



# **THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION**

May 2005

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## **PAPER III**

### **PRINCIPLES OF CORPORATE AND INTERNATIONAL TAXATION**

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B - EUROPEAN COMMUNITY OPTION

Answers

## Question 1

Key EU institutions, which have an impact on Member States' direct tax systems, include

- the Council of Ministers, (Council)
- the European Commission, (Commission)
- the European Parliament, (EP)
- the Court of Justice of the European Communities, (CJEC).
- Brief discussion of the EC Treaty provisions granting powers to the Community's Institutions and limiting such powers (Principle of attributed powers)

### The Council of Ministers and direct taxation:

- The Council adopts Community rules (e.g. Parent Subsidiary Directive, the Merger Directive, the Mutual Assistance Directive, the Savings Directive and the Interest and Royalties Directive)
- Brief discussion of secondary Community legislation and its effect on national direct tax systems
- Brief discussion on supremacy of Community law, direct effect and direct applicability
- Brief discussion of the provisions of the EC Treaty giving the Council its powers
- Brief discussion on the provisions of the Treaty where the Council is given powers with an impact on direct tax matters in corporate sphere (e.g. the freedom of establishment/services/capital)

### The European Commission and direct taxation:

- The Commission drafts Community legislation (power of initiation)
- The Commission acts as the Community's civil service
- The Commission acts as Community enforcer ( e.g. Commission v France - "Avoir Fiscal") and brings infringement proceedings (brief discussion of EC Treaty provisions giving powers to the Council)
- The Commission's powers in relation to State Aids (brief discussion of the Commission's [powers and duties in this area])
- The Commission's role in the legislative process (brief discussion of its powers under the EC Treaty in this respect, and on the role of the President of the Commission).

### The European Parliament and direct taxation:

- The role that the EP plays in the legislative process (brief discussion of the EC Treaty provisions relating to the EP and its role in making Community rules relating to direct taxation)
- Example – the role the EP played in relation to the Saving Directive
- The Consultative role of the EP
- EP Communications and consultative documents
- EP power to ask the Commission for legislation

- The EP power of veto over legislation
- The EP power of assent over international agreements such as Association agreements which have an effect on direct tax systems.

The Court of Justice of the European Communities and direct tax matters:

- The role of the CJEC (brief discussion of the EC Treaty provisions)
- Brief discussion of the case law of the CJEC and its impact on national tax systems (e.g. *Metallgesellschaft* and the GLO's)
- Brief discussion on how the CJEC fits into the Community scheme and how national courts are linked to it (e.g. the Preliminary ruling procedure – e.g. *Manninen* case)
- The role of the CJEC in relation to infringement proceedings (e.g. *Commission v Belgium* – “Eurobonds”)

General discussion of the topic	5 marks
Discussion concerning each institution	<u>20</u> marks
Total	<b>25</b>

Question 2

The question breaks down into two sections

- a discussion of the concept of state aid in relation to Insurance Premium Tax (IPT)
- an analysis of the state aid issues raised in *Lunn Poly* and *GIL Insurance*

Concept of State Aid:

- Brief discussion of the EC Treaty provisions on State Aid – the components of what is an “aid” (caselaw relating to the concept of State Aid e.g. *SFEI, Italy v Commission, GEMO*)
- Brief discussion of the Commission Guidelines on State Aids
- Brief discussion of the exceptions concerning State Aids
- Brief discussion of Commission powers in the area of State Aids
- Brief discussion of the IPT and the differential rates in *Lunn Poly* and *GIL Insurance*

*Lunn Poly*:

- Court of Appeal case which held there was a state aid
- Discuss the facts and the basic state aid arguments in the case
- The significance of the components of State Aid “distortion of competition” and “affect trade between Member States”
- Concept of (1) “aid” (2) granted by a Member State or through State resources in any form whatsoever which (3) distorted or threatened to distort competition and (4) which affected trade between Member States.
- Discussion on the “effect” of the introduction of the “lower rate”

- Discussion on the concept of “selectivity” (clearly defined part of a group providing travel insurance) – note the significance of this point and how it was distinguished in *GIL Insurance* by the ECJ

#### *GIL Insurance*:

- Decision of the ECJ
- Brief discussion of the facts
- Brief discussion of the arguments in the case
- Brief discussion of the holding – not a state aid – and of how the ECJ distinguished *Lunn Poly* reasoning –
- Discussion of the comparison test adopted by the ECJ: compared to others in “a comparable legal and factual situation” and “in the light of the objective pursued by the” tax system in question (*Adria-Wien Pipeline* case) – condition of selectivity not satisfied by a measure which is justified by the nature or general scheme of the tax system
- Discussion of the reason for the higher rate IPT in *GIL Insurance*
- Discussion on the findings of the ECJ – imposition of the higher rate of IPT not intended to confer an advantage in *GIL Insurance* situation and its relationship with the VAT system in the UK
- Discussion of the justification accepted by the ECJ in its finding that the differential IPT rates were not a state aid
- Conclusions on the two cases – *Lunn Poly* and *GIL Insurance*.

General discussion on concept of State aid	15 marks
Analysis of <i>Lunn Poly</i> and <i>GIL Insurance</i>	8 marks
Conclusions	<u>2</u> marks
Total	<b>25</b>

#### Question 3

Main cases – “*Avoir Fiscal*”, *Biehl*, *Daily Mail*, *Schumacker*, *Commerzbank*, *RBS*, *Halliburton*, *ICI*, *Futura*, *Metallgesellschaft*, *Bosal*, *AMID*, *Saint-Gobain*, *Sandoz*, *Marks and Spencer*, *Bachmann*, *Danner*, *Skandia*, *Eurowings*, *Manninen*.

#### Concept of discrimination:

- Brief discussion of the provisions of the EC Treaty concerning prohibition of discrimination (“General” and “Special” provisions/freedoms)
- Starting point – Article 12 EC Treaty – “without prejudice to the special provisions”
- Overt and covert discrimination (brief discussion of the difference e.g. *Sotgiu*, *Biehl*, *Schumacker*, *Commerzbank*, *Halliburton*)
- Justifications (brief discussion on the distinction between direct and indirect discrimination on grounds of nationality – and what justifications can be proffered)
- *Schumacker AG* Opinion – distinction between resident and non-resident and discrimination on grounds of residence equated with indirect/covert discrimination on grounds of nationality – *Sotgiu*)

#### Concept of restriction:

- Brief discussion of the EC Treaty provisions (Article 3(1)(c), Article 14 and the fundamental freedom provisions)
- *Dassonville*, *Bosman* and *Keck*: brief discussion
- *Futura* – discrimination analysis and restriction analysis
- Origin State (*Dail Mail*) and Host state (*Avoir Fiscal*) distinction (brief discussion of *Marks and Spencer* case)
- Restrictions and the fundamental freedoms (Discussion of freedoms pertaining to companies – establishment (*Daily Mail*, *Halliburton*, *Metallgesellschaft*, *Bosal*, *AMID*, *RBS*), capital (*Baars*, *Verkooijen*, *Manninen*), services (*Eurowings*, *Skandia*))

#### Concept of justification:

- Derogations contained in the EC Treaty
- *Cassis de Dijon* and “judge-made” justifications (e.g. *Bachmann/Danner/Skandia*)
- *Bachmann* defence – “cohesion of the tax system” (*Wielockx*, *Asscher*: limits, *Danner*, *Manninen*)
- Territoriality (*Futura*, *Manninen*) – effective fiscal supervision – significance of Mutual Assistance directive
- Loss of Tax Revenue (*Avoir Fiscal*)
- Administrative difficulties (*Avoir Fiscal*)
- Tax Treaties (*Avoir Fiscal*, *Wielockx*, *Asscher*)
- Other advantages (*Avoir fiscal*, *Eurowings*)
- Resident/non-resident distinction (*Avoir Fiscal*, *Schumacker*)
- *Gebhard* criteria – non-discriminatory, public interest, proportional and necessary (Discussion of the Principle of Proportionality)
- Discussion of the cases illustrating any of the above or related points – (e.g. *Futura* as an example of all three elements: discrimination, restriction and justifications).

Case law analysis	10 marks
Discussion concerning discrimination	5 marks
Discussion concerning restrictions	5 marks
Discussion concerning justifications	5 marks
Total	<b>25</b>

#### Question 4

##### **Memorandum**

Dated:

From:

Re:

##### **The European Convention on Human Rights**

- Discussion concerning the provisions of the European Convention for the Protection of Human Rights and Fundamental Freedoms, 1950 relevant to taxation

- General principle of Community law (e.g. *Internationale Handelsgesellschaft*, *Molenheide Garage*)
- TEU – Article 6 “respect for human rights and fundamental freedoms”
- Right to a fair trial – right to enjoyment of property – right to non-discrimination – right of privacy – applicability to tax matters
- Right to a fair trial (components right to a court, right to a public hearing, right to determination within a reasonable time-frame, right to an independent and impartial tribunal) – civil and criminal cases (*Ferrazzini*, *Bendenoun*, *Vasteborg Taxi*), social security matters (*Schouten and Meldrum*), administrative penalties (*Lindsay*, *Louloudakis*) – other rights in criminal cases (right to legal aid, right of silence and presumption of innocence) (*Funke*, *King*)
- Article 1 First Protocol – right of peaceful enjoyment of property – applicability to tax matters (e.g. excessive burden, lack of legal certainty, retrospective legislation) – wide discretion given to States in tax matters (*Fratrik*, *Dangeville*)
- Non-discrimination: Article 14 – not a stand-alone provision – application of different treatment of objectively similar persons – principle of proportionality and justifications (*Darby v Sweden*, *Crossland*, *Louloudakis*)
- Article 8 – right to respect for private and family life (*Funke*, *Tamosius*)
- Discussion of Human Rights Act 1998 and any appropriate UK cases.

Drafting Memorandum and overall presentation	2 marks
Discussion of ECHR and case law	5 marks
Right to Fair trial analysis	7 marks
Right to enjoy property	5 marks
Non-discrimination discussion	2 marks
Right to privacy	2 marks
Conclusions	2 marks
Total	<b>25</b>

#### Question 5

- Discussion of the facts of the Cadbury Schweppes case and how the UK’s CFC rules apply (briefly) and their purpose – “piercing the corporate veil.”
- Discussion of the Community rights involved – establishment/capital/services
- Is there discrimination involved?
- Is there a restriction of a fundamental freedom
- Are there any justifications? (Tax avoidance? Loss of tax revenue? Prevents Deferral?)
- Principle of proportionality
- Origin State/Host State distinction.
- Cases – Baars, Manninen, Verkooijen, Metallgesellschaft, Avoir Fiscal, Daily Mail, Commerzbank, Halliburton, RBS, Schumacker, ICI, Marks and Spencer, Sandoz, Eurowings, De Lasteyrie, Lankhorst, Bachmann, Danner, Skandia.
- Discussion of the issues raised by the Special Commissioners and the parties –
  - Is establishing subsidiaries in another Member State solely to gain the benefit of a more favourable tax regime an abuse of the fundamental freedoms or merely an exercise of such rights?
  - Are the UK CFC rules a restriction on the exercise of the freedom of establishment?

- Is there any significance in the fact that Cadbury's Schweppes would pay the same tax as a UK company with subsidiaries in the UK?
- Express an opinion on the issues and the likely outcome of the case, and what it may mean for the UK's CFC rules
- Mention CFC GLO which has been referred to the ECJ and the questions asked for a Preliminary Ruling

Identifying the issues and cases	5 marks
Discrimination analysis	5 marks
Restriction analysis	5 marks
Justification analysis	5 marks
Conclusions and overall discussion	<u>5</u> marks
Total	<b>25</b>

### Question 6

Main secondary legislation relating to companies operating in the Internal Market:

- Parent Subsidiary Directive
- Merger Directive
- Interest and Royalties Directive
- Mutual Assistance Directive
- In the Transfer pricing area – the Arbitration Convention (International agreement)

### Parent-subsidiary directive:

- Where parent and subsidiaries are located in different Member States – designed to eliminate tax obstacles when dividends are distributed between groups of companies
- Abolished withholding taxes on payments of dividends between associated companies in different Member States
- Prevented double taxation of parent companies on the profits of their subsidiaries
- Recently amended – increasing the list of “companies” covered by the directive (now covers certain co-operatives, mutual companies, savings banks, the European Company –[SE], and the European Co-operative Society from 2006); reduction of the participation threshold from 25% to 10% over a transitional period (20% from January 05, 15% from January 07, 10% from January 09); eliminated double taxation for subsidiaries of subsidiary companies (indirect tax credit must also be granted relating to the taxation of sub-subsidiaries)
- The amended directive applies to the new Member States.
- Cases to consider and discuss include – *Denkavit*, *Leur-Bloem*, *Epson*, *Athinaiki-Zythopoiia*, and *Oce van der Grinten*.

### Merger Directive:

- The Merger Directive provides for a common set of rules applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies located in different Member States
- The directive has been recently amended
  - The list of companies covered by the directive has been amended (including the SE and European Co-operative Society from 2006)
  - Certain transparent entities – subject to some exceptions
  - New transactions – (e.g. a special division known as a “split off”)
  - A CGT exemption when the receiving company holds shares in the transferring company
  - Relief for the conversion of branches into subsidiaries
  - New rules governing the transfer of the registered office of the SE (tax deferral where assets remain connected with a PE situated in the Member State from which it is moving).

### Case law to discuss

- *Andersen og Jensen*

### Interest and Royalties Directive:

- This directive provides for common rules on the taxation of interest and royalty payments made between associated companies located in different Member states
- Intended to eliminate tax obstacles in the area of cross-border interest and royalty payments within a group of companies – abolishing withholding taxes on royalty payments arising in a Member State; and abolishing withholding taxes on interest payments arising in a Member State
- Exemption from taxes provided that the beneficial owner of the payment is a company or PE in another Member State
- Benefits are granted to certain companies (subject to CT in the EU, tax resident in an EU Member State, and of a type listed in the annex to the Directive)
- Annex has been amended to cover the new EU Member States (subject to certain transitional exceptions)
- New list – proposed amendment to include the SE and the European Co-operative Society
- Case law – none to date.

### Mutual Assistance Directive:

- Objective – speed up the flow of information between Member States' tax authorities
- Relates to income, corporation and capital gains taxes, and Insurance Premium tax
- Enables Member States to co-ordinate their tax investigations and to carry out more procedures on behalf of each other
- Case law – e.g. *Bachmann*, *Verkooijen*, *Danner*, *Skandia*, *Safir* and any other ECJ cases where the ECJ indicates that the Mutual Assistance Directive may be used by the Member States



Other points of interest that might be covered briefly include:

- Transfer Pricing / Arbitration Convention
- The European Company
- Savings Directive (relating to Individuals)
- The Tax Package
- State Aids
- Capital Duties and cases
- European Economic Interest Grouping
- European Economic Area Agreement

Conclusion on the effect that the common rules have for EU companies.

Overall discussion of the Community's Secondary legislation in the tax arena together with the relevant case law	5 marks
Parent Subsidiary Directive	4 marks
Merger Directive	4 marks
Interest and Royalties Directive	4 marks
Mutual Assistance Directive and Arbitration Convention and Conclusions	8 marks
Total	<b>25</b>

### Question 7

Report on the Impact of Community Law on the Taxation of Dividends

- (a) when a dividend is paid by a company resident in Member State A to a company resident in Member State B (inbound and outbound dividends) (Intra-EU)
- (b) a dividend is paid by a company resident in Member State C to a company resident in a third country (D) (outbound and inbound dividends) (Involves a Third Country)
- Brief discussion of the EC Treaty provisions relating to free movement of capital –
  - Member State-Member State and
  - Member State-Third Country situations
- Brief discussion of each of the cases – *Saint-Gobain* (Third Country dividends), *Verkooijen*, *Lenz and Manninen* (Intra-Community dividends)
- Brief discussion of discrimination, restriction and justification in each of the cases related to dividends
- Brief discussion of *Avoir Fiscal*
- Brief discussion of EFTA Case – *Fokus Bank* (outbound dividends)(Optional)
- Brief discussion of *Lasertec* (German Third Country and Article 57(1) case referred to ECJ) (Optional) and *Sanz de Lera* (Third Country ECJ case) and Third Country exceptions
- Conclusion on dividends – impact on Member States' imputation systems – impact and relevance for companies resident in countries operating incompatible dividend taxation systems (e.g. UK)

- Brief discussion on UK GLO's
- Brief discussion on *Marks and Spencer* (Optional)
- Overall conclusions for your Report.

Drafting Report and overall presentation	2 marks
Member State-Member State dividend analysis including cases	10 marks
Member State-Third Country dividend analysis including cases	10 marks
Overall conclusions	<u>3 marks</u>
Total	<b>25</b>