign Losses Necessarily Be Deducted in the Home State?

7.1. Introduction 305

7.2. Requiring from the home state an automatic and unconditional relief for all the final losses incurred in the host state: A satisfactory solution? 308

7.2.1. An automatic and unconditional relief for all the final losses in the home state creates tax planning opportunities 308

7.2.2. An automatic and unconditional relief for all the final losses in the home state may contradict the arm’s length principle 313

7.3. Requiring from the host state a tax refund corresponding to the value of the final losses for tax purposes: A convincing alternative to the *Marks & Spencer* doctrine? 319

7.4. The suggested solution: A split of final losses between the home state and the host state 322

7.5. Possible methods for splitting the final foreign losses between the home state and the host state 327

7.5.1. Splitting the final foreign losses on the basis of an allocation key 328

7.5.2. Splitting the final foreign losses on the basis of the arm’s length principle 333

7.6. Conclusion 337

## Chapter 8: Summary and Conclusions

8.1. Introduction 339

8.2. Summary of the main findings of the dissertation 339

8.3. Reconciliation of the findings and discussion from a tax policy perspective 342

8.3.1. CFC taxation 343

8.3.2. Taxation of permanent establishments’ profits by the Member State of residence 344

8.3.3. Deduction of foreign losses incurred by foreign subsidiaries and permanent establishments subject to the exemption method 345

8.3.4. Taxation of foreign business income attributable to a permanent establishment by the Member State of establishment 348
<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>8.4.</td>
<td>Suggestions on possible future research about the conflict between the objective of achievement of the internal market and Member States’ taxation of companies’ foreign business income</td>
<td>349</td>
</tr>
<tr>
<td>8.5.</td>
<td>General conclusion</td>
<td>350</td>
</tr>
</tbody>
</table>

References 355

Other Titles in the IBFD Doctoral Series 395