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Removal of tax obstacles to the cross-frontier activities of companies

EUROPEAN COMMUNITIES

Commission

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Contents

Preface 5

Guidelines on company taxation 7

Introduction 7

First part: The tax problems to be resolved and the measures to be implemented before 1993 7

Second part: Problems of company taxation raised by the development of the internal market 11

Conclusions 12

Annexes 13

Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States 21

Annex: List of companies referred to in Article 3 (a) 25

Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States 27

Annex: List of companies referred to in Article 2 (a) 30

Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises 31

Final act 38

Joint declarations 42

Unilateral declarations 43

Proposal for a Council Directive on a common system of taxation applicable to interest and royalty payments made between parent companies and subsidiaries in different Member States 47

Explanatory memorandum 51

Proposal for a Council Directive concerning arrangements for the taking into account by enterprises of the losses of their permanent establishments and subsidiaries situated in other Member States 55

Explanatory memorandum 60

Reference documents 67

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Preface

In the context of the single market, the Commission's prime objective is to ensure that companies operating in two or more Community countries are not penalized on tax grounds and thus placed at a disadvantage compared with companies whose activities are restricted to national territory.

In order to achieve that objective and to make the single market more and more a reality for companies, all forms of double taxation in the Community must disappear by 1 January 1993.

A vital step was taken in July 1990, when, with the adoption of three proposals which had been under discussion in the Council of Ministers for 20 years, many of the tax obstacles to cross-frontier activity by companies were removed.

Since then, I have put forward, on behalf of the Commission, two further proposals for directives designed to facilitate the cross-frontier operations of Community companies by eliminating other forms of double taxation which impede the activity of groups of companies established in two or more Member States.

It is hoped that these two proposals can be adopted as speedily as possible in line with companies' expectations.

By publishing these two proposals in this *Supplement to the Bulletin*, the Commission is aiming, above all else, to bring to the attention of the public and, in particular, of firms the results of the efforts it has made to ensure that completion of the single Community market is no longer hampered by tax costs which do not exist in Member States' domestic markets and which stem from the compartmentalization of domestic markets.

Christiane Scrivener
Member of the Commission
of the European Communities

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Guidelines on company taxation

1. The purpose of this communication is to set out the guidelines which the Commission plans to follow in the field of company taxation and the measures which it thinks should be taken at Community level to create a company tax environment tailored to the establishment and further development of the internal market.

2. The first part of the communication is given over to an examination of the tax problems that will need to be resolved between now and completion of the internal market by the end of 1992. The general analysis is supplemented by an account of the measures that should be taken as a matter of priority between now and 31 December 1992.

The second part examines the procedure to be followed in the face of closer integration of Member States' economies.

Introduction: A tax strategy geared to the requirements of economic integration

3. According to conventional economic analysis, any form of company taxation is liable to bring about economic distortions (lack of neutrality) because it may give rise to decisions on the location, nature and financing of investment that would not have been taken in the absence of company taxation. Such distortions arise because company taxation introduces a bias into the relationship between an investment project's economic rate of return and the after-tax rate of return to the investor. It should be pointed out that in the Community context the extent of this tax bias on an investment project may vary between Member States depending on differences in the tax base, the rate of tax and, sometimes, the characteristics of the tax system.

4. From a theoretical viewpoint, the possibility could therefore be considered of harmonizing national company tax systems at Community level so as to ensure complete tax neutrality.

5. However, there are a number of basic considerations why the Community should hold back on the harmonization of company tax systems in the Member States, particularly in view of the principle of subsidiarity.

Member States should remain free to determine their tax arrangements, except where these would lead to major distortions.

A further analysis is necessary to check the possible existence and extent of such distortions, and particularly those which might affect decisions as to the location of investment.

Quite apart from the differences in the tax burden on companies, there are many other factors determining the decisions of direct investors. These include, for example, the need to locate a project close to the market served, differences in labour costs, the quality of public services and economic infrastructures.

6. In view of these factors, the Commission has reached the conclusion that Community action should concentrate on the measures essential for completing the internal market. The important question of the advisability and possible forms of the harmonization of company taxation should be re-examined closely and on new bases before any proposals can be presented.

First part: The tax problems to be resolved and the measures to be implemented before 1993

The main tax problems posed by cross-frontier cooperation

7. The Single European Act defines the internal market as 'an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured ...'.

8. At the present time, there are 12 tax territories in the Community, each with its own tax system. Each

of these systems is complete as regards the internal situation of the Member State concerned. By its very nature, national legislation provides for the unilateral tax treatment of the activities of companies. That legislation frequently entails tax treatment which places cross-frontier activities at a disadvantage compared with national activities and leads in particular to double taxation; and this in turn places an equivalent, extra burden on companies.

9. Now, one of the aims of the internal market is to enable companies to operate throughout the Community without falling foul of legislative frontiers or obstacles. The economic benefits of the internal market will flow from the expansion of companies' transnational activities. National legislation must, therefore, be adapted to that objective. Given the magnitude of the differences between national systems, Community measures are needed.

10. Although bilateral double taxation agreements have in come cases helped to reduce the extent of these obstacles, they are far from providing a satisfactory answer to the requirements of the internal market. This is because they do not cover all bilateral relations between Member States,[1] they do not achieve complete abolition of double taxation and, in particular, they never provide any uniform solution for triangular and multilateral relations between Member States.

11. In the case of the setting-up of transnational companies, the obstacles encountered stem from the system of taxation of capital gains realized on mergers, divisions, contributions of assets or exchanges of shares between enterprises from different Member States.

Although taxation of such operations within a Member State is generally deferred until the capital gains are actually realized, there is no such possibility for transnational operations, where the resultant tax cost may be such that they are no longer worth while.

Such obstacles are not restricted only to companies with share capital but may also affect enterprises which do not have legal personality, which is the case, for example, with many small and medium-sized firms (SMEs).

12. In the case of the functioning of groups of companies, the tax obstacles are manifold. The most important obstacle lies in the withholding taxes applied by a large majority of Member States to dividends distributed by a subsidiary in a particular Member State to its parent company in another Member State.[2]

13. A second category of obstacle involves double taxation resulting from adjustments in transfer prices made by Member States according to different rules and procedures.

Such economic double taxation arises between associated enterprises where transactions are not carried out at market prices but at internal prices, known as 'transfer prices'. National tax administrations may decide to adjust these prices if, in their view, they do not correspond to the prices that would be fixed between independent enterprises under conditions of unrestricted competition. Where the upward adjustment of a price which is deemed to be too low by the tax administration in a Member State is not accompanied by a corresponding reduction in the tax base in the other Member State, double taxation occurs.

At the moment such double taxation can admittedly be resolved by way of the amicable procedure provided for in bilateral conventions, in accordance with Article 25 of the model OECD Convention. However, while the amicable procedure must be initiated in all cases, it does not require the administrations concerned to reach an agreement. In practice, therefore, this instrument has shown itself incapable of resolving all cases of double taxation.

14. A third factor penalizing transfrontier activities is the absence in many cases of national provisions allowing an enterprise to set against its profits the losses incurred by its permanent establishments or subsidiaries abroad.[3]

The inequality of treatment where transfrontier activities are concerned is particularly striking in the case of permanent establishments. Whereas the results of establishments in the Member State in which the head office is located form an integral part of the results of the enterprise, the mere existence of a frontier between a permanent establishment and the head office means, in some Member States, that losses incurred by the foreign permanent establishment are not deductible from profits made by the head office. As a result, the enterprise pays an amount of tax that is excessive in terms of its total net results, since tax is applied to the results achieved solely in the Member State in which the head office is located.

This problem does not arise in Member States which take into consideration the profits or losses of a for-

[1] See Annex 1.
[2] See Annex 2.
[3] See Annex 3.

eign permanent establishment and which, in the case of profits, avoid double taxation by crediting the foreign tax against their own tax (imputation or tax-credit method). In addition, some Member States which exempt the profits of the foreign permanent establishment allow deduction of foreign losses. To the extent that the permanent establishment earns profits in a subsequent year, the sums deducted are re-incorporated into the head office's results and taxed.

Such inequality of treatment in respect of transfrontier activities also affects subsidiaries, although the legal position is not the same as in the case of permanent establishments. This is because subsidiaries have legal personality and, even where subsidiaries set up on national territory are concerned, not all Member States allow their losses to be set off against the parent company's profits and, where this is allowed, it is subject to restrictive conditions.

15. There are also obstacles that impede the flows of royalties and interest within groups of companies. While such payments do not attract withholding tax within a Member State, widely differing rates of withholding tax are levied in the case of most international relations.[1] In theory, such withholding taxes can, it is true, be set off against the tax payable by the recipient enterprises. However, leaving aside the fact that this is not always possible, implementation of the provisions of bilateral agreements laying down reduced rates invariably entails administrative formalities that are often cumbersome and costly.

16. The removal of all of these tax obstacles currently preventing or impeding cross-frontier business activity within the Community is one of the Community's priority tasks. To that end, it is necessary to implement as soon as possible a series of measures whose adoption should be facilitated by the fact that they do not affect the essence of national tax systems and their budgetary consequences are relatively limited.

Measures to be implemented as soon as possible

17. The Commission has already presented three proposals for Directives on this subject together with a tax measure linked to the proposal on the Statute for a European company. It will shortly present two further proposals and it intends to take certain measures relating to the tax environment of companies.

Proposals already presented

18. The Commission has put forward a package of three proposals for Directives designed to encourage cooperation between enterprises from different Member States:

The 'mergers' Directive

19. This proposal provides for any capital gains arising from a merger, a division or contribution of assets or an exchange of shares to be taxed not at the time of the operation in question but only when capital gains are actually realized. It specifies the conditions which Member States may impose on the deferral of taxation.

The adoption of this proposal is important for the actual formation of European companies by merger, which is the principal method of formation provided for in the draft Statute for a European company presented by the Commission in August 1989.

The 'parent companies and subsidiaries' Directive

20. This proposal is intended to eliminate the double taxation of the dividends distributed by a subsidiary established in one Member State to its parent company established in another Member State. To that end, it provides for:

- the Member State in which the subsidiary is established to abolish any withholding tax;

- the Member State in which the parent company is established to exempt the dividends or else to tax them while at the same time imputing the tax charged in the Member State in which the subsidiary is established against its own tax.

The 'arbitration procedure' Directive

21. The third proposal provides for the introduction of procedures designed to ensure, within specified periods, the elimination of double taxation that occurs in connection with the adjustment of the profits of associated enterprises when an upward adjustment in an enterprise's profits in one Member State is not accompanied by a corresponding adjustment in

[1] See Annex 4.

the results of the other enterprise in another Member State. To that end, it provides, firstly, for the general application of the amicable procedure already provided for in bilateral double taxation agreements and, secondly, for the introduction of an arbitration procedure which must be initiated automatically in the event of the failure of the amicable procedure and which must lead to the elimination of double taxation.

22. As most of the problems raised by these three very old proposals in the Council have been resolved, the Commission considers it essential for the Council to adopt them as soon as possible, as it was urged to do by the European Council at its meeting in Strasbourg in December 1989.

Proposals to be presented

Need for account to be taken of foreign profits or losses

23. In its proposal for a Council Regulation on the Statute for a European company, the Commission included provisions (Article 133) stipulating that, where, during a tax period, the aggregation of profits and losses of the permanent establishments which a European company has in a Member State or third country results in a net loss, that loss may be offset against the profits of the European company in the Member State where it is resident for tax purposes.

24. The Commission considers that the provisions permitting foreign losses to be taken into account at company level should apply to all companies engaged in transnational activities. It will, therefore, shortly present a proposal for a Directive covering all companies irrespective of legal status, including SMEs.

That proposal will also deal with the treatment of losses of subsidiaries established abroad.

25. The practical implementation of the solutions set out in the two previous points will be greatly facilitated if all Member States apply the same arrangements for the carry-forward or carry-back of losses for tax purposes. Those arrangements currently differ — in some cases appreciably — as regards the possibility of carry-back, the length of the period of carry-forward and the definition of the losses which may be carried forward or back. [1]

In 1984, the Commission presented a proposal for a Directive on the harmonization of systems for the carry-forward and carry-back of losses for tax purposes, on which the Council has not yet taken a decision. It urges the Council to resume its examination of that proposal, which has been held up for a number of years, with a view to its speedy adoption.

The abolition of withholding taxes on interest and royalty payments within groups of companies

26. The Commission will shortly propose that these taxes be abolished altogether. Arrangements could be made for their gradual abolition to help those Member States which are major net importers of capital and technology and for which the taxes on these payments represent an appreciable source of tax revenue.

Other measures to be taken

Rules and regulations governing transfer pricing

27. The implementation of the provisions relating to the arbitration procedure will guarantee the abolition of economic double taxation occurring between associated enterprises.

While that procedure undoubtedly represents an improvement compared with the present situation, the best solution would be to prevent any double taxation.

The Commission therefore proposes to carry out a systematic examination of Member States' rules and regulations on transfer pricing (the differences in which constitute the main cause of double taxation) with a view to making them more uniform. It will also examine with the Member States the conditions under which a cooperation procedure could be established between the administrations concerned where one of them intends to adjust the profits of an associated enterprise. The organization of simultaneous tax checks on companies or establishments of a multinational company situated in different Member States could greatly facilitate such cooperation.

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[1] See Annex 5.

Transparency of incentives

28. In almost all the Member States, company taxation is used as a vehicle for incentives through which economic or structural policy objectives are pursued. Of course, where such measures take the form of aid, the Treaty rules on competition apply.

The difficulty stems from the lack of transparency of these specific tax measures. Most of them take the form of special tax rules and regulations concerning the tax base. They are also increasingly making the tax base more complicated, for example in the field of depreciation. In addition, for SMEs, this lack of transparency and complication may be prejudicial and may impede the development of cross-frontier activities.

There is absolutely no intention of questioning the aim of these tax incentives, provided that the Treaty obligations are observed.

However, Member States should examine their legislation to ensure that incentives applied are more transparent. For example, incentives in the form of base reductions could be converted into tax credits or rate reductions.

Direct application of the Treaty

29. Furthermore, in the absence of Community legislation in certain fields, it is essential that the Treaty be applied. In particular, the free movement of capital cannot be hindered by tax measures which do not guarantee the principle of equality of treatment.

Second part: Problems of company taxation raised by the development of the internal market

The need for new longer-term guidelines

30. The problems of tax harmonization at Community level were examined as long ago as the first half of the 1970s by various *ad hoc* committees, in particular the Werner Committee, in the context of the approach to economic and monetary union. Subsequently, in 1975, the Commission presented a proposal for a Directive on the harmonization of systems and rates of company taxation in the Member States. Its aim was to limit the economic double taxation of distributed dividends.

That proposal, which has not been discussed by the Council or the European Parliament for more than 10 years now, was based on a centralized approach to tax harmonization and economic and monetary union.

Since then, and in particular since the Single European Act and the Report on economic and monetary union in the European Community drawn up in April 1989 at the request of the European Council, a new approach to economic integration has been defined.

This approach gives priority to the coordination and approximation of policies rather than to systematic use of harmonization. It is also clearly in keeping with the principle of subsidiarity (see First part).

In the tax field, priority has been given to removing tax barriers to completion of the internal market and, in particular, to abolishing all forms of double taxation between now and 1993.

Under the circumstances, the 1975 proposal, which, in any case, no longer corresponds to the current situation in the Community or world-wide, has ceased to meet the needs, associated with development of the internal market beyond 1992. Moreover, some instances of double taxation between Member States can be resolved in other ways.

It would therefore be logical to withdraw that proposal.

31. However, the matter cannot be left there. With the completion of the internal market between now and the end of 1992, physical and technical barriers will disappear and the differences between tax systems in the Member States may well become increasingly apparent and influence investment decisions. In this situation of more rapid integration, the question arises as to whether further action on direct company taxation is necessary at Community level.

32. It is true that competition between the different economies already constitutes a powerful stimulus to the approximation of national legislation in the company taxation field, and the gradual completion of the internal market will further amplify that phenomenon.

For example, the tax base and the rates of corporation tax have undergone fairly marked changes in recent years in most Member States following the reform which was undertaken by the United Kingdom and the United States of America, and which consisted of cutting nominal tax rates while at the same time broadening the tax base. This reform offers the advantages of transparency and simplification, which should prove particularly beneficial to SMEs.

33. However, the question arises as to whether, in view of the relatively major differences between Member States as regards the tax burden on companies, [1] this spontaneous alignment will alone be sufficient to meet the needs of an integrated market and whether it will lead to economically desirable taxation.

Finally, any attempt by Member States to outbid each other too much in cutting company taxation would not be without its problems, whether in terms of loss of resources for national budgets or of equity as regards its impact on the distribution of the tax burden within each Member State between the various taxes and charges.

Study of new proposals

34. Under these conditions and in order to be able to examine whether or not new measures are advisable, the Commission sees a need for a fresh study which will have to take account, firstly, of the current state of, and prospects for, Community integration and, secondly, of the results of the major tax reforms of the 1980s, both inside and outside the Community.

35. This study will be entrusted to a committee made up of independent persons chosen for their expertise. This committee, for which the Commission will provide the secretariat, will have to submit its report within a maximum period of one year.

The study will have to answer the following main questions:

(a) Do the disparities which exist between corporation taxes [2] and the tax burdens on companies from one Member State to the next induce distortions in investment decisions affecting the functioning of the internal market?

(b) If so, can those distortions be eliminated simply through the interplay of market forces and competition between national tax systems or are Community measures required?

(c) Should any action at Community level concentrate on one or more elements of company taxation, namely the different corporation tax systems, the differences in tax treatment associated with the legal status of companies, the tax base or rates?

(d) Should any measures envisaged lead to harmonization, approximation or the straightforward establishment of a framework for national taxation? What would be the effect of such measures or the absence of such measures on Community objectives such as cohesion, environmental protection and fair treatment of small and medium-sized firms?

In the light of this study, the Commission will decide what proposals for measures it should present to the Council.

Stepping-up of consultations

36. In order to promote cooperation with representatives from the Member States, the Commission considers that consultations should be stepped up in this field between those responsible for taxation policy in the various Member States. Meetings should be held at regular intervals, at least once or twice a year, to exchange information and viewpoints with the Commission on the main proposals. Such consultation should make it easier for Member States to take account, in pursuing their national tax policies, of both the impact of the internal market and the consequences of those policies for the other Member States in the context of the growing integration and solidarity between the Community economies. These meetings should deal not only with the problems which arise within the Community but also with those encountered in relations with non-member countries.

Conclusions

The Commission invites the Council and Parliament to:

- take note of the withdrawal of the 1975 proposal concerning the harmonization of systems of company

[1] See Annex 6.
[2] See Annex 7.

taxation and of withholding taxes on dividends and of the guidelines resulting from this communication for direct company taxation in the light of completion of the internal market by the end of 1992 and beyond; and

• endorse the Commission's decisions to:

— arrange for a study to be made of the company taxation problems posed by greater economic integration;

— step up consultations in the company taxation field with Member States.

The Commission asks the Council:

• to adopt without delay the following proposals which have already been transmitted to it and which are of special importance for the establishment of the internal market:

— the proposal for a Directive on a common system of taxation applicable to mergers, divisions and contributions of assets involving companies from different Member States;

— the proposal for a Directive on a common system of taxation applicable to parent companies and subsidiaries from different Member States;

— the proposal for a Directive introducing an arbitration procedure for eliminating double taxation in the event of the adjustment of profits between associated enterprises; and

• to examine in the light of this communication the proposals concerning:

— arrangements for the taking into account by the parent company of foreign results;

— the abolition of witholding taxes on royalties and interest payments

as soon as the Commission has presented them.

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* *

Annexes

Annex 1

Relations between Member States not covered by a bilateral agreement

(Situation as at 1 January 1990)

Denmark — Greece
Greece — Spain
Greece — Ireland
Greece — Luxembourg
Greece — Portugal
Spain — Ireland
Portugal — Luxembourg
Portugal — The Netherlands
Portugal — Ireland

Withholding tax rates applicable to dividend payments between companies

Situation as at 1 January 1990

Country in which the distributing company is established / Country in which the recipient comany is established	Belgium		Denmark		Germany		Greece		Spain		France		Ireland		Italy		Luxembourg		Netherlands		Portugal		United Kingdom	
	a	b	a	b	a	b	a	b	a	b	a	b	a	b	a	b	a	b	a	b	a	b	a	b
Countries without agreement		25		30		25		c		25		25		0		32.4		15		25		25		0[g]
Member States																								
Belgium	—	—		15	25 (25)	15		25		15	10 (10)	15		0		15	10 (25)	15	5 (25)	15		15		20[h]
Denmark		15	—	—	25 (25)	15		c	10 (50)	15		0		0		15	5 (25)	15	0 (25)	15	10 (25)	15	5[i]	15[h]
Germany		15	10 (25)	15	—	—		25	10 (25)	15	0 (25)	15		0		32.4	10 (25)	15	10 (25)	15		15	0[g]	0[g]
Greece		15		30		25	—	—		25		25		0		25		15	5 (25)	15		25	0[g]	0[g]
Spain		15	10 (50)	15	25 (25)	15		c	—	—	10 (25)	15		0		15	5 (25)	15	5 (50)	15	10 (50)	15	0 (10)[g]	15[h]
France	10 (10)	15		0	25 (25)	15		c	10 (25)	15	—	—		0		15	5 (25)	15	5 (25)	15		15	0 (10)[g]	15[h]
Ireland		15		0	20 (25)	15		c		25	10 (50)	15	—	—		15	5 (25)	15	0 (25)	15		25	0 (10)[g]	15[h]
Italy		15		15		25		25		15		15		0	—	—		15		0		15	0[g]	0[g]
Luxembourg	10 (25)	15	5 (25)	15	25 (25)	15		c	10 (25)	15	5 (25)	15		0		15	—	—	2.5 (25)	15		25	5 (10)[i]	15[h]
Netherlands	5 (25)	15	0 (25)	15	25 (25)	15[j]		35	10 (50)[d]	15	5 (25)	15		0	0 (75)	32.4	2.5 (25)	15	—	—		25	5 (10)[i]	15[h]
Portugal		15	10 (25)	15		15		c	10 (50)	15		15		0		15		15		15	—	—	0[g]	0[g]
Un. Kingdom		15	0 (25)	15	20 (25)	15		c	10 (10)	15	5 (10)	15		0	5 (51)	15	5 (25)	15	5 (25)	15	10 (25)	15	—	—
Non-member countries																								
Switzerland	10 (25)	15		0		15		35	10 (25)	15	5 (20)[e]	15[e]		0		15		15	0 (25)	15	10 (25)	15	5 (10)[i]	15[h]
Un. St. of Amer.		15	5 (95)	15	25 (25)	15		c		25	5 (10)	15		0	5 (50)[f]	15	5 (10)	7.5	5 (25)	15		25	5 (10)[i]	15[h]
Japan		15	10 (25)	15		15		c	10 (25)	15	10 (15)	15		0	10 (25)	15		15	5 (25)	15		25	0 (10)[g]	15[h]

Source: International Bureau of Fiscal Documentation.

[a] Rate applicable in the case of a substantial holding; the minimum percentage required for a holding to be considered substantial is indicated in brackets.

[b] Rate applicable in the case of a minority holding.

[c] Four rates are applied depending on the circumstances:

	Shares quoted on the Athens Stock Exchange	Shares not quoted on the Athens Stock Exchange
Bearer shares	45	50
Registered shares	42	47

[d] Rate reduced to 5% if the recipient company is not liable to Dutch tax on the same dividends.

[e] Cases where Swiss companies are controlled by Swiss residents.

[f] Rate for a holding of at least 10% : 10%.

[g] No tax credit granted.

[h] Tax credit granted = 25/75 of the dividend.

[i] Tax credit granted = 25/150 of the dividend.

[j] Rates provided for by the bilateral agreement; in practice the rate of 15% is also applicable in the case of a substantial holding.

Tax arrangements applicable to losses in the Member States

Summary table showing the extent to which losses may be offset within each Member State and in relations with other countries

Member State	Subsidiary in the Member State	Permanent foreign establishment	Subsidiary abroad
Belgium		Offsetting with reincorporation in a given order (Art. 66 et *seq*. AR-CIR)	—
Denmark	Consolidation (consolidated profits) (wholly owned subidiary)	— Where no agreement: imputation — Deduction with reincorporation where an agreement provides for exemption	Consolidation (consolidated profits) (wholly owned subsidiary)
Germany	Offsetting where 'Organschaft' (subsidiary under financial, structural and economic control)	— Where no agreement: imputation — In accordance with agreements: exemption in principle but deduction of losses with reincorporation	—
Spain	Consolidation (consolidated profits) (subsidiary, minimum holding of 90%)	Imputation method	—
France	Consolidation if application of: (i) consolidated profits system (ii) integrated profits system (subsidiary, minimum holding of 95%)	Imputation under world profits system if opted for by company	Consolidation if application of: (i) 'consolidated balance sheet system' (very limited use in practice) (ii) provisions for losses in the first 5 years if trading within the EEC, with automatic reincorporation (Art. 39(8) (D) CGI)
Greece	—	Imputation method in principle except where the overall result of all permanent establishments is negative (no deduction of losses in such cases)	—
Ireland	Consolidation where: (i) subsidiary, minimum holding of 75%; or (ii) consortium	Imputation method	—
Italy	—	Imputation method	—
Luxembourg	Offsetting where 'Organschaft' system applies (subsidiary, 99%)	— If no agreement: imputation — Agreements provide for exemption without deduction of losses	—
Netherlands	Offsetting where single entity status (subsidiary, 99%)	Combination of both methods — exemption with progression in case of profits — Deduction and reincorporation in case of losses	—
Portugal	Consolidation (consolidated profits) (subsidiary, minimum holding of 90%)	— If no agreement, *no* unilateral provisions — Agreements provide for imputation	—
United Kingdom	Consolidation where: (i) subsidiary with minimum holding of 75%; or (ii) consortium; or (iii) combination of (i) and (ii)	Imputation method	—

N.B.
(i) Permanent establishments resident in the same State as the company are not included in the table. The profits or losses of such establishments are always included in the company's results, in all Member States.
(ii) A 'consortium' means a holding company owned by a group of companies (in Ireland, a maximum of five), each with at least 5%, and jointly 75%, of the share capital.

Rates of withholding tax applicable to interest payments between enterprises

Situation as at 1 January 1990

Country of residence of the debtor / Country of residence of the beneficiary	Belgium [1]	Denmark	Germany	Greece	Spain	France	Ireland	Italy	Luxembourg	Netherlands	Portugal	UK
Country without tax convention	25	0	0	46 [3]	25	45 [5]	32	15	0	0	20	25
Member country												
Belgium	—	0	0	15	15	15	15	15	0	0	15	15 [10]
Denmark	15	—	0	46	10	0	0	15	0	0	15	0
Germany	15 [2]	0	—	10	10 [4]	0	0	15	0	0	15 [9]	0
Greece	15	0	0	—	25	0	32	10	0	0	20	0
Spain	15	0	0	46	—	10	32	12	0	0	15	12
France	15	0	0	10	10	—	0	15	0	0	12	0
Ireland	15	0	0	46	25	0	—	10	0	0	20	0
Italy	15	0	0	10	12	15	10	—	0	0	15	25
Luxembourg	15 [2]	0	0	46	10	10	0	10	—	0	20	0
Netherlands	10	0	0	10	10	10 [6]	0	15	0	—	20	0
Portugal	10	0	0	46	15	12	32	15	0	0	—	10
United Kingdom	15	0	0	0	12	10	0	15	0	0	10	—
Non-member country												
Switzerland	10	0	0	10	10	10 [7]	0	12.5	0	0	10	0
United States	15	0	0	46	25	0	0 [8]	15	0	0	20	0
Japan	15	0	0	46	10	10	10	10	0	0	20	10

Source: International Bureau of Fiscal Documentation.

1 No withholding tax on:
— interest on commercial debts;
— interest paid to foreign banks by banks established in Belgium.

2 Only for a holding of at least 25%; no withholding tax in the other cases.

3 For non-resident companies, the rate is equal to the rate of corporation tax.

4 Exemption for interest paid to the German Bundesbank of to the Kreditanstalt für Wiederaufbau.

5 Domestic rate of duty with a large number of exemptions.

6 Apart from certain exempt payments.

7 Rate applicable in the case of Swiss companies controlled by Swiss residents.

8 Withholding tax of 35% if the beneficiary is a company holding 50% of the shares in the Irish company.

9 Withholding tax of 10% on interest on borrowings guaranteed by German banks provided that the borrowings are officially recognized as being in the economic or social interests of Portugal.

10 No withholding tax on interest paid by banks.

Annex 4.2

Rates of withholding tax applicable to royalty payments between enterprises[1]

Situation as at 1 January 1990

Country of residence of the debtor / Country of residence of the beneficiary	Belgium	Denmark	Germany	Greece	Spain	France	Ireland	Italy	Luxembourg	Netherlands	Portugal	UK
Country without tax convention	25	30	25	25	25	33 1/3	32	30[3]	12	0	15	25
Member country												
Belgium	—	0	0	5	5	0	0	5	0	0	5	0
Denmark	0	—	0	25	6	0	0	5	0	0	10	0
Germany	0	0	—	0	5	0	0	0	5	0	10	0
Greece	5	30	0	—	25	5	32	0	12	0	15	0
Spain	5	6	5	25	—	6	32	8	10	0	5	10
France	0	0	0	5	6	—	0	0	0	0	5	0
Ireland	0	0	0	25	25	0	—	0	0	0	15	0
Italy	0	5	0	0	8	0	0	—	10	0	12	0
Luxembourg	0	0	5	25	10	0	0	10	—	0	15	5
Netherlands	0	0	0	7	6	0	0	0	0	—	15	0
Portugal	5	10	10	25	5	5	32	12	12	0	—	5
United Kingdom	0	0	0	0	10	0	0	0	0	0	5	—
Non-member country												
Switzerland	0	0	0	5	5	5[2]	0	5	12	0	5	0
United States	0	0	0	0	25	5	0	10	0	0	15	0
Japan	10	10	10	25	10	10	10	10	12	0	15	10

Source: International Bureau of Fiscal Documentation.

1 No account has been taken of the VAT payable in certain countries on royalties.

2 Rate for Swiss companies controlled by Swiss residents.

3 Rate applied to 70% of the gross amount, giving an effective rate of 21%.

Tax arrangements applicable to the carry-over of losses

Situation as at 1 January 1990

	Carry-back, maximum number of years authorized	Carry-forward, maximum number of years authorized
Community		
Belgium	—	5 [a]
Denmark	—	5
Germany	2 [b]	no limit
Greece	—	3 [c]
Spain	—	5
France	3 [d]	5
Ireland	1	no limit
Italy	—	5
Luxembourg	—	5
Netherlands	3	8
Portugal	—	5
United Kingdom	1	no limit
Other countries		
Japan [e]	1	5
USA	3	15
Switzerland	—	— [f]

Sources: International Bureau of Fiscal Documentation for the Member States; Coopers and Lybrand for the other countries.

[a] Exceptions:
- for companies established after 1 January 1972, no limit on carry-forward of losses in first five years;
- for compulsory depreciation: no limit on carry-forward.

[b] Amount limited to DM 10 000 000.

[c] Five years for hotels, mines and factories.

[d] Under certain conditions.

[e] Under certain conditions.

[f] As a rule, a tax period covers two years. A loss in one year is automatically carried over to the second year of the same period. In the case of federal taxes the loss incurred in one period may be carried forward for three periods.

Annex 6

Revenue from corporation tax, 1987

	Revenue from corporation tax	
	As a percentage of GDP	As a percentage of total tax revenue
Community		
Belgium	3.0	6.6
Denmark	2.3	4.5
Germany	1.9	5.0
Greece	1.7	4.4
Spain	2.2	6.7
France	2.3	5.2
Ireland	1.3	2.1
Italy	3.8	10.5
Luxembourg	7.5	17.1
Netherlands	3.7	7.7
Portugal	n.a.	n.a.
United Kingdom	4.0	10.6
Other countries		
Japan	6.9	22.9
USA	2.4	8.1
Switzerland	2.2	6.2

n.a: Not available.
Source: OECD.

Systems of corporation tax

Situation as at 1 January 1990

Systems of corporation tax (with alleviation, without alleviation or with avoidance of economic double taxation of dividends)	Rates of corporation tax on:		Rate of tax credit for resident beneficiary:		Rate of withholding tax for resident beneficiary
	distributed profits	undistributed profits	as % of corporation tax	as % of gross dividend	
Member country					
1. *System without alleviation*					
Belgium [a]	43 [b]	43 [b]	—	—	25 [j]
Luxembourg	34 [c]	34 [c]	—	—	15 [h]
Netherlands	35	35	—	—	25
2. *System with alleviation*					
Denmark	40	40	25	16,7	30 [i]
Spain	35	35	18,57	10	25
France	42	37	69,04	50	0 [i]
Ireland	43	43		28/72	0
Portugal	36,5	36,5	20	11,5	25
United Kingdom	35	35		25/75	0
3. *System with avoidance*					
Germany	36	50	100 [h]		25
Greece	0	46	—	—	[m]
Italy	46,368 [d]	46,368 [d]	100 [i]		10
Non-member country					
1. *System without alleviation*					
United States	34 [e]	34 [e]	—	—	0 [i]
Switzerland	progressive rates	[g]	—	—	35
2. *System with alleviation*					
Japan	35 [f]	40 [f]	—	from 7.4 to 12.8	20

a From 1 January 1989 Belgium abolished its relief system for natural persons who do not appropriate their investment income to their business activity.
b Standard rate for profits in excess of BFR 16 000 000. This rate will be reduced to 41% from 1 January 1991, and to 39% from 1 January 1992.
c Standard rate for profits in excess of LFR 1 312 001; an additional charge of 2% is due for the employment fund, based on the amount of corporation tax.
d In full discharge of tax liability.
e Does not apply to dividends distributed by Luxembourg holding companies.
f With coupon statement.
g One hundred per cent of the tax on distributed profits.
h Four rates are applied:

	Shares quoted on the Athens Stock Exchange	Shares not quoted on the Athens Stock Exchange
Bearer shares	45%	50%
Registered shares	42%	47%

i National rate of tax (36%) plus local tax, or ILOR, at 16.2%.
j The tax credit relates only to the national tax of 36%.
h Standard rate at federal level for profits not exceeding USD 100 000. State and municipal taxes must be added to federal tax. In the case of New York, for instance, the overall rate is 45.25%.
l At federal level, the tax is calculated on the basis of the ratio (%) of taxable profits to equity. Rates are progressive and range from 3.63% to 9.8%. To this charge must be added cantonal, church and municipal taxes, which range from 7.8% to 22.6% and are deductible from the base for federal tax purposes.
In the case of Zurich, for instance, the combination of the various rates produces an overall tax rate of between 11.1% and 30.2%.
m National tax rate.

COUNCIL DIRECTIVE

of 23 July 1990

on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States

(90/434/EEC)

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular Article 100 thereof,

Having regard to the proposal of the Commission [1],

Having regard to the opinion of the European Parliament [2],

Having regard to the opinion of the Economic and Social Committee [3],

Whereas mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States may be necessary in order to create within the Community conditions analogous to those of an internal market and in order thus to ensure the establishment and effective functioning of the common market; whereas such operations ought not to be hampered by restrictions, disadvantages or distortions arising in particular from the tax provisions of the Member States; whereas to that end it is necessary to introduce with respect to such operations tax rules which are neutral from the point of view of competition, in order to allow enterprises to adapt to the requirements of the common market, to increase their productivity and to improve their competitive strength at the international level;

Whereas tax provisions disadvantage such operations, in comparison with those concerning companies of the same Member State; whereas it is necessary to remove such disadvantages;

(1) OJ No C 39, 22. 3. 1969, p. 1.
(2) OJ No C 51, 29. 4. 1970, p. 12.
(3) OJ No C 100, 1. 8. 1969, p. 4.

Whereas it is not possible to attain this objective by an extension at the Community level of the systems presently in force in the Member States, since differences between these systems tend to produce distortions; whereas only a common tax system is able to provide a satisfactory solution in this respect;

Whereas the common tax system ought to avoid the imposition of tax in connection with mergers, divisions, transfers of assets or exchanges of shares, while at the same time safeguarding the financial interests of the State of the transferring or acquired company;

Whereas in respect of mergers, divisions or transfers of assets, such operations normally result either in the transformation of the transferring company into a permanent establishment of the company receiving the assets or in the assets becoming connected with a permanent establishment of the latter company;

Whereas the system of deferral of the taxation of the capital gains relating to the assets transferred until their actual disposal, applied to such of those assets as are transferred to that permanent establishment, permits exemption from taxation of the corresponding capital gains, while at the same time ensuring their ultimate taxation by the State of the transferring company at the date of their disposal;

Whereas it is also necessary to define the tax regime applicable to certain provisions, reserves or losses of the transferring company and to solve the tax problems occurring where one of the two companies has a holding in the capital of the other;

Whereas the allotment to the shareholders of the transferring company of securities of the receiving or acquiring company would not in itself give rise to any taxation in the hands of such shareholders;

Whereas it is necessary to allow Member States the possibility of refusing to apply this Directive where the merger, division, transfer of assets or exchange of shares operation has as its objective tax evasion or avoidance or results in a company, whether or not it participates in the operation, no longer fulfilling the conditions required for the representation of employees in company organs,

HAS ADOPTED THIS DIRECTIVE:

TITLE I

General provisions

Article 1

Each Member State shall apply this Directive to mergers, divisions, transfers of assets and exchanges of shares in which companies from two or more Member States are involved.

Article 2

For the purposes of this Directive:

(a) 'merger' shall mean an operation whereby:

- one or more companies, on being dissolved without going into liquidation, transfer all their assets and liabilities to another existing company in exchange for the issue to their shareholders of securities respresenting the capital of that other company, and, if applicable, a cash payment not exceeding 10 % of the nominal value, or, in the absence of a nominal value, of the accounting par value of those securities,
- two or more companies, on being dissolved without going into liquidation, transfer all their assets and liabilities to a company that they form, in exchange for the issue to their shareholders of securities representing the capital of that new company, and, if applicable, a cash payment not exceeding 10 % of the nominal value, or in the absence of a nominal value, of the accounting par value of those securities,
- a company, on being dissolved without going into liquidation, transfers all its assets and liabilities to the company holding all the securities representing its capital;

(b) 'division' shall mean an operation whereby a company, on being dissolved without going into liquidation, transfers all its assets and liabilities to two or more existing or new companies, in exchange for the pro rata issue to its shareholders of securities representing the capital of the companies receiving the assets and liabilities, and, if applicable, a cash payment not exceeding 10 % of the nominal value or, in the absence of a nominal value, of the accounting par value of those securities;

(c) 'transfer of assets' shall mean an operation whereby a company transfers without being dissolved all or one or more branches of its activity to another company in exchange for the transfer of securities representing the capital of the company receiving the transfer;

(d) 'exchange of shares' shall mean an operation whereby a company acquires a holding in the capital of another company such that it obtains a majority of the voting rights in that company in exchange for the issue to the shareholders of the latter company, in exchange for their securities, of securities representing the capital of the former company, and, if applicable, a cash payment not exceeding 10 % of the nominal value or, in the absence of a nominal value, of the accounting par value of the securities issued in exchange;

(e) 'transferring company' shall mean the company transferring its assets and liabilities or transferring all or one or more branches of its activity;

(f) 'receiving company' shall mean the company receiving the assets and liabilities or all or one or more branches of the activity of the transferring company;

(g) 'acquired company' shall mean the company in which a holding is acquired by another company by means of an exchange of securities;

(h) 'acquiring company' shall mean the company which acquires a holding by means of an exchange of securities;

(i) 'branch of activity' shall mean all the assets and liabilities of a division of a company which from an organizational point of view constitute an independent business, that is to say an entity capable of functioning by its own means.

Article 3

For the purposes of this Directive, 'company from a Member State' shall mean any company which:

(a) takes one of the forms listed in the Annex hereto;

(b) according to the tax laws of a Member State is considered to be resident in that State for tax purposes and, under the terms of a double taxation agreement concluded with a third State, is not considered to be resident for tax purposes outside the Community;

(c) moreover, is subject to one of the following taxes, without the possibility of an option or of being exempt:

- impôt des sociétés/vennootschapsbelasting in Belgium,
- selskabsskat in Denmark,
- Körperschaftsteuer in the Federal Republic of Germany,
- φόρος εισοδήματος νομικών προσώπων κερδοσκοπικού χαρακτήρα, in Greece,
- impuesto sobre sociedades in Spain,
- impôt sur les sociétés in France,
- corporation tax in Ireland,
- imposta sul reddito delle persone giuridiche in Italy,

— impôt sur le revenu des collectivités in Luxembourg,
— vennootschapsbelasting in the Netherlands,
— imposto sobre o rendimento das pessoas colectivas in Portugal,
— corporation tax in the United Kingdom,

or to any other tax which may be substituted for any of the above taxes.

TITLE II

Rules applicable to mergers, divisions and exchanges of shares

Article 4

1. A merger or division shall not give rise to any taxation of capital gains calculated by reference to the difference between the real values of the assets and liabilities transferred and their values for tax purposes. The following expressions shall have the meanings assigned to them:

— value for tax purposes: the value on the basis of which any gain or loss would have been computed for the purposes of tax upon the income, profits or capital gains of the transferring company if such assets or liabilities had been sold at the time of the merger or division but independently of it,

— transferred assets and liabilities: those assets and liabilities of the transferring company which, in consequence of the merger or division, are effectively connected with a permanent establishment of the receiving company in the Member State of the transferring company and play a part in generating the profits or losses taken into account for tax purposes.

2. The Member States shall make the application of paragraph 1 conditional upon the receiving company's computing any new depreciation and any gains or losses in respect of the assets and liabilities transferred according to the rules that would have applied to the transferring company or companies if the merger or division had not taken place.

3. Where, under the laws of the Member State of the transferring company, the receiving company is entitled to have any new depreciation or any gains or losses in respect of the assets and liabilities transferred computed on a basis different from that set out in paragraph 2, paragraph 1 shall not apply to the assets and liabilities in respect of which that option is exercised.

Article 5

The Member States shall take the necessary measures to ensure that, where provisions or reserves properly constituted by the transferring company are partly or wholly exempt from tax and are not derived from permanent establishments abroad, such provisions or reserves may be carried over, with the same tax exemption, by the permanent establishments of the receiving company which are situated in the Member State of the transferring company, the receiving company thereby assuming the rights and obligations of the transferring company.

Article 6

To the extent that, if the operations referred to in Article 1 were effected between companies from the Member State of the transferring company, the Member State would apply provisions allowing the receiving company to take over the losses of the transferring company which had not yet been exhausted for tax purposes, it shall extend those provisions to cover the take-over of such losses by the receiving company's permanent establishments situated within its territory.

Article 7

1. Where the receiving company has a holding in the capital of the transferring company, any gains accruing to the receiving company on the cancellation of its holding shall not be liable to any taxation.

2. The Member States may derogate from paragraph 1 where the receiving company's holding in the capital of the transferring company does not exceed 25 %.

Article 8

1. On a merger, division or exchange of shares, the allotment of securities representing the capital of the receiving or acquiring company to a shareholder of the transferring or acquired company in exchange for securities representing the capital of the latter company shall not, of itself, give rise to any taxation of the income, profits or capital gains of that shareholder.

2. The Member States shall make the application of paragraph 1 conditional upon the shareholder's not attributing to the securities received a value for tax purposes higher than the securities exchanged had immediately before the merger, division or exchange.

The application of paragraph 1 shall not prevent the Member States from taxing the gain arising out of the subsequent transfer of securities received in the same way as the gain arising out of the transfer of securities existing before the acquisition.

In this paragraph the expression 'value for tax purposes' means the amount on the basis of which any gain or loss would be computed for the purposes of tax upon the income, profits or capital gains of a shareholder of the company.

3. Where, under the law of the Member State in which he is resident, a shareholder may opt for tax treatment different from that set out in paragraph 2, paragraph 1 shall not apply to the securities in respect of which such an option is exercised.

4. Paragraphs 1, 2 and 3 shall not prevent a Member State from taking into account when taxing shareholders any cash payment that may be made on the merger, division or exchange.

TITLE III

Rules applicable to transfers of assets

Article 9

The provisions of Articles 4, 5 and 6 shall apply to transfers of assets.

TITLE IV

Special case of the transfer of a permanent establishment

Article 10

1. Where the assets transferred in a merger, a division or a transfer of assets include a permanent establishment of the transferring company which is situated in a Member State other than that of the transferring company, the latter State shall renounce any right to tax that permanent establishment. However, the State of the transferring company may reinstate in the taxable profits of that company such losses of the permanent establishment as may previously have been set off against the taxable profits of the company in that State and which have not been recovered. The State in which the permanent establishment is situated and the State of the receiving company shall apply the provisions of this Directive to such a transfer as if the former State were the State of the transferring company.

2. By way of derogation from paragraph 1, where the Member State of the transferring company applies a system of taxing world-wide profits, that Member State shall have the right to tax any profits or capital gains of the permanent establishment resulting from the merger, division or transfer of assets, on condition that it gives relief for the tax that, but for the provisions of this Directive, would have been charged on those profits or capital gains in the Member State in which that permanent establishment is situated, in the same way and in the same amount as it would have done if that tax had actually been charged and paid.

TITLE V

Final provisions

Article 11

1. A Member State may refuse to apply or withdraw the benefit of all or any part of the provisions of Titles II, III and IV where it appears that the merger, division, transfer of assets or exchange of shares:

(a) has as its principal objective or as one of its principal objectives tax evasion or tax avoidance; the fact that one of the operations referred to in Article 1 is not carried out for valid commercial reasons such as the restructuring or rationalization of the activities of the companies participating in the operation may constitute a presumption that the operation has tax evasion or tax avoidance as its principal objective or as one of its principal objectives;

(b) results in a company, whether participating in the operation or not, no longer fulfilling the necessary conditions for the representation of employees on company organs according to the arrangements which were in force prior to that operation.

2. Paragraph 1 (b) shall apply as long as and to the extent that no Community law provisions containing equivalent rules on representation of employees on company organs are applicable to the companies covered by this Directive.

Article 12

1. Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive not later than 1 January 1992 and shall forthwith inform the Commission thereof.

2. By way of derogation from paragraph 1, the Portuguese Republic may delay the application of the provisions concerning transfers of assets and exchanges of shares until 1 January 1993.

3. Member States shall communicate to the Commission the texts of the main provisions of national law which they adopt in the field covered by this Directive.

Article 13

This Directive is addressed to the Member States.

Done at Brussels, 23 July 1990.

For the Council
The President
G. CARLI

ANNEX

List of companies referred to in Article 3 (a)

(a) companies under Belgian law known as 'société anonyme' / 'naamloze vennootschap', 'société en commandite par actions' / 'commanditaire vennootschap op aandelen', 'société privée à responsabilité limitée' / 'besloten vennootschap met beperkte aansprakelijkheid' and those public law bodies that operate under private law;

(b) companies under Danish law known as: 'aktieselskab', 'anpartsselskab';

(c) companies under German law known as: 'Aktiengesellschaft', 'Kommanditgesellschaft auf Aktien', 'Gesellschaft mit beschränkter Haftung', 'bergrechtliche Gewerkschaft';

(d) companies under Greek law known as: 'ανώνυμη εταιρεία';

(e) companies under Spanish law known as: 'sociedad anónima', 'sociedad comanditaria por acciones', 'sociedad de responsabilidad limitada' and those public law bodies which operate under private law;

(f) companies under French law known as 'société anonyme', 'société en commandite par actions', 'société à responsabilité limitée' and industrial and commercial public establishments and undertakings;

(g) the companies in Irish law known as public companies limited by shares or by guarantee, private companies limited by shares or by guarantee, bodies registered under the Industrial and Provident Societies Acts or building societies registered under the Building Societies Acts;

(h) companies under Italian law known as 'società per azioni', 'società in accomandita per azioni', 'società a responsabilità limitata', and public and private entities carrying on industrial and commercial activities;

(i) companies under Luxembourg law known as 'société anonyme', 'société en commandite par actions', 'société à responsabilité limitée';

(j) companies under Dutch law known as: 'naamloze vennootschap', 'besloten vennootschap met beperkte aansprakelijkheid';

(k) commercial companies or civil law companies having a commercial form as well as other legal persons carrying on commercial or industrial activities, which are incorporated in accordance with Portuguese law;

(l) companies incorporated under the law of the United Kingdom.

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COUNCIL DIRECTIVE

of 23 July 1990

on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States

(90/435/EEC)

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular Article 100 thereof,

Having regard to the proposal of the Commission [1],

Having regard to the opinion of the European Parliament [2],

Having regard to the opinion of the Economic and Social Committee [3],

Whereas the grouping together of companies of different Member States may be necessary in order to create within the Community conditions analogous to those of an internal market and in order thus to ensure the establishment and effective functioning of the common market; whereas such operations ought not to be hampered by restrictions, disadvantages or distortions arising in particular from the tax provisions of the Member States; whereas it is therefore necessary to introduce with respect to such grouping together of companies of different Member States, tax rules which are neutral from the point of view of competition, in order to allow enterprises to adapt to the requirements of the common market, to increase their productivity and to improve their competitive strength at the international level;

Whereas such grouping together may result in the formation of groups of parent companies and subsidiaries;

Whereas the existing tax provisions which govern the relations between parent companies and subsidiaries of different Member States vary appreciably from one Member State to another and are generally less advantageous than those applicable to parent companies and subsidiaries of the same Member State; whereas cooperation between companies of different Member States is thereby disadvantaged in comparison with cooperation between companies of the same Member State; whereas it is necessary to eliminate this disadvantage by the introduction of a common system in order to facilitate the grouping together of companies;

Whereas where a parent company by virtue of its association with its subsidiary receives distributed profits, the State of the parent company must:

— either refrain from taxing such profits,

— or tax such profits while authorizing the parent company to deduct from the amount of tax due that fraction of the corporation tax paid by the subsidiary which relates to those profits;

Whereas it is furthermore necessary, in order to ensure fiscal neutrality, that the profits which a subsidiary distributes to its parent company be exempt from withholding tax; whereas, however, the Federal Republic of Germany and the Hellenic Republic, by reason of the particular nature of their corporate tax systems, and the Portuguese Republic, for budgetary reasons, should be authorized to maintain temporarily a withholding tax,

HAS ADOPTED THIS DIRECTIVE:

Article 1

1. Each Member State shall apply this Directive:

— to distributions of profits received by companies of that State which come from their subsidiaries of other Member States,

— to distributions of profits by companies of that State to companies of other Member States of which they are subsidiaries.

2. This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse.

Article 2

For the purposes of this Directive 'company of a Member State' shall mean any company which:

(a) takes one of the forms listed in the Annex hereto;

(b) according to the tax laws of a Member State is considered to be resident in that State for tax purposes and, under the terms of a double taxation agreement concluded with a third State, is not considered to be resident for tax purposes outside the Community;

(c) moreover, is subject to one of the following taxes, without the possibility of an option or of being exempt:

   — impôt des sociétés/vennootschapsbelasting in Belgium,

   — selskabsskat in Denmark,

   — Körperschaftsteuer in the Federal Republic of Germany,

(1) OJ No C 39, 22. 3. 1969, p. 7 and Amendment transmitted on 5 July 1985.

(2) OJ No C 51, 29. 4. 1970, p. 6.

(3) OJ No C 100, 1. 8. 1969, p. 7.

— φόρος εισοδήματος νομικών προσώπων κερδοσκοπικού χαρακτήρα in Greece,

— impuesto sobre sociedades in Spain,

— impôt sur les sociétés in France,

— corporation tax in Ireland,

— imposta sul reddito delle persone giuridiche in Italy,

— impôt sur le revenu des collectivités in Luxembourg,

— vennootschapsbelasting in the Netherlands,

— imposto sobre o rendimento das pessoas colectivas in Portugal,

— corporation tax in the United Kingdom,

or to any other tax which may be substituted for any of the above taxes.

Article 3

1. For the purposes of applying this Directive,

(a) the status of parent company shall be attributed at least to any company of a Member State which fulfils the conditions set out in Article 2 and has a minimum holding of 25 % in the capital of a company of another Member State fulfilling the same conditions;

(b) 'subsidiary' shall mean that company the capital of which includes the holding referred to in (a).

2. By way of derogation from paragraph 1, Member States shall have the option of:

— replacing, by means of bilateral agreement, the criterion of a holding in the capital by that of a holding of voting rights,

— not applying this Directive to companies of that Member State which do not maintain for an uninterrupted period of at least two years holdings qualifying them as parent companies or to those of their companies in which a company of another Member State does not maintain such a holding for an uninterrupted period of at least two years.

Article 4

1. Where a parent company, by virtue of its association with its subsidiary, receives distributed profits, the State of the parent company shall, except when the latter is liquidated, either:

— refrain from taxing such profits, or

— tax such profits while authorizing the parent company to deduct from the amount of tax due that fraction of the corporation tax paid by the subsidiary which relates to those profits and, if appropriate, the amount of the withholding tax levied by the Member State in which the subsidiary is resident, pursuant to the derogations provided for in Article 5, up to the limit of the amount of the corresponding domestic tax.

2. However, each Member State shall retain the option of providing that any charges relating to the holding and any losses resulting from the distribution of the profits of the subsidiary may not be deducted from the taxable profits of the parent company. Where the management costs relating to the holding in such a case are fixed as a flat rate, the fixed amount may not exceed 5 % of the profits distributed by the subsidiary.

3. Paragraph 1 shall apply until the date of effective entry into force of a common system of company taxation.

The Council shall at the appropriate time adopt the rules to apply after the date referred to in the first subparagraph.

Article 5

1. Profits which a subsidiary distributed to its parent company shall, at least where the latter holds a minimum of 25 % of the capital of the subsidiary, be exempt from withholding tax.

2. Notwithstanding paragraph 1, the Hellenic Republic may, for so long as it does not charge corporation tax on distributed profits, levy a withholding tax on profits distributed to parent companies of other Member States. However, the rate of that withholding tax must not exceed the rate provided for in bilateral double-taxation agreements.

3. Notwithstanding paragraph 1, the Federal Republic of Germany may, for as long as it charges corporation tax on distributed profits at a rate at least 11 points lower than the rate applicable to retained profits, and at the latest until mid-1996, impose a compensatory withholding tax of 5 % on profits distributed by its subsidiary companies.

4. Notwithstanding paragraph 1, the Portuguese Republic may levy a withholding tax on profits distributed by its subsidiaries to parent companies of other Member States until a date not later than the end of the eighth year following the date of application of this Directive.

Subject to the existing bilateral agreements concluded between Portugal and a Member State, the rate of this withholding tax may not exceed 15 % during the first five years and 10 % during the last three years of that period.

Before the end of the eighth year the Council shall decide unanimously, on a proposal from the Commission, on a possible extension of the provisions of this paragraph.

Article 6

The Member State of a parent company may not charge withholding tax on the profits which such a company receives from a subsidiary.

Article 7

1. The term 'withholding tax' as used in this Directive shall not cover an advance payment or prepayment (précompte) of corporation tax to the Member State of the subsidiary which is made in connection with a distribution of profits to its parent company.

2. This Directive shall not affect the application of domestic or agreement-based provisions designed to eliminate or lessen economic double taxation of dividends, in particular provisions relating to the payment of tax credits to the recipients of dividends.

Article 8

1. Member States shall bring into force the laws, regulations and administrative provisions necessary for them to comply with this Directive before 1 January 1992. They shall forthwith inform the Commission thereof.

2. Member States shall ensure that the texts of the main provisions of domestic law which they adopt in the field covered by this Directive are communicated to the Commission.

Article 9

This Directive is addressed to the Member States.

Done at Brussels, 23 July 1990.

For the Council
The President
G. CARLI

ANNEX

List of companies referred to in Article 2 (a)

(a) companies under Belgian law known as 'société anonyme' / 'naamloze vennootschap', 'société en commandite par actions' / 'commanditaire vennootschap op aandelen', 'société privée à responsabilité limitée' / 'besloten vennootschap met beperkte aansprakelijkheid' and those public law bodies that operate under private law;

(b) companies under Danish law known as: 'aktieselskab', 'anpartsselskab';

(c) companies under German law known as: 'Aktiengesellschaft', 'Kommanditgesellschaft auf Aktien', 'Gesellschaft mit beschränkter Haftung', 'bergrechtliche Gewerkschaft';

(d) companies under Greek law known as: 'ανώνυμη εταιρία';

(e) companies under Spanish law known as: 'sociedad anónima', 'sociedad comanditaria por acciones', 'sociedad de responsabilidad limitada' and those public law bodies which operate under private law;

(f) companies under French law known as 'société anonyme', 'société en commandite par actions', 'société à responsabilité limitée' and industrial and commercial public establishments and undertakings;

(g) the companies in Irish law known as public companies limited by shares or by guarantee, private companies limited by shares or by guarantee, bodies registered under the Industrial and Provident Societies Acts or building societies registered under the Building Societies Acts;

(h) companies under Italian law known as 'società per azioni', 'società in accomandita per azioni', 'società a responsabilità limitata', and public and private entities carrying on industrial and commercial activities;

(i) companies under Luxembourg law known as 'société anonyme', 'société en commandite par actions', 'société à responsabilité limitée';

(j) companies under Dutch law known as: 'naamloze vennootschap', 'besloten vennootschap met beperkte aansprakelijkheid';

(k) commercial companies or civil law companies having a commercial form cooperatives and public undertakings incorporated in accordance with Portuguese law;

(l) companies incorporated under the law of the United Kingdom.

CONVENTION

on the elimination of double taxation in connection with the adjustment of profits of associated enterprises

(90/463/EEC)

THE HIGH CONTRACTING PARTIES TO THE TREATY ESTABLISHING THE EUROPEAN ECONOMIC COMMUNITY,

DESIRING to give effect to Article 220 of that Treaty, by virtue of which they have undertaken to enter into negotiations with one another with a view to securing for the benefit of their nationals the elimination of double taxation,

CONSIDERING the importance attached to the elimination of double taxation in connection with the adjustment of profits of associated enterprises,

HAVE DECIDED to conclude this Convention, and to this end have designated as their Plenipotentiaries:

HIS MAJESTY THE KING OF THE BELGIANS:

Philippe de SCHOUTHEETE de TERVARENT,

Ambassador Extraordinary and Plenipotentiary;

HER MAJESTY THE QUEEN OF DENMARK:

Niels HELVEG PETERSEN,

Minister for Economic Affairs;

THE PRESIDENT OF THE FEDERAL REPUBLIC OF GERMANY:

Theo WAIGEL,

Federal Minister for Finance;

Jürgen TRUMPF,

Ambassador Extraordinary and Plenipotentiary;

THE PRESIDENT OF THE HELLENIC REPUBLIC:

Ioannis PALAIOKRASSAS,

Minister for Finance;

HIS MAJESTY THE KING OF SPAIN:

Carlos SOLCHAGA CATALÁN,

Minister for Economic Affairs and Finance;

THE PRESIDENT OF THE FRENCH REPUBLIC:

Jean VIDAL,

Ambassador Extraordinary and Plenipotentiary;

THE PRESIDENT OF IRELAND:

Albert REYNOLDS,

Minister for Finance;

THE PRESIDENT OF THE ITALIAN REPUBLIC:

Stefano DE LUCA,

State Secretary for Finance;

HIS ROYAL HIGHNESS THE GRAND DUKE OF LUXEMBOURG:

Jean-Claude JUNCKER,

Minister for the Budget, Minister for Finance, Minister for Labour;

HER MAJESTY THE QUEEN OF THE NETHERLANDS:

P.C. NIEMAN,

Ambassador Extraordinary and Plenipotentiary;

THE PRESIDENT OF THE PORTUGUESE REPUBLIC:

Miguel BELEZA,

Minister for Finance;

HER MAJESTY THE QUEEN OF THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND:

David H.A. HANNAY KCMG,

Ambassador Extraordinary and Plenipotentiary;

WHO, meeting within the Council and having exchanged their Full Powers, found in good and due form,

HAVE AGREED AS FOLLOWS:

CHAPTER I

SCOPE OF THE CONVENTION

Article 1

1. This Convention shall apply where, for the purposes of taxation, profits which are included in the profits of an enterprise of a Contracting State are also included or are also likely to be included in the profits of an enterprise of another Contracting State on the grounds that the principles set out in Article 4 and applied either directly or in corresponding provisions of the law of the State concerned have not been observed.

2. For the purposes of this Convention, the permanent establishment of an enterprise of an Contracting State situated in another Contracting State shall be deemed to be an enterprise of the State in which it is situated.

3. Paragraph 1 shall also apply where any of the enterprises concerned have made losses rather than profits.

Article 2

1. This Convention shall apply to taxes on income.

2. The existing taxes to which this Convention shall apply are, in particular the following:

(a) in Belgium:

- impôt des personnes physiques/personenbelasting,
- impôt des sociétés/vennootschapsbelasting,
- impôt des personnes morales/rechtspersonenbelasting,
- impôt des non-résidents/belasting der niet-verblijfhouders,
- taxe communale et la taxe d'agglomération additionnelles à l'impôt des personnes physiques/aanvullende gemeentebelasting en agglomeratiebelasting op de personenbelasting;

(b) in Denmark:

- selskabsskat,
- indkomstskat til staten,
- kommunale indkomstskat,
- amtskommunal indkomstskat,
- særlig indkomstskat,
- kirkeskat,
- udbytteskat,
- renteskat,
- royaltyskat,
- frigørelsesafgift;

(c) in the Federal Republic of Germany:

- Einkommensteuer,
- Körperschaftsteuer,
- Gewerbesteuer, in so far as this tax is based on trading profits;

(d) in Greece:

- φόρος εισοδήματος φυσικών προσώπων,
- φόρος εισοδήματος νομικών προσώπων,
- εισφορά υπέρ των επιχειρήσεων ύδρευσης και αποχέτευσης;

(e) in Spain:

- impuesto sobre la renta de las personas fisicas,
- impuesto sobre sociedades;

(f) in France:

- impôt sur le revenu,
- impôt sur les sociétés;

(g) in Ireland:

- Income Tax,
- Corporation Tax;

(h) in Italy:

- imposta sul reddito delle persone fisiche,
- imposta sul reddito delle persone giuridiche,
- imposta locale sui redditi;

(i) in Luxembourg:

- impôt sur le revenu des personnes physiques,
- impôt sur le revenu des collectivités,
- impôt commercial, in so far as this tax is based on trading profits;

(j) in the Netherlands:

- inkomstenbelasting,
- vennootschapsbelasting;

(k) in Portugal:

- imposto sobre o rendimento das pessoas singulares,
- imposto sobre o rendimento das pessoas colectivas,
- derrama para os municípios sobre o imposto sobre o rendimento das pessoas colectivas;

(l) in the United Kingdom:

- Income Tax,
- Corporation Tax.

3. The Convention shall also apply to any identical or similar taxes which are imposed after the date of signature thereof in addition to, or in place of existing taxes. The competent authorities of the Contracting States shall inform each other of any changes made in the respective domestic laws.

CHAPTER II

GENERAL PROVISIONS

Section I

Definitions

Article 3

1. For the purposes of this Convention: 'competent authority' shall mean:

- in Belgium:

  De Minister van Financiën or an authorized representative,

  Le Ministre des Finances or an authorized representative,

- in Denmark:

  Skatteministeren or an authorized representative,

- in the Federal Republic of Germany:

  Der Bundesminister der Finanzen or an authorized representative,

- in Greece:

  Ο Υπουργός των Οικονομικών or an authorized representative,

- in Spain:

  El Ministro de Economía y Hacienda or an authorized representative,

- in France:

  Le Ministre chargé du budget or an authorized representative,

- in Ireland:

  The Revenue Commissioners or an authorized representative,

- in Italy:

  Il Ministro delle Finanze or an authorized representative,

- in Luxembourg:

  Le Ministre des Finances or an authorized representative,

- in the Netherlands:

  De Minister van Financiën or an authorized representative,

- in Portugal:

  O Ministro das Finanças or an authorized representative,

- in the United Kingdom:

  The Commissioners of Inland Revenue or an authorized representative.

2. Any term not defined in this Convention shall, unless the context otherwise requires, have the meaning which it has under the double taxation convention between the States concerned.

Section II

Principles applying to the adjustment of profits of associated enterprises and to the attribution of profits to permanent establishments

Article 4

The following principles shall be observed in the application of this Convention:

1. Where:

   (a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of another Contracting State,

   or

(b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of one Contracting State and an enterprise of another Contracting State,

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ form those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

2. Where an enterprise of a Contracting State carries on business in another Contracting State through a permanent establishment situated therein, there shall be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

Article 5

Where a Contracting State intends to adjust the profits of an enterprise in accordance with the principles set out in Article 4, it shall inform the enterprise of the intended action in due time and give it the opportunity to inform the other enterprise so as to give that other enterprise the opportunity to inform in turn the other Contracting State.

However, the Contracting State providing such information shall not be prevented from making the proposed adjustment.

If after such information has been given the two enterprises and the other Contracting State agree to the adjustment, Articles 6 and 7 shall not apply.

Section 3

Mutual agreement and arbitration procedure

Article 6

1. Where an enterprise considers that, in any case to which this Convention applies, the principles set out in Article 4 have not been observed, it may, irrespective of the remedies provided by the domestic law of the Contracting States concerned, present its case to the competent authority of the Contracting State of which it is an enterprise or in which its permanent establishment is situated. The case must be presented within three years of the first notification of the action which results or is likely to result in double taxation within the meaning of Article 1.

The enterprise shall at the same time notify the competent authority if other Contracting States may be concerned in the case. The competent authority shall then without delay notify the competent authorities of those other Contracting States.

2. If the complaint appears to it to be well-founded and if it is not itself able to arrive at a satisfactory solution, the competent authority shall endeavour to resolve the case by mutual agreement with the competent authority of any other Contracting State concerned, with a view to the elimination of double taxation on the basis of the principles set out in Article 4. Any mutual agreement reached shall be implemented irrespective of any time limits prescribed by the domestic laws of the Contracting States concerned.

Article 7

1. If the competent authorities concerned fail to reach an agreement that eliminates the double taxation referred to in Article 6 within two years of the date on which the case was first submitted to one of the competent authorities in accordance with Article 6 (1), they shall set up an advisory commission charged with delivering its opinion on the elimination of the double taxation in question.

Enterprises may have recourse to the remedies available to them under the domestic law of the Contracting States concerned; however, where the case has so been submitted to a court or tribunal, the term of two years referred to in the first subparagraph shall be computed from the date on which the judgment of the final court of appeal was given.

2. The submission of the case to the advisory commission shall not prevent a Contracting State from initiating or continuing judicial proceedings or proceedings for administrative penalties in relation to the same matters.

3. Where the domestic law of a Contracting State does not permit the competent authorities of that State to derogate from the decisions of their judicial bodies, paragraph 1 shall not apply unless the associated enterprise of that State has allowed the time provided for appeal to expire, or has withdrawn any such appeal before a decision has been delivered. This provision shall not affect the appeal if and in so far as it relates to matters other than those referred to in Article 6.

4. The competent authorities may by mutual agreement and with the agreement of the associated enterprises concerned waive the time limits referred to in paragraph 1.

5. In so far as the provisions of paragraphs 1 to 4 are not applied, the rights of each of the associated enterprises, as laid down in Article 6, shall be unaffected.

Article 8

1. The competent authority of a Contracting State shall not be obliged to initiate the mutual agreement procedure or

to set up the advisory commission referred to in Article 7 where legal or administrative proceedings have resulted in a final ruling that by actions giving rise to an adjustment of transfers of profits under Article 4 one of the enterprises concerned is liable to a serious penalty.

2. Where judicial or administrative proceedings, initiated with a view to a ruling that by actions giving rise to an adjustment of profits under Article 4 one of the enterprises concerned was liable to a serious penalty, are being conducted simultaneously with any of the proceedings referred to in Articles 6 and 7, the competent authorities may stay the latter proceedings until the judicial or administrative proceedings have been concluded.

Article 9

1. The advisory commission referred to in Article 7 (1) shall consist of, in addition to its Chairman:

— two representatives of each competent authority concerned; this number may be reduced to one by agreement between the competent authorities,

— an even number of independent persons of standing to be appointed by mutual agreement from the list of persons referred to in paragraph 4 or, in the absence of agreement, by the drawing of lots by the competent authorities concerned.

2. When the independent persons of standing are appointed an alternate shall be appointed for each of them according to the rules for the appointment of the independent persons in case the independent persons are prevented from carrying out their duties.

3. Where lots are drawn, each of the competent authorities may object to the appointment of any particular independent person of standing in any circumstance agreed in advance between the competent authorities concerned or in one of the following situations:

— where that person belongs to or is working on behalf of one of the tax administrations concerned,

— where that person has, or has had, a large holding in or is or has been an employee of or adviser to one or each of the associated enterprises,

— where that person does not offer a sufficient guarantee of objectivity for the settlement of the case or cases to be decided.

4. The list of independent persons of standing shall consist of all the independent persons nominated by the Contracting States. For this purpose each Contracting State shall nominate five persons and shall inform the Secretary-General of the Council of the European Communities thereof.

Such persons must be nationals of a Contracting State and resident within the territory to which this Convention applies. They must be competent and independent.

The Contracting States may make alterations to the list referred to in the first subparagraph; they shall inform the Secretary-General of the Council of the European Communities thereof without delay.

5. The representatives and independent persons of standing appointed in accordance with paragraph 1 shall elect a Chairman from among those persons of standing on the list referred to in paragraph 4, without prejudice to the right of each competent authority concerned to object to the appointment of the person of standing thus chosen in one of the situations referred to in paragraph 3.

The Chairman must possess the qualifications required for appointment to the highest judicial offices in his country or be a jurisconsult of recognized competence.

6. The members of the advisory commission shall keep secret all matters which they learn as a result of the proceedings. The Contracting States shall adopt appropriate provisions to penalize any breach of secrecy obligations. They shall, without delay inform the Commission of the European Communities of the measures taken. The Commission of the European Comunities shall inform the other Contracting States.

7. The Contracting States shall take all necessary steps to ensure that the advisory commission meets without delay once cases are referred to it.

Article 10

1. For the purposes of the procedure referred to in Article 7, the associated enterprises concerned may provide any information, evidence or documents which seem to them likely to be of use to the advisory commission in reaching a decision. The enterprises and the competent authorities of the Contracting States concerned shall give effect to any request made by the advisory commission to provide information, evidence or documents. However, the competent authorities of any such Contracting State shall not be under any obligation:

(a) to carry out administrative measures at variance with its domestic law or its normal administrative practice;

(b) to supply information which is not obtainable under its domestic law or in its normal administrative practice;

or

(c) to supply information which would disclose any trade, business, industrial or professional secret or trade process, or information the disclosure of which would be contrary to public policy *(ordre public)*.

2. Each of the associated enterprises may, at its request, appear or be represented before the advisory commission. If

the advisory commission so requests, each of the associated enterprises shall appear or be represented before it.

Article 11

1. The advisory commission referred to in Article 7 shall deliver its opinion not more than six months from the date on which the matter was referred to it.

The advisory commission must base its opinion on Article 4.

2. The advisory commission shall adopt its opinion by a simple majority of its members. The competent authorities concerned may agree on additional rules of procedure.

3. The costs of the advisory commission procedure, other than those incurred by the associated enterprises, shall be shared equally by the Contracting States concerned.

Article 12

1. The competent authorities party to the procedure referred to in Article 7 shall, acting by common consent on the basis of Article 4, take a decision which will eliminate the double taxation within six months of the date on which the advisory commission delivered its opinion.

The competent authorities may take a decision which deviates from the advisory commission's opinion. If they fail to reach agreement, they shall be obliged to act in accordance with that opinion.

2. The competent authorities may agree to publish the decision referred to in paragraph 1, subject to the consent of the enterprises concerned.

Article 13

The fact that the decisions taken by the Contracting States, concerning the taxation of profits resulting from a transaction between associated enterprises, have become final shall not prevent recourse to the procedures set out in Articles 6 and 7.

Article 14

For the purposes of this Convention, the double taxation of profits shall be regarded as eliminated if either:

(a) the profits are included in the computation of taxable profits in one State only;

or

(b) the tax chargeable on those profits in one State is reduced by an amount equal to the tax chargeable on them in the other.

CHAPTER III

FINAL PROVISIONS

Article 15

Nothing in this Convention shall affect the fulfilment of wider obligations with respect to the elimination of double taxation in the case of an adjustment of profits of associated enterprises resulting either from other conventions to which the Contracting States are or will become parties or from the domestic law of the Contracting States.

Article 16

1. The territorial scope of this Convention shall be that defined in Article 227 (1) of the Treaty establishing the European Economic Community, without prejudice to paragraph 2 of this Article.

2. This Convention shall not apply to:

— the French territories referred to in Annex IV to the Treaty establishing the European Economic Community,

— the Faroe Islands and Greenland.

Article 17

This Convention will be ratified by the Contracting States. The instruments of ratification will be deposited at the office of the Secretary-General of the Council of the European Communities.

Article 18

This Convention shall enter into force on the first day of the third month following that in which the instrument of ratification is deposited by the last signatory State to take that step. The Convention shall apply to proceedings referred to in Article 6 (1) which are initiated after its entry into force.

Article 19

The Secretary-General of the Council of the European Communities shall inform the Contracting States of:

(a) the deposit of each instrument of ratification;

(b) the date on which this Convention will enter into force;

(c) the list of independent persons of standing appointed by the Contracting States and any alterations thereto in accordance with Article 9 (4).

Article 20

This Convention is concluded for a period of five years. Six months before the expiry of that period, the Contracting

States will meet to decide on the extension of this Convention and any other relevant measure.

Article 21

Each Contracting State may, at any time, ask for a revision of this Convention. In that event, a conference to revise the Convention will be convened by the President of the Council of the European Communities.

Article 22

This Convention, drawn up in a single original in the Danish, Dutch, English, French, German, Greek, Irish, Italian, Portuguese and Spanish languages, all 10 texts being equally authentic, shall be deposited in the archives of the General Secretariat of the Council of the European Communities. The Secretary-General shall transmit a certified copy to the Government of each Signatory State.

FINAL ACT

THE PLENIPOTENTIARIES OF THE HIGH CONTRACTING PARTIES,

meeting at Brussels, on the twenty-third day of July nineteenhundred and ninety, for the signature of the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises,

have, on the occasion of signing the said Convention:

(a) adopted the following joint Declarations attached to the Final Act:
   - Declaration on Article 4 (1),
   - Declaration on Article 9 (6),
   - Declaration on Article 13;

(b) taken note of the following unilateral Declarations attached to this Final Act:
   - Declaration of France and the United Kingdom on Article 7,
   - Individual Declarations of the Contracting States on Article 8,
   - Declaration of the Federal Republic of Germany on Article 16.

En fe de lo cual, los abajo firmantes suscriben la presente Acta Final.

Til bekræftelse heraf har undertegnede underskrevet denne slutakt.

Zu Urkund dessen haben die Unterzeichneten ihre Unterschrift unter diese Schlußakte gesetzt.

Σε πίστωση των ανωτέρω, οι υπογράφοντες πληρεξούσιοι έθεσαν την υπογραφή τους κάτω από την παρούσα τελική πράξη.

In witness whereof, the undersigned have signed this Final Act.

En foi de quoi, les soussignés ont apposé leurs signatures au bas du présent acte final.

Dá fhianú sin, chuir na daoine thíos-sínithe a lámh leis an Ionstraim Chríochnaitheach seo.

In fede di che, i sottoscritti hanno apposto le loro firme in calce al presente atto finale.

Ten blijke waarvan de ondergetekenden hun handtekening onder deze Slotakte hebben gesteld.

Em fé do que os abaixo assinados apuseram as suas assinaturas no final do presente Acto Final.

Hecho en Bruselas, el veintitrés de julio de mil novecientos noventa.

Udfærdiget i Bruxelles, den treogtyvende juli nitten hundrede og halvfems.

Geschehen zu Brüssel am dreiundzwanzigsten Juli neunzehnhundertneunzig.

Έγινε στις Βρυξέλλες, στις είκοσι τρεις Ιουλίου χίλια εννιακόσια ενενήντα.

Done at Brussels on the twenty-third day of July in the year one thousand nine hundred and ninety.

Fait à Bruxelles, le vingt-trois juillet mil neuf cent quatre-vingt-dix.

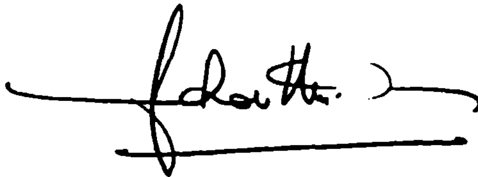
Arna dhéanamh sa Bhruiséil, an tríú lá fichead de Iúil, míle naoi gcéad nócha.

Fatto a Bruxelles, addì ventitré luglio millenovecentonovanta.

Gedaan te Brussel, de drieëntwintigste juli negentienhonderd negentig.

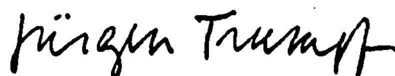
Feito em Bruxelas, em vinte e três de Julho de mil novecentos e noventa.

Pour Sa Majesté le Roi des Belges
Voor Zijne Majesteit de Koning der Belgen

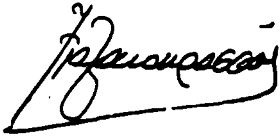


For Hendes Majestæt Danmarks Dronning

Für den Präsidenten der Bundesrepublik Deutschland

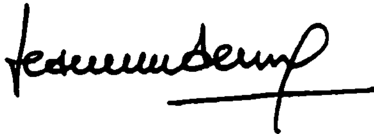


Για τον Πρόεδρο της Ελληνικής Δημοκρατίας

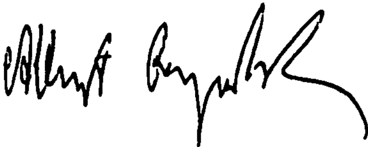


Por Su Majestad el Rey de España

Pour le président de la République française

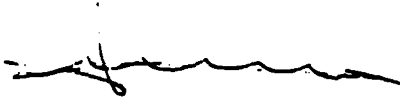


For the President of Ireland
Thar ceann Uachtarán na hÉireann



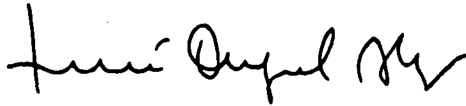
Per il presidente della Repubblica italiana

Pour Son Altesse Royale le Grand-Duc de Luxembourg

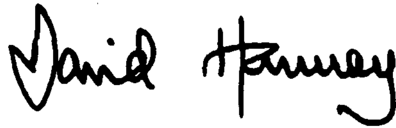


Voor Hare Majesteit de Koningin der Nederlanden

Pelo Presidente da República Portuguesa



For Her Majesty the Queen of the United Kingdom of Great Britain and Northern Ireland



JOINT DECLARATIONS

Declaration on Article 4 (1)

The provisions of Article 4 (1) shall cover both cases where a transaction is carried out directly between two legally distinct enterprises as well as cases where a transaction is carried out between one of the enterprises and the permanent establishment of the other enterprise situated in a third country.

Declaration on Article 9 (6)

The Member States shall be entirely free as regards the nature and scope of the appropriate provisions they adopt for penalizing any breach of secrecy obligations.

Declaration on Article 13

Where, in one or more of the Contracting States concerned, the decisions regarding the taxation giving rise to the procedures referred to in Articles 6 and 7 have been altered after the procedure referred to in Article 6 has been concluded or after the decision referred to in Article 12 has been taken and where double taxation within the meaning of Article 1 results, account being taken of the application of the outcome of that procedure or that decision, Articles 6 and 7 shall apply.

UNILATERAL DECLARATIONS

Declaration on Article 7

France and the United Kingdom declare that they will apply Article 7 (3).

Individual Declarations of the Contracting States on Article 8

Belgium

The term 'serious penalty' means a criminal or administrative penalty in cases:

— either of a common law offence committed with the aim of tax evasion,

— or infringements of the provisions of the Code of income tax or of decisions taken in implementation thereof, committed with fraudulent intention or with the intention of causing injury.

Denmark

The concept of 'serious penalty' means a penalty for the intentional infringement of provisions of the Criminal Law or of special legislation in cases which cannot be regulated by administrative means.

Cases of infringement of provisions of tax law may, as a general rule, be regulated by administrative means where it is considered that the infringement will not entail a punishment greater than a fine.

Germany

An infringement of the tax laws punishable by a 'serious penalty' is constituted by any infringement of the tax laws penalized by detention, criminal or administrative fines.

Greece

Under Greek legislation governing taxation, an undertaking is liable to 'severe penalties':

1. if it fails to submit declarations, or submits incorrect declarations, in respect of taxes, charges or contributions which must be withheld and paid to the State under existing provisions, or in respect of value added tax, turnover tax or the special tax on luxury goods, in so far as the total amount of the above taxes, charges and contributions which should have been declared and paid to the State as a result of trade or other activities carried out over a period of six months exceeds an amount of six hundred thousand (600 000) Greek drachmas or one million (1 000 000) Greek drachmas over a period of one calendar year;

2. if it fails to submit a declaration of income tax, in so far as the tax due in respect of the income not declared is more than three hundred thousand (300 000) Greek drachmas;

3. if it fails to supply the taxation details laid down in the Code on Taxation Data;

4. if it supplies details as referred to under the previous case 3, which are incorrect as regards quantity or unit price or value, in so far as the inaccuracy results in a discrepancy which exceeds ten per cent (10 %) of the total amount or of the total value of the goods, the provision of services or the trade generally;

5. if it fails to keep accurately the books and records required by the Code on Taxation Data, in so far as that inaccuracy has been noted in the course of a regular check, the findings of which have been confirmed either by administrative resolution of the discrepancy or because the period allowed for an appeal has expired or as a result of a definitive decision by an administrative tribunal, provided that during the management period checked the discrepancy between gross income and the income declared is more than twenty per cent (20 %) and in any case not less than one million (1 000 000) Greek drachmas;

6. if it fails to observe the obligation to keep books and records as laid down in the relevant provisions of the Code on Taxation Data;

7. if it issues false or fictitious — or itself falsifies — invoices for the sale of goods or the supply of services or any other taxation details as referred to in case 3 above.

   A taxation document is regarded as false if it has been perforated or stamped in any way without the proper authentication having been entered in the relevant books of the competent tax authority, in so far as failure to make such an entry has occurred in the knowledge that such authentication is required for the taxation document. A taxation document is also regarded as false if the content and other details of the original or the copy differ from those which are recorded on the counterfoil of that document.

   A taxation document is regarded as fictitious if it has been issued for a transaction or part of a transaction, transfer or any other reason not recorded in the total or for a transaction carried out by persons different from those recorded in the taxation document;

8. if it is aware of the intention of the action taken and collaborates in any way in the production of false taxation documents or is aware that the documents are false or fictitious and collaborates in any way in their issue or accepts the false, fictitious or falsified taxation documents with the intention of concealing material relevant to taxation.

Spain

The term 'serious penalties' includes administrative penalties for serious tax infringements, as well as criminal penalties for offences committed with respect to the taxation authorities.

France

The term 'serious penalties' includes criminal penalties and tax penalties such as penalties for failure to make a tax return after receiving a summons, for lack of good faith, for fraudulent practices, for opposition to tax inspection, for secret payments or distribution, or for abuse of rights.

Ireland

'Serious penalties' shall include penalties for:

(a) failing to make a return;

(b) fraudulently or negligently making an incorrect return;

(c) failing to keep proper records;

(d) failing to make documents and records available for inspection;

(e) obstructing persons exercising statutory powers;

(f) failing to notify chargeability to tax;

(g) making a false statement to obtain an allowance.

The legislative provisions governing these offences, as at 3 July 1990, are as follows:

— Part XXXV of the Income Tax Act, 1967,

— Section 6 of the Finance Act, 1968,

— Part XIV of the Corporation Tax Act, 1976,

— Section 94 of the Finance Act, 1983.

Any subsequent provisions replacing, amending or updating the penalty code would also be comprehended.

Italy

The term 'serious penalties' means penalties laid down for illicit acts, within the meaning of the domestic law, constituting a tax offence.

Luxembourg

Luxembourg considers to be a 'serious penalty' what the other Contracting State considers to be so for the purposes of Article 8.

Netherlands

The term 'serious penalty' means a penalty imposed by a judge for any action, committed intentionally, which is mentioned in Article 68 of the General Law on taxation.

Portugal

The terms 'serious penalties' include criminal penalties as well as the further tax penalties applicable to infringements committed with intent to defraud or in which the fine applicable is of an amount exceeding 1 000 000 (one million) Portuguese escudos.

United Kingdom

The United Kingdom will interpret the term 'serious penalty' as comprising criminal sanctions and administrative sanctions in respect of the fraudulent or negligent delivery of incorrect accounts, claims or returns for tax purposes.

Declaration by the Federal Republic of Germany on Article 16

The Government of the Federal Republic of Germany reserves the right to declare, when lodging its instrument of ratification that the Convention also applies to Land of Berlin.

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Proposal for a Council Directive on a common system of taxation applicable to interest and royalty payments made between parent companies and subsidiaries in different Member States

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular Article 100 thereof,

Having regard to the proposal from the Commission,

Having regard to the opinion of the European Parliament,

Having regard to the opinion of the Economic and Social Committee,

Whereas, in a common market having the characteristics of a domestic market, transactions between companies in different Member States must not be subject to less favourable tax conditions than those applicable to the same transactions carried out between companies in the same Member State;

Whereas this requirement is not currently met as regards interest and royalty payments; whereas national tax laws coupled, where applicable, with bilateral agreements do not ensure complete elimination of double taxation, and whereas their application entails administrative formalities and cash-position problems for the companies concerned;

Whereas abolition of all withholding taxes on interest and royalty payments is the most appropriate means of eliminating such formalities and problems and of ensuring equality of tax treatment as between national and transnational transactions; whereas it is necessary, initially, to abolish withholding tax in respect of such payments of special importance made between parent companies and subsidiaries; whereas the arrangements should not apply under certain conditions where the payment is made to a permanent establishment of the recipient company located in the Member State of the debtor; whereas Greece and Portugal should, for budgetary reasons, be authorized to retain a withholding tax temporarily;

Whereas it is necessary to ensure that interest and royalty payments are actually taxed; whereas it is therefore necessary to permit Member States to take the appropriate measures to combat fraud or abuse,

HAS ADOPTED THIS DIRECTIVE:

Article 1

Member States shall exempt from any withholding tax interest and royalty payments made between parent companies and subsidiaries in different Member States.

Article 2

For the purposes of this Directive:

(a) 'interest' means income from debt-claims of every kind, whether or not carrying a right to participate in the debtor's profits, including premiums and prizes attaching to bonds or debentures;

(b) 'royalties' means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial, or scientific equipment, or for information concerning industrial, commercial or scientific experience.

Article 3

For the purposes of this Directive, 'company of a Member State' means any company which:

(a) takes one of the forms listed in the Annex hereto;

(b) according to the tax laws of a Member State, is considered to be resident in that State for tax purposes and, under the terms of a double taxation agreement concluded with a third State, is not considered to be resident for tax purposes outside the Community;

(c) is subject to one of the following taxes, without the possibility of an option or of being exempt in respect of the income covered by this Directive:

- impôt des sociétés/vennootschapsbelasting in Belgium,
- selskabsskat in Denmark,
- Körperschaftsteuer in the Federal Republic of Germany,
- φόρο εισοδήματος νομικών προσώπων κερδοσκοπικού χαρακτήρα in Greece,

— impuesto sobre sociedades in Spain,

— impôt sur les sociétés in France,

— corporation tax in Ireland,

— imposta sul reddito delle persone giuridiche in Italy,

— impôt sur le revenu des collectivités in Luxembourg,

— vennootschapsbelasting in the Netherlands,

— imposto sobre o rendimento das pessoas colectivas in Portugal,

— corporation tax in the United Kingdom,

or to any other tax which may be substituted for any of the above taxes.

Article 4

1. For the purposes of this Directive:

(a) the status of parent company shall be attributed at least to any company in a Member State which fulfils the conditions set out in Article 3 and has a minimum holding of 25 % in the capital of a company in another Member State fulfilling the same conditions;

(b) 'subsidiary' means that company the capital of which includes the holding referred to in (a).

2. By way of derogation from paragraph 1, Member States shall have the option of:

— replacing, by means of bilateral agreement, the criterion of a capital holding by that of a holding of voting rights,

— not applying this Directive to companies in their countries which do not retain, for an uninterrupted period of at least two years, holdings qualifying them as parent companies, or to those companies in their countries in which a company in another Member State does not retain such a holding for an uninterrupted period of at least two years.

Article 5

Notwithstanding Article 1, Greece and Portugal may levy a withholding tax on interest and royalty payments made by subsidiaries to parent companies in other Member States until a date not later than the end of the seventh year following the date of application of this Directive.

Subject to the existing bilateral agreements concluded between Greece or Portugal and a Member State, the rate of this withholding tax may not exceed 10 % during the first five years and 5 % during the last two years of that period.

Before the end of the seventh year, the Council shall decide unanimously, on a proposal from the Commission, on a possible extension of the provisions of this Article.

Article 6

The provisions of this Directive shall apply to interest and royalty payments made to a permanent establishment of the recipient company located in the Member State of the debtor company only if that Member State does not apply withholding tax to payments of the kind made between resident parent companies and subsidiaries.

Article 7

This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse.

Article 8

1. Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive before 1 January 1993.

They shall immediately inform the Commission thereof.

When Member States adopt these measures, these shall contain a reference to this Directive or shall be accompanied by such reference at the time of their official publication. The procedure for such reference shall be adopted by Member States.

2. Member States shall ensure that the texts of the main provisions of national law which they adopt in the field covered by this Directive are communicated to the Commission.

Article 9

This Directive is addressed to the Member States.

ANNEX

List of forms of companies referred to in Article 3

(a) companies under Belgian law known as 'société anonyme'/'naamloze vennootschap', 'société en commandite par actions'/'commanditaire vennootschap op aandelen', 'société privée à responsabilité limitée'/'besloten vennootschap met beperkte aansprakelijkheid' and those public-law bodies that operate under private law;

(b) companies under Danish law known as: 'aktieselskab', 'anpartsselskab';

(c) companies under German law known as: 'Aktiengesellschaft', 'Kommanditgesellschaft auf Aktien', 'Gesellschaft mit beschränkter Haftung', 'bergrechtliche Gewerkschaft';

(d) companies under Greek law known as: 'ανώνυμη εταιρεία';

(e) companies under Spanish law known as: 'sociedad anónima', 'sociedad comanditaria por acciones', 'sociedad de reponsabilidad limitada' and those public-law bodies which operate under private law;

(f) companies under French law known as 'société anonyme', 'société en commandite par actions', 'société à responsabilité limitée' and industrial and commercial public establishments and undertakings;

(g) the companies in Irish law known as 'companies incorporated under Irish law', 'registered building societies', and 'registered industrial and provident societies';

(h) companies under Italian law known as 'società per azioni', 'società in accomandita per azioni', 'società a responsabilità limitata', and public and private entities carrying on industrial and commercial activities;

(i) companies under Luxembourg law known as 'société anonyme', 'société en commandite par actions', 'société à responsabilité limitée';

(j) companies under Dutch law known as: 'naamloze vennotschap', 'besloten vennootschap met beperkte aansprakelijkheid';

(k) commercial companies or civil-law companies having a commercial form, cooperatives and public undertakings incorporated in accordance with Portuguese law;

(l) companies incorporated under the law of the United Kingdom.

Withholding tax rates on royalties (1)

Situation on 1 July 1990

(in percent)

Residence State of the beneficiary \ Residence State of the debtor	Belgium	Denmark	Spain	France	Greece	Ireland	Italy	Luxembourg	Netherlands	Portugal	Germany	United Kingdom
Country without tax treaty	10	30	25	33 1/3	25	30	21	12	0	15	25	25
Belgium	—	0	5	0	5	0	5	0	0	5	0	0
Denmark	0	—	6	0	25 (2)	0	5	0	0	10	0	0
Spain	5	6	—	6	25 (2)	30 (2)	4	10	0	5	5	10
France	0	0	6	—	5	0	0	0	0	5	0	0
Greece	5	30 (2)	25 (2)	5	—	30 (2)	0	12 (2)	0	15 (2)	0	0
Ireland	0	0	25 (2)	0	25 (2)	—	0	0	0	15 (2)	0	0
Italy	5	5	8	0	0	0	—	10	0	12	0	8
Luxembourg	0	0	10	0	25 (2)	0	10	—	0	15 (2)	5	5
Netherlands	0	0	6	0	7	0	0	0	—	15 (2)	0	0
Portugal	5	10	5	5	25 (2)	30 (2)	12	12 (2)	0 (2)	—	10	5
Germany	0	0	5	0	0	0	0	5	0	10	—	0
United Kingdom	0	0	10	0	0	0	0	5	0	5	0	—

(1) The possible value added tax applied is not included in these rates.
(2) No tax treaty.

Withholding tax rates on ordinary interest payments by a non-resident subsidiary to its parent company

Situation on 1 July 1990

(in percent)

Residence State of the beneficiary \ Residence State of the debtor	Belgium	Denmark	Spain	France	Greece (1)	Ireland	Italy	Luxembourg	Netherlands	Portugal	Germany	United Kingdom
Country without tax treaty	10	0	25	0	46	30	30	0	0	20	0	25
Belgium	—	0	15	0	15	15	15	0	0	15	0	15
Denmark	10	—	10	0	46 (2)	0	15	0	0	15	0	0
Spain	10	0	—	0	46 (2)	30 (2)	12	0	0	15	0	12
France	10	0	10	—	10	0	15	0	0	12	0	0
Greece	10	0 (2)	25 (2)	0	—	30 (2)	10	0 (2)	0	20 (2)	0	0
Ireland	10	0	25 (2)	0	46 (2)	—	10	0	0	20 (2)	0	0
Italy	10	0	12	0	10	10	—	0	0	15	0	10
Luxembourg	10	0	10	0	46 (2)	0	10	—	0	20 (2)	0	0
Netherlands	0	0	10	0	10	0	15	0	—	20 (2)	0	0
Portugal	10	0	15	0	46 (2)	30 (2)	15	0 (2)	0 (2)	—	0	10
Germany	10	0	10	0	10	0	0	0	0	15	—	0
United Kingdom	10	0	12	0	0	0	15	0	0	10	0	—

(1) Moreover, 2,4 % stamp duty withheld from interest other than interest on bonds and bank deposits.
(2) No tax treaty.

Explanatory memorandum

General

1. In its communication of 20 April 1990 setting out guidelines on company taxation,[1] the Commission pointed out that one of the aims of the internal market was to enable companies to operate throughout the Community without falling foul of legislative frontiers or obstacles.

2. One of the frontiers between Member States is due to taxation, which affects financial flows between companies established in different Member States. Transactions between different companies within the internal market should take place under the same conditions as those between companies operating within a single Member State.

3. The withholding tax levied on interest and royalty payments is one of the tax measures impeding transnational cooperation between companies from different Member States.

4. While the unilateral measures taken by Member States to eliminate the double taxation of such income and bilateral tax agreements have gone some way towards overcoming this obstacle, they are not a satisfactory solution and do not fully meet the requirements of the internal market.

5. Such unilateral measures and bilateral agreements generally allow withholding taxes, often levied at reduced rates, to be set against the tax payable by recipient companies. However, double taxation occurs wherever it is not stipulated that withholding taxes are deductible from the taxable profits of the recipient company or where that company cannot use or can only partially use the tax credit because the amount of tax payable by it is insufficient or nil.

6. What is more, bilateral agreements generally make the reduction or abolition of the withholding tax conditional on completion of administrative formalities. Application of withholding taxes may also give rise to a cash-position problem, since some time will elapse between receipt of the income from which the withholding tax has been deducted and the setting-off of the tax credit against payment of tax.

7. The most sensible solution is therefore to abolish these withholding taxes altogether. The OECD Model Double Taxation Convention lays down the principle that no withholding tax should be levied on royalties. While all the member countries have endorsed this principle, it is not applied in all bilateral relations.

8. In order to cushion the budgetary impact of such a step, particularly for those Member States which are net importers of capital and technology and for which withholding tax on such payments represents an appreciable source of tax revenue, a gradual approach would seem to be appropriate.

Initially, therefore, it is proposed that only withholding taxes on royalty payments made between companies belonging to the same group should be abolished, subject to the same conditions as are laid down in the parent companies/subsidiaries Directive.[2] The imposition of withholding tax is particularly harsh in the case of dealings between companies belonging to the same group. It will be possible for the measure to be extended later to withholding taxes levied on royalty and interest payments made between companies not belonging to the same group as part of the further development of the single market.

As a second step specifically designed to help those Member States which are net importers of capital and technology, it would be appropriate to introduce arrangements for the gradual abolition of withholding taxes along the lines of the parent companies/subsidiaries Directive.

9. It would seem justifiable not to alter the established practice in most Member States regarding a company which receives royalty and interest payments and which has a permanent establishment in the Member State of the debtor company. In such cases, the Member State concerned applies to these flows the same rules it applies to other companies established on its territory.

10. This Directive in no way restricts Member States' freedom to take steps to combat fraud and abuse; in particular, it does not affect the tax authorities' right to adjust transfer prices.

Furthermore, the provisions of the Council Directive of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation[3] also apply to royalty and

[1] SEC(90) 601 final of 20 April 1990, pp. 7–20, this volume.

[2] Directive 90/435/EEC of 23 July 1990, OJ L 225 of 20 August 1990, pp. 27–30.

[3] OJ L 336, 27.12.1977.

interest payments and the exchange — and in particular the spontaneous exchange — of information where there appears to be a transfer of profits can enhance the effectiveness of measures to prevent evasion and avoidance in these fields.

Commentary

Article 1

The aim of this Article is to exempt, from withholding tax, interest and royalty payments made by a subsidiary to its parent company or by a parent company to its subsidiary established in another Member State where the conditions set out in Article 4 are met.

Article 2

(a) The term 'interest' as used for the purposes of this Directive denotes income from debt-claims of every kind, whether or not carrying a right to participate in profits. The term 'debt-claims of every kind' embraces cash deposits and security in the form of money, as well as bonds and debentures. The definition applied is that given in Article 11 of the 1977 OECD Model Convention.

Debt-claims, bonds and debentures which carry a right to participate in the debtor's profits are, non the less, still regarded as loans if the contract by its general character clearly evidences a loan at interest. Anyhow, the parent companies/subsidiaries Directive already provides for the abolition of withholding tax on dividends. It, therefore, seems logical to provide for the abolition of withholding tax on the payment of income derived from these securities.

(b) The term 'royalties' as used for the purposes of this Directive denotes payments received as a consideration for the use of, or the entitlement to use, rights or property constituting the different forms of literary and artistic property, the elements of industrial and commercial property specified in the Article and information concerning industrial, commercial or scientific experience. As in the case of interest, the definition given in the OECD Model Convention (Article 12) has been taken over.

A distinction has to be made between royalties paid for the use of equipment and payments constituting consideration for the sale of equipment. The latter do not constitute royalties and are not covered by this Directive. In the case of leasing, the principal purpose of the contract is normally that of hire, even if the hirer has the right to opt during its term to purchase the equipment in question outright. This Article therefore applies to the rentals paid by the hirer.

The reference to royalties paid as consideration for information concerning industrial, commercial or scientific experience is an allusion to the concept of 'know-how'. In a know-how contract, one of the parties agrees to impart his knowledge and experience to the other, so that he can use them for his own account. Payments made as consideration for after-sales service, for services rendered by a seller to the purchaser under a guarantee, for pure technical assistance or for an opinion do not constitute royalties, since they stem from contracts for the provision of services in which one of the parties undertakes to use the customary skills of his calling to execute work himself for other party.

Article 3

The aim of this Article, which is identical to Article 2 in the parent companies/subsidiaries Directive, is to indicate those companies which may benefit from the application of this Directive. It covers all companies with share capital that are subject to the laws of a Member State and to corporation tax in a Member State.

Given that the proposal measure is being presented in the context of transnational cooperation between firms in different Member States, it seems logical to confine its coverage to companies which are resident for tax purposes in a Member State.

Article 4

This Article defines the concepts of 'parent company' and 'subsidiary'. Two problems arise in this connection:

- the fixing of a minimum threshold for holdings; and

- the period during which such holdings have to be retained.

For the purposes of this Directive, the criteria adopted are the same as those laid down in the parent companies/subsidiaries Directive.

Article 5

The abolition of the withholding tax should, in principle, take place without delay in all Member States.

As in the case of the parent companies/subsidiaries Directive, however, it is appropriate to introduce arrangements for the gradual abolition of withholding taxes in those Member States which are large net importers of capital and technology and for which withholding taxes represent an appreciable source of tax revenue, namely Greece and Portugal. Provision has been made for a transitional period of seven years — during which the rate of withholding tax is to be reduced progressively — so as to ensure parallelism with the parent companies/subsidiaries Directive, which provides for transitional arrangements expiring on 31 December 1999.

Article 6

In order to ensure that permanent establishments and companies are treated equally, this Article stipulates that the Directive applies also to interest and royalty payments made to a permanent establishment of the recipient company located in the Member State of the debtor company only if that Member State does not apply withholding tax to payments of the kind made between parent companies and subsidiaries established on its territory.

Article 7

It is essential to ensure that interest and royalties are actually charged to tax, since they can normally be deducted by the debtor company.

Member States should therefore be in a position to combat fraud and abuse effectively.

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Proposal for a Council Directive concerning arrangements for the taking into account by enterprises of the losses of their permanent establishments and subsidiaries situated in other Member States

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular Article 100 thereof,

Having regard to the proposal from the Commission,

Having regard to the opinion of the European Parliament,

Having regard to the opinion of the Economic and Social Committee,

Whereas in a common market having the characteristics of an internal market, the activities of enterprises across Community borders should not be treated less favourably than activities limited to a single Member State, a requirement that is not currently met, since existing legislation often does not permit enterprises to take into account the losses incurred by their permanent establishments and subsidiaries situated in other Member States; whereas it is consequently necessary to introduce common rules covering all enterprises, whatever their legal form;

Whereas, in the case of permanent establishments, Member States should ensure that the enterprises of which they form an integral part are able to take account of their losses, either by allowing the results of such permanent establishments to be included in those of the enterprises and, at the same time, authorizing the latter to deduct the tax paid by the said establishments in the other Member States from any tax due in respect of their profits, or by authorizing the enterprise to deduct the losses of its permanent establishments from its own profits and taxing subsequent profits of the latter to the extent of the losses deducted; whereas the results of permanent establishments should be determined Member State by Member State;

Whereas in the case of subsidiaries, the latter method appears under the present circumstances to be the most appropriate means of allowing enterprises to offset the losses incurred with respect to activities across Community borders; whereas it is appropriate for the account taken by the parent enterprise of its subsidiaries' losses and profits to be determined separately for each subsidiary in proportion to the parent's holding therein; whereas, since a subsidiary is a legally independent entity, the enterprise which controls it should be free to decide whether or not to take into account its losses; whereas provision should be made to prevent the same losses from being taken into account twice by excluding the use of the method specified in this Directive in conjunction with an adjustment to the value of the holding;

Whereas, where the enterprise applies the method of deducting losses with reintegration of subsequent profits, the results of permanent establishments and subsidiaries may without any difficulty be determined according to the law of the Member State in which they are situated;

Whereas, in order to preclude unjustified advantages for enterprises and to safeguard the Member States' tax revenues, Member States must be allowed, in certain circumstances, to reincorporate automatically losses previously deducted; whereas, in addition, Member States should be free to apply provisions designed to prevent tax evasion and abuse;

Whereas it is appropriate to allow Member States the option of maintaining or introducing other means of taking into account subsidiaries' losses alongside the common method defined in this Directive;

Whereas, with a view to improving the worldwide competitiveness of Community enterprises, it appears appropriate to extend the arrangements laid down by this Directive to permanent establishments and subsidiaries situated in non-member countries; whereas Member States should be free to determine the conditions and scope of any such extension,

HAS ADOPTED THIS DIRECTIVE:

Article 1

Member States shall adopt, in accordance with the provisions of this Directive, arrangements enabling their enterprises to take account of the losses incurred by permanent establishments or subsidiaries situated in other Member States.

TITLE I

General provisions

Article 2

For the purposes of this Directive:

— *'enterprise of a Member State'* means any enterprise which, under the tax legislation of a Member State, is considered to be resident for tax purposes in that State,

— *'permanent establishment'* means any fixed place of business through which an enterprise of a Member State carries on all or part of its activities,

— *'subsidiary'* means any company in the capital of which an enterprise of a Member State has a minimum holding of 75 %, giving it a majority of voting rights. Member States may, however, stipulate a lower minimum holding.

Article 3

In order to fall within the provisions of this Directive, the enterprises, permanent establishments, and subsidiaries referred to in Article 2 must be subject to, without being exempt from, one of the following taxes:

(a) in Belgium:

— impôt des personnes physiques/personenbelasting,

— impôt des sociétés/vennootschapsbelasting,

— impôt des non-résidents/belasting der niet-verblijfhouders;

(b) in Denmark:

— selskabsskat,

— indkomstskat til staten;

(c) in Germany:

— Einkommensteuer,

— Körperschaftsteuer;

(d) in Greece:

— φόρος εισοδήματος φζσικών προσώπων,

— φόρος εισοδήματος νομικών προσώπων,

(e) in Spain:

— impuesto sobre la renta de las personas físicas,

— impuesto sobre sociedades;

(f) in France:

— impôt sur le revenu,

— impôt sur les sociétés;

(g) in Ireland:

— income tax,

— corporation tax;

(h) in Italy:

— imposta sul reddito delle persone fisiche,

— imposta sul reddito delle persone giuridiche;

(i) in Luxembourg:

— impôt sur le revenu des personnes,

— impôt sur le revenu des collectivités;

(j) in the Netherlands:

— inkomstenbelasting,

— vennootschapsbelasting;

(k) in Portugal:

— imposto sobre o rendimento das pessoas singulares,

— imposto sobre o rendimento das pessoas collectivas;

(l) in the United Kingdom:

— income tax,

— corporation tax,

or any other tax which may be considered a substitute for one of these taxes.

Article 4

Member States may extend the application of this Directive, under conditions which they shall lay down, to all or some of their enterprises' permanent establishments and subsidiaries situated outside the Community. However, these conditions may not be more favourable than those applicable to permanent establishments and subsidiaries situated in the other Member States.

TITLE II

Provisions relating to permanent establishments

Article 5

Member States shall make provision for their enterprises to take account of the losses incurred by permanent establishments situated in another Member State either by means of the credit method defined in Article 6, or by means of the method of deducting losses and reincorporating subsequent profits, as defined in Article 7.

Application of the credit method shall be obligatory for enterprises in Member States that have chosen it; application of the method of deducting losses and reincorporating subsequent profits is a matter for each enterprise to decide.

Article 6

The credit method shalll consist of including in the enterprise's results for a given tax period the positive or negative results of all the enterprise's permanent establishments situated in another Member State, and where appropriate, crediting the tax paid by the latter against any tax which may be payable by the enterprise on the profits of such establishments.

Article 7

1. The method of deducting losses and reincorporating subsequent profits shall involve:

(a) the deduction from the enterprise's taxable profits for a given tax period of the loss incurred in the same tax period by the enterprise's permanent establishments situated in other Member States;

(b) the incorporation of subsequent profits of such permanent establishments into the enterprise's taxable income to the extent of the loss deducted pursuant to subparagraph (a).

2. The income of permanent establishments shall be determined Member State by Member State in accordance with the rules of the law of the Member State in which the permanent establishment is situated.

Article 8

Member States may make provision for losses which are deductible pursuant to Article 7 to be automatically reincorporated into the enterprise's taxable results in one of the following circumstances:

(a) where reincorporation has not occurred by the end of the fifth year following that during which the loss became deductible;

(b) where the permanent establishment has been sold, wound up or transformed into a subsidiary.

TITLE III

Provisions relating to subsidiaries

Article 9

1. Member States shall make provision for their enterprises to take account of the losses incurred by subsidiaries situated in another Member State by means of the method of deducting losses and reincorporating subsequent profits.

This method shall involve:

(a) the deduction from the enterprise's taxable profits for a given tax period of the loss incurred in the same tax period by the enterprise's subsidiaries situated in other Member States;

(b) the incorporation of subsequent profits of such subsidiaries into the enterprise's taxable income to the extent of the loss deducted pursuant to subparagraph (a).

2. The income of each subsidiary shall be determined in accordance with the rules of the law of the Member State in which it is situated, in proportion to the holding which the enterprise has in its capital. The level of holding to be applied in this respect shall be the lowest obtaining during the tax period in question.

Article 10

Member States may make provision for losses which are deductible pursuant to Article 9 to be automatically reincorporated into the enterprise's taxable income in one of the following circumstances:

(a) where reincorporation has not occurred by the end of the fifth year following that in which the loss became deductible;

(b) where the subsidiary is sold, wound up or transformed into a permanent establishment;

(c) where the enterprise's holding in the capital of the subsidiary has fallen below the minimum level laid down by the Member State in which the enterprise is situated.

Article 11

Application of the method defined in Article 9 shall be incompatible with any correction of the value of the holding of that enterprise in a subsidiary.

Article 12

The provisions of this Directive shall not prevent Member States from maintaining or introducing other methods of taking into account the losses of subsidiaries of its enterprises located in other Member States, including the consolidated profit method.

TITLE IV

Final provisions

Article 13

This Directive shall not preclude the application of provisions laid down by national law or under agreements to prevent tax evasion or abuse.

Article 14

1. Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive before 1 January 1993. They shall immediately inform the Commission thereof.

When Member States adopt these measures, these shall contain a reference to this Directive or shall be accompanied by such reference at the time of their official publication. The procedure for such reference shall be adopted by Member States.

2. Member States shall ensure that the texts of the main provisions of national law which they adopt in the field covered by this Directive are communicated to the Commission, and, should the occasion arise, the texts of measures taken to extend the provisions of this Directive to permanent establishments and, subsidiaries of their enterprises located outside the Community.

Article 15

This Directive is addressed to the Member States.

ANNEX

Tax arrangements applicable to losses of subsidiaries and foreign permanent establishments

Member State	Resident subsidiary	Foreign permanent establishment	Foreign subsidiary
Belgium	—	— No tax treaty: deduction with reintegration following a certain order (Article 66 and following AR — CIR) — Tax treaties: exemption method — Deduction with reintegration where a treaty provides for exemption	—
Denmark	Consolidation (consolidated profit 100 % subsidiary)	— No tax treaty: taxation of worldwide income with tax credit — Tax treaties: taxation of worldwide income with either tax credit or exemption with progression, or exemption	Consolidation (consolidated profit 100 % subsidiary) Double taxation is in practice avoided in the same way as for foreign permanent establishments
Germany	Consolidation when the Organschaft system is applied (subsidiary under financial (51 % of votes) structural and economic control) at the option of the parent company	— No tax treaty: taxation of worldwide income with tax credit — Tax treaties: exemption method deduction of losses with reintegration where a treaty provides for exemption	—
Greece	—	— No tax treaty: in principle tax credit method except if the global result of all permanent establishments is negative (no deduction of losses in such cases) — Tax treaties: tax credit method	—
Spain	Consolidation (consolidated profit) 90 % subsidiary minimum	— No tax treaty: taxation of worldwide income with tax credit — Tax treaties: tax credit method	—
France	Consolidation if: 1. Consolidated profit (bénéfice consolidé) upon authorization by the tax authorities [1] 2. System of fiscal integration (régime d'intégration fiscale) 95 % subsidiary minimum	— Tax treaties: exemption method — Taxation of worldwide income in the framework of the 'bénéfice mondial' system upon authorization by the tax authorities [1] and irrespective of whether a treaty applies or not	Consolidation if: 1. Regime of 'bénéfice consolidé on authorization [1] 2. Deduction of losses of the first five years to the invested amount for investment in the EEC with automatic reincorporation once profits are carried and at the latest after 10 years (Article 39-80-B-CGI)
Ireland	Loss offsetting if: 1. A minimum participation of 75 % in a subsidiary or 2. Consortium	— No tax treaty: taxation of world wide income with tax credit — Tax treaties: tax credit method — If the foreign tax rate exceeds the Irish rate, a partial deduction is granted for the excess amount	—

[1] In practice very limited application.

Member State	Resident subsidiary	Foreign permanent establishment	Foreign subsidiary
Italy	—	— No tax treaty: taxation of world wide income with tax credit — Tax treaties: tax credit method	—
Luxembourg	Tax consolidation when the Organschaft system is applied (subsidiary at 99 %) at the option of the parent enterprise and upon authorization by the Minister of Finance	— No tax treaty: taxation of world wide income with tax credit — Tax treaties: exemption method without deduction of losses	—
Netherlands	Tax consolidation when application of fiscal entity (fiscale eenheid) 99 % subsidiary. Under certain conditions losses which arise in the case of winding up a subsidiary that is part of a fiscal entity can be taken into account	No tax treaty: taxation of world wide income with tax credit Tax treaties: exemption method Deduction with reintegration in case of losses when a treaty provides for the exemption method	Under certain conditions, losses which arise in the case of winding up a subsidiary can be taken into account
Portugal	*Consolidation* (90 % subsidiary at the option of the parent enterprise)	— No tax treaty: taxation of world wide income — Tax treaties: taxation of worldwide income with tax credit	—
United Kingdom	Tax arrangements for losses if: 1. 75 % subsidiary minimum or 2. Consortium	— No tax treaty: taxation of world wide income with tax credit — Tax treaties: tax credit method	—

(¹) In practice very limited application.

Explanatory memorandum

General

Introduction

1. One of the obstacles which might seriously hamper the activities of enterprises in a common market having the same characteristics as an internal market is their inability to deduct from their profits the losses incurred by permanent establishments and subsidiaries situated in Member States other than the one in which the enterprise in question is resident for tax purposes.

In its communication to Parliament and the Council of 20 April 1990 concerning 'Guidelines on company taxation' (Doc. SEC(90) 601 final), the Commission stressed the need to find a common solution enabling this obstacle to the single European market to be removed.

Problems affecting permanent establishments

2. While the results of establishments situated within the country of the head office form an integral part of the enterprise's results, the mere fact that there is a frontier between a permanent establishment and its head office may result in the losses of the foreign permanent establishment not being deductible from the profits of the head office. The enterprise therefore pays an excessive amount of tax in relation to the total net result of its activity since taxation is based on the result achieved solely in the country in which the head office is situated.

3. This problem does not arise in Member States which take account of the results — positive or negative — of a foreign permanent establishment, thus avoiding double taxation, where profits are made, by crediting foreign tax to the domestic tax payable in respect of the permanent establishment (imputation or tax credit method).[1]

In contrast, those other Member States which exempt the profits of a foreign permanent establishment (exemption method) do not in principle take into account the losses incurred by such a permanent establishment. However, some of them do allow foreign losses to be deducted while also taxing subsequently any profits the permanent establishment makes by reincorporating them into the results of the head office to the extent of the amounts previously deducted.

4. It is the latter solution (reincorporation method) which the Commission has opted for in its proposal for a Council Regulation on the Statute for a European Company (Article 133).[2]

The Commission considers, however, that this solution should be available not solely to the European company but to all companies engaged in transfrontier activities through permanent establishments or subsidiaries, whatever their legal form.

The general application of arrangements for taking losses into account will also be of benefit to a new legal structure for transfrontier cooperation governed directly by Community law, i.e. the European economic interest grouping (EEIG). In practice, an EEIG might be regarded by the tax authorities as a permanent establishment of its members. In this case, the results of the EEIG will be calculated separately from the results determined at the level of its members.

In view of the auxiliary nature of an EEIG's activity, the risk that such determination of results in the country in which the EEIG is established will lead to losses is considerably greater than in the case of the other enterprises. The non-deductibility of such losses in the member's country of residence constitutes an obstacle to making use of this new Community instrument for the purposes of transfrontier cooperation.

Problems affecting subsidiaries

5. An enterprise may carry on its activity outside the territory of the Member State in which its head office is situated, either through the intermediary of a permanent establishment, or through that of a subsidiary, the latter having its own legal personality and coming under the law of the Member State in which it is established. Economically speaking, these two structures used to carry on an activity abroad are equivalent, and the choice between them should not

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[1] See Annex, p. 58.

[2] Doc. COM(89) 268 Final — SYN 218 and SYN 279, 25 August 1989.

necessarily be influenced by tax considerations. However, the choice between them would not be neutral if the arrangements for deducting losses incurred by foreign subsidiaries were less favourable than those applicable to permanent establishments.

Equality of treatment between permanent establishments and subsidiaries is not, however, a generally accepted idea. Traditionally, company taxation is based on the legal concept of the independence of companies without consideration of the economic ties which may exist between them. In some Member States, this approach also determines the tax rules applicable to subsidiaries, not only on an international level but also domestically.

Annex 1 contains a summary of the rules applicable in the Member States at both these levels.

Possible solutions in the case of a permanent establishment

6. Given that a number of Member States [1] already apply the credit method to the results of foreign permanent establishments, it seems logical to adopt this method as one of the common solutions.

This method must still allow any negative result which may arise for all foreign permanent establishments combined to be deducted from the profits of the head office. Consequently, provisions imposing limits in this regard, such as those currently applied in Greece, cannot be maintained.

7. Another solution is to permit enterprises to deduct losses incurred by their permanent establishments situated abroad from the results of the head office and subsequently to tax the profits of such permanent establishments by reincorporating them into the results of the head office to the extent of amounts previously deducted ('method of deducting losses and reincorporating subsequent profits').

This method may, for example, be chosen by Member States in which the law does not provide for the credit method and which consequently exempt profits earned outside the country.

8. However, according to the particular characteristics of each of these two methods, certain arrangements must be made in order to safeguard the revenue interests of the country in which the enterprise is established and to prevent manipulation.

This is particularly true for the method of deduction and subsequent reincorporation since it would give the enterprise an unjustified advantage if it were possible to escape recovery of the tax not previously due because of reduced taxation. For this reason, Member States should be permitted to reincorporate automatically amounts previously deducted if reincorporation has still not occurred after five years or if the permanent establishment ceases to exist in that form.

9. At the same time, compulsory reincorporation allows for some flexibility in the choice of tax legislation to be applied for determining the results of foreign permanent establishments. Since the country in which the head office is situated is authorized subsequently to compensate for the deduction of losses by taxing the profits of the permanent establishment, there is no reason why both the losses and profits taken into account should not be those determined in accordance with the rules of the Member State in which the permanent establishment is situated.

10. Arrangements for taking into account the losses of foreign permanent establishments must be compulsory only in respect of permanent establishments situated within the Community. Of course, Member States remain free to extend the scope of the method they choose to cover all or some of the permanent establishments situated outside the Community, and to determine the conditions of such extension. Some of them, in particular those which apply the credit method as the basic arrangement, have already done so.

11. In the interests of the proper functioning of the reincorporation mechanism based on the deduction method it is desirable for there to be parallel harmonization of the rules enabling the losses of the permanent establishment to be carried forward to subsequent tax years in the country in which it is situated. It is thus important that the proposal for a Council Directive on the harmonization of the laws of the Member States relating to tax arrangements for the carry-over of losses of enterprises [2], presented by the Commission on 11 September 1984, be adopted alongside this proposal for a Directive.

Possible solutions in the case of a subsidiary

12. The first question to be decided is that of the basic approach: is it sufficient simply to extend

[1] See Annex, p. 58.
[2] OJ C 253, 20.9.1984, p. 5; and OJ C 170, 9.7.1985, p. 3.

beyond national frontiers the arrangements for taking into account the losses of domestic subsidiaries wherever they exist, or should common arrangements be established?

The former approach, i.e. extending the scope of national arrangements beyond the country's frontiers, at first sight offers the advantage that it affords strictly equal treatment to transfrontier activities and those carried on within the country. There are, however, two drawbacks. On the one hand, it would offer no solution to the three Member States whose domestic legislation makes no provision for taking the losses of domestic subsidiaries into account. On the other hand, given the major disparities which exist between the Member States' domestic arrangements, it would create new distortions between their enterprises engaged in transborder activities.

This approach, therefore, does not satisify at all the requirements of fiscal neutrality with respect to competitive conditions on the Community level. For this reason, it has been ruled out by the Commission.

The second approach, i.e. the establishment of common arrangements, does not have these drawbacks. On the contrary, it responds entirely to the necessity of fiscal neutrality.

13. Before moving on to discuss the choice of methods to be adopted for the purposes of the common arrangements, it is necessary to establish the minimum holding which an enterprise must have in a subsidiary before the relationship between the enterprise and the subsidiary can be considered equivalent to that between an enterprise and a permanent establishment.

The holding of a limited number of shares in another company tends to constitute a form of investment for a given enterprise. In order to justify the results, and particularly the losses, of that subsidiary being taken into account for tax purposes at the level of the enterprise heading the group, the latter should have a sufficient influence on the management of the subsidiary. This condition can be considered satisfied if the holding in the subsidiary's capital is greater than 50 %, thereby giving the enterprise heading the group a majority of voting rights.

If a closer parallelism is to be established between permanent establishment and subsidiary as regards their respective degree of economic integration with the head of the group, a threshold of 100 % might even be envisaged. However, whilst this would offer clear advantages in terms of simplicity, it would considerably limit the scope of the arrangements because the holding of the entire capital of a subsidiary is only possible in practice where new companies are formed.

In this respect, it must be stressed that even those Member States which apply a system of consolidation at national level do not, with the exception of Denmark, require a 100 % holding.

On the other hand, in order to avoid inverse distortions that work to the detriment of resident groups of undertakings, the conditions of common arrangements for taking foreign losses into account should not be too different from those applied at national level. In this regard, it is noteworthy that those Member States with a system of loss offsetting at the national level for subsidiaries require a holding of 75 % or more by the parent in its subsidiary.

A holding of 75 % would therefore appear to be appropriate for a common transborder system. It would ensure equal treatment among permanent establishments and subsidiaries and at the same time permit significant use of the common system.

14. As for the methods to be employed, the losses of a foreign subsidiary can, in principle, be taken into account in a similar manner to that described above for permanent establishments, the imputation method being similar to that of profit consolidation.

Nevertheless, the Commission considers that, in view of current national tax laws involving differences in both the tax base and tax rates, the application of this method would encounter considerable practical difficulties, and that it would be extremely difficult for the enterprise concerned to assess the usefulness of such a method. The fact that the French system of consolidation is seldom used is evidence of the latter difficulty.

As the internal market becomes more integrated, however, the Commission does not rule out future use of a common system of consolidation. It is with this prospect in mind, that the Commission will ask the Committee of experts responsible for studying the problems of business taxation to examine the broad range of questions related to the establishment of a common system of consolidation.

15. Consequently, the Commission proposes only the second method, which involves allowing the enterprise heading the group to deduct the losses incurred in a given tax period by its subsidiaries situated in other Member States from its taxable prof-

its for the same tax period, with any subsequent profits by these subsidiaries being reincorporated into the enterprise's taxable results to the extent of the loss previously deducted.

In order to safeguard the tax revenue interests of the Member State in which the enterprise is situated and to prevent manipulation, provision should be made, as in the case of permanent establishments, to allow Member States to reincorporate deducted losses automatically into the enterprise's taxable results if such reincorporation has not been carried out after five years.

16. The Commission has not deemed it appropriate to include at the Community level, another method of taking account of the losses incurred by subsidiaries, i.e. that of writing down the book value of the enterprise's holding. Making this method generally available comes up against the problem that taxable profits are not determined in all Member States in accordance with commercial accounting rules. For this reason, it would be virtually impossible to apply in Member States whose tax legislation lays down that profits for tax purposes are to be determined independently of commercial profits.

But even in those countries which do determine their enterprises' taxable profits in accordance with commercial accounting rules, the effect of the write-down method is limited to the present value of the holding. In cases in which the amount of the subsidiary's losses is greater than the present value of the holding in the enterprise's balance sheet, that portion of losses in excess of the present value may not be taken into account.

Moreover, reincorporation into the enterprise's profits of amounts previously deducted unter the write-down method gives rise to a number of problems. This is because the subjective scope of the Directive takes in all enterprises which, under the tax laws of a Member State, are considered to be resident in that State for tax purposes, whereas the Fourth Council Directive of 25 July 1978 on annual accounts [1], Article 35(1)(c)(dd) of which requires the lower value to be increased if the reasons for which the value adjustments were made have ceased to apply, applies only to limited companies. There would not be any requirement on the other forms of enterprise falling within the scope of this Directive to revalue the holding in their balance sheet. Even in the case of limited companies, the occurrence of subsequent profits in a subsidiary does not as such give rise to revaluation unless it reflects a continuous improvement in the subsidiary's productivity. In other words, the fact that a subsidiary makes a profit in a subsequent tax period does not necessarily result in an adjustment of the value of the holding in the parent enterprise's balance sheet.

17. Each enterprise will be free either to make use of the common method of taking into account the losses incurred by subsidiaries or to have the ordinary arrangements, i.e. separate taxation of subsidiaries, applied to it.

Moreover, there is nothing to prevent a Member State from maintaining or introducing another method of loss offsetting, such as the consolidation method, alongside either of the methods laid down by the Directive, provided it is understood that an enterprise may not combine the former with the common system.

Commentary on individual articles

Article 1

18. Member States will have to make it possible under their laws for their enterprises to take into account the losses they incur through ventures situated in other Member States, be they permanent establishments or subsidiaries.

It is not only limited companies which carry on transfrontier activities through permanent establishments or subsidiaries in other Member States, but also other forms of enterprise, including partnerships and oneman businesses. One of the main aims of this Directive is to establish the principle of equal treatment for all legal forms of enterprise.

Article 2

19. The purpose of this Article is to define three basic notions, i.e. 'enterprise of a Member State', 'permanent establishment' and 'subsidiary'.

- An enterprise is deemed to be situated in a Member State if it is resident there for tax purposes according to the law of the Member State in question, account being taken of the provisions of bilateral agreements.

[1] OJ L 222, 14.8.1978, p. 11.

• The definition of 'permanent establishment' is modelled on that of Article 5 of the OECD Model Convention.

• The notion of subsidiary is defined with reference to two criteria: a majority of voting rights to be held by an enterprise of a Member State, and its holding in the subsidiary's capital to stand at a minimum level. The combination of these two criteria is necessary because of the existence in several Member States of multiple voting shares and non-voting shares.

Although a Member State is free to fix a lower minimum holding, it must always respect the majority voting rights criterion.

Article 3

20. This Article lists the taxes to which the enterprise, permanent establishment or subsidiary must be liable in order to qualify for application of the Directive. These are either personal income tax or corporation tax, depending on the enterprise's legal form.

Article 4

21. It is left to the discretion of each Member State whether to widen the geographical scope of the arrangements laid down by the Directive to permanent establishments or subsidiaries situated outside the Community. Whereas all permanent establishments or subsidiaries situated in the Community must be covered, it is up to the Member States to determine the extent to which the arrangements should apply on a world scale.

However, the provisions applicable to permanent establishments or subsidiaries situated outside the Community may not be more favourable than those applied within the Community. The results of all permanent establishments are already taxed in the hands of the head office in those Member States which apply credit or world-wide profit arrangements.

Article 5

22. This Article lays down that Member States are required to apply to the losses of their enterprises' permanent establishments one of the two methods described in Articles 6 and 7, which are of equal status.

Article 6

23. Article 6 defines the credit method. It is important to note that this method involves taking into account, at the level of the enterprise's head office, both the positive and the negative results of its permanent establishments.

Article 7

24. Since the method of deducting losses and reincorporating subsequent profits gives the enterprise which applies it only a temporary cash advantage, it would seem justified to stipulate that the Member State in which the enterprise in question is resident for tax purposes must allow the losses of permanent establishments situated in other Member States to be deducted as they are shown on the permanent establishments' tax accounts, and should not recalculate them according to its own tax rules.

Should the Member State extend the scope of this method's application to permanent establishments situated outside the Community, it is free to lay down more strict rules stipulating, for example, that foreign results must be recalculated according to the domestic rules.

Article 8

25. This Article offers Member States the possibility of prescribing compulsory reincorporation of amounts previously deducted if the enterprise's foreign activity does not yield a profit within five years. This five-year time-limit applies separately to each tax period at the end of which losses have been deducted.

26. Another situation which may give rise to automatic reincorporation is where a permanent establishment is sold, wound up or transformed into a subsidiary; this is because such an operation takes the permanent establishment outside the scope of the method.

Article 9

27. The method laid down for taking a subsidiary's losses into account is identical to that used for permanent establishments as described in Article 7, except that the losses allowed as a deduction are

determined separately for each subsidiary, without any aggregation.

Article 10

28. As in the case of the method of deducting the losses of permanent establishments, the Directive authorizes Member States to provide in their laws for the automatic reincorporation of amounts previously deducted if reincorporation has not occured by the end of the fifth year following deduction of the loss. The same rule applies where the subsidiary is sold, would up or transformed into a permanent establishment.

Provision must also be made to cover one further situation. Since the Directive is applicable only if the enterprise's holding in the subsidiary reaches a minimum threshold, it is logical that amounts previously deducted should automatically be reincorporated if its holding falls below that threshold.

Article 13

29. Notwithstanding the fact that the present Directive does not provide the method of writing down the book value of the holding as a Community solution, Member States are free to include this method as an additional one into their internal legislation. In such a case, it shall, however, be avoided that an enterprise applies at the same time both the method provided by this Directive and the method of writing down the book value, because otherwise the same loss would be taken into account twice.

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Reference documents

This supplement is established on the basis of:

- *Commission communication to Parliament and the Council on guidelines on company taxation*
  (SEC(90) 601)
- *Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States*
  (OJ L 225, 20. 8. 1990)
- *Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States*
  (OJ L 225, 20. 8. 1990)
- *Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises*
  (OJ L 225, 20. 8. 1990)
- *Proposal for a Council Directive on a common system of taxation applicable to interest and royalty payments made between parent companies and subsidiaries in different Member States*
  (submitted by the Commission to the Council on 6 December 1990)
  (COM(90)571 and 05 C 53, 28. 2. 1991)
- *Proposal for a Council Directive concerning arrangements for the taking into account by enterprises of the losses of their permanent establishments and subsidiaries situated in other Member States*
  (submitted by the Commission to the Council on 6 December 1990)
  (COM(90)595 and 0J C 53, 28. 2. 1991)

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Economic and financial unification will make it necessary to eliminate the tax problems hampering firms' transfrontier activities before 1993.

Through its declarations and the instruments, whether already in force or proposed, which are published in this supplement, the Commission of the European Communities has proved its determination to achieve a single market as regards the taxation of businesses.