COMMISSION OF THE EUROPEAN COMMUNITIES

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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

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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,

— imposte 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 debtor / Residence State of the beneficiary	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 debtor / Residence State of the beneficiary	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

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[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.