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**Double Taxation Resulting from the ATAD:
Is There A Relief?**

by

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TABLE OF CONTENT

ABBREVIATIONS	3
ABSTRACT	4
1. INTRODUCTION.....	5
1.1. Background.....	5
1.2. Aim	6
1.3. Method and materials.....	7
1.4. Delimitation	7
1.5. Outline	8
2. OCCURRENCE OF DOUBLE TAXATION	9
2.1. Conflicts of Classification	9
2.2. Conflicts of Qualification	10
2.3. The Nature of Double Taxation.....	12
3. DOUBLE TAXATION RESULTING FROM THE IMPLEMENTATION OF INTEREST DEDUCTION LIMITATION AND CONTROLLED FOREIGN COMPANY RULES OF THE ANTI-TAX AVOIDANCE DIRECTIVE.....	15
3.1. Interest Deduction Limitation Rule	15
3.1.1. Double Taxation arising from Interest Deduction Limitation Rule	17
3.2. Controlled Foreign Company Rules	18
3.2.1. Double Taxation from Controlled Foreign Company Rules	21
4. RELIEF FOR DOUBLE TAXATION RESULTING FROM THE INTEREST DEDUCTION LIMITATION AND CONTROLLED FOREIGN COMPANY RULES OF THE ANTI-TAX AVOIDANCE DIRECTIVE.....	24
4.1. Relief Under the OECD Model Convention.....	24
4.1.1. Interest Deduction Limitation Rule	26
4.1.2. Controlled Foreign Company Rules	27
4.2. Relief Under European Union Legislation	29
4.2.1. Interest Deduction Limitation Rule	32
4.2.2. Controlled Foreign Company Rules	34
5. CONCLUSIONS.....	37
BIBLIOGRAPHY	39

ABBREVIATIONS

ATAD	Directive 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market
ATAD 2	Directive 2017/952 of 29 May 2017 amending directive 2016/1164 as regards hybrid mismatches with third countries
BEPS	Base Erosion and Profit Shifting
CFC	Controlled Foreign Company
CJEU	Court of Justice of the European Union
Commission	European Commission
Council	Council of the European Union
EBITDA	Earnings Before Interest, Taxes, Depreciation and Amortization
EU	European Union
EU Arbitration Convention	Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises
EU Dispute Directive	Directive 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union
EUR	Euro
GAAR	General Anti Abuse Rule
Interest and Royalty Directive	Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.
MLI	Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS
OECD	Organisation for Economic Co-operation and Development
OECD MC	OECD Model Convention on Income and Capital 2017 (full version)
Parent-Subsidiary Directive	Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States
SAAR	Specific Anti Abuse Rule
TEU	Treaty on European Union
TFEU	Treaty of Functioning of European Union

ABSTRACT

Despite of the ambitious aim of the ATAD, the adverse effect of double taxation caused by the implementation of it is unsolved. It is therefore up to taxpayers to solve the conflict of norms by identifying the correct source of law for eliminating double taxation.

The thesis focuses on the double taxation caused by the implementation of ATAD and identifying the correct source of law, if possible, to provide relief for such double taxation. As the potential sources of law, the OECD MC and European Union legislation has been analyzed. The scope of the thesis is limited to the rule on interest deduction limitation and CFC rules as provided in the ATAD.

1. INTRODUCTION

1.1. Background

By implementing the anti-tax avoidance directive (ATAD),¹ Member States expand their taxing rights in a way which could lead to double taxation. Double taxation caused by the ATAD has been acknowledged also in the recital 5 of ATAD as a potential adverse effect. Despite of double taxation being deemed to be incompatible with the internal market,² the ATAD does not foresee any obligation for Member States to provide a relief for double taxation other than economic double taxation arising from the actual dividend distribution by a controlled foreign company (CFC) or disposal of shares in the CFC.³ Therefore, it is up to a taxpayer to find a correct source of law to eliminate the double tax burden caused by the ATAD. As the tax treaty law, European Union (EU) law and to some extent the domestic legislation of Member States are all independent legal spheres, it is unclear which source of law would be applicable to provide relief for double taxation caused by the ATAD.

Since the introduction of the EU Anti-Tax Avoidance Package by the Commission on 28th January 2016,⁴ the scholars and tax experts have been analyzing several aspects of the ATAD. Nevertheless, the publications available at the time of this thesis do not examine the conflict of sources of law in connection with double taxation caused by the ATAD nor provide any guidance on correct source of law to eliminate the double tax burden.

Since all taxpayers subject to corporate income tax in the EU fall under the scope of the ATAD,⁵ ATAD aims to enforce a single tax principle in cross-border situations and interfere in the allocation of fair taxing rights.⁶ Furthermore, the ATAD obliges Member States to fight avoidance of domestic tax law even in wholly domestic situations.⁷ As a directive, the ATAD requires Member States to achieve the result aimed by it, however, Member States are free to choose most suitable form and method.⁸ The margin of discretion left to the Member States in combination with the extended opportunity to tax, increases also ATAD's potential to cause double taxation.

Double taxation is commonly divided as juridical and economic double taxation, without further discussion regarding the underlying conflict of classification or qualification. As it is evident from the case law of Court of Justice of the European Union (CJEU), juridical double taxation, despite of having adverse effect on the internal market, is generally⁹ not deemed to be a restriction of fundamental

¹ Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market. Official Journal L 193, 19.7.2016, pages 1–14.

² This has been pointed out by the Commission already in 1996, for example see Commission of The European Communities. Taxation in the European Union. 20.03.1996. SEC(96) 487 final, page 13.

³ ATAD, article 8(5) and (6).

⁴ Communication from The Commission to The European Parliament and The Council. Anti-Tax Avoidance Package: Next steps towards delivering effective taxation and greater tax transparency in the EU. COM/2016/023 final.

⁵ ATAD, recital 4.

⁶ Dourado, A. P. The EU Anti Tax Avoidance Package: Moving Ahead of BEPS? *INTERTAX*, Volume 44, Issue 6 & 7, page 441.

⁷ De Lillo, F. The Impact of the EU Anti-Tax Avoidance Package on the Exercise of National Tax Sovereignty in European Tax Integration: Law, Policy and Politics. Edited by Pistone, P. *IBFD*, 2018, section 16.4.1.

⁸ TFEU, article 288.

⁹ Except in case of discriminatory withholding tax on dividends, see for example judgement of 8 November 2007, Amurta, C-379/05, EU:C:2007:655.

freedoms but a consequence of parallel exercise of taxing rights and compatible with EU law.¹⁰ Therefore, EU primary law is most likely not a reliable source of law for providing a relief for juridical double taxation. Hence, it is under the jurisdiction of Member States to eliminate such double tax burden of a taxpayer. On the other hand, the CJEU found EU primary law applicable in case the discriminative domestic legislation led to the economic double taxation.¹¹ Therefore, EU primary law could be a reliable source of law for eliminating the economic double taxation.

In addition to EU primary law, disputes of double taxation could be solved under the Arbitration Convention¹² or Dispute Resolution Directive.¹³ Moreover, Member State's right to impose taxes could be restricted by EU secondary legislation – in the context of ATAD, namely by the Interest and Royalty Directive¹⁴ and Parent-Subsidiary Directive.¹⁵

To solve the problem of double taxation, the OECD Model Convention on Income and Capital (OECD MC) could also be an applicable source of law. However, it has been discussed by the scholars that the scope of articles 23A and 23B could be limited only to juridical double taxation.¹⁶ Should one agree with such interpretation, it would be up to the states to hold bilateral negotiations to provide relief for the economic double taxation falling outside the scope of articles 23A and 23B.¹⁷ However, scholars supporting the opposing view agree that only economic double taxation resulting from classical corporate tax system should be excluded from the scope of OECD MC. Therefore, the relief of double taxation under the OECD MC depends above all on the approach chosen.

1.2. Aim

As the implementation of the ATAD could lead to the double taxation resulting from the conflict of norms, the first aim of this thesis is to detect which sources of law could be applicable to eliminate the problem of double taxation. Is it EU primary law, EU secondary legislation or tax treaty law? Secondly, the purpose of this thesis is to identify the source of law based on which the double taxation could be relieved after the implementation of the ATAD. In other words, to establish if there is any relief for double taxation resulting from the ATAD? To analyze the impact of the ATAD on double taxation, the thesis aims to i) distinguish between classification and qualification conflicts; ii) analyze the nature of

¹⁰ For example, judgement of 12 February 2009, *Margarete Block*, C-67/08, EU:C:2009:92, paragraph 31. Wattel, P. *Conceptual Background of the CJEU Case Law in Direct Tax Matters*. European Tax Law. Volume 1 – General Topics and Direct Taxation. 7th Student edition. Edited by Wattel, P., Marres, O., Vermuelen, H. Deventer: Wolters Kluwer, 2018, page 316 and case law cited.

¹¹ For example, judgement of 13 November 2012, *Test Claimants in the FII Group Litigation*, C-35/11, EU:C:2012:707, paragraph 38 and case law cited.

¹² 90/436/EEC: Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises. Official Journal L 225, 20.8.1990, pages 10–24.

¹³ Council Directive 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union, Official Journal L 265, 14.10.2017, p. 1–14.

¹⁴ Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States. Official Journal L 157, 26.6.2003, pages 49–54.

¹⁵ Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States. Official Journal L 345, 29.12.2011, pages 8–16.

¹⁶ Lang, M. *The Application of the OECD Model Tax Convention to Partnerships*. A Critical Analysis of the Report Prepared by the OECD Committee on Fiscal Affairs. Linde, 2000, page 29.

¹⁷ OECD MC Commentaries on article 23A and B, paragraph 2.

double taxation; iii) examine the rule on interest deduction limitation and CFC rules of the ATAD; and iv) identify the correct source of law to eliminate the double taxation, if possible.

1.3. Method and materials

In order to provide answers to the legal questions of this thesis and determine the relevant sources of law,¹⁸ the traditional legal dogmatic method has been used. By using the aforesaid method, research of current positive law as it has been stated in the European and international law, case law and the literature has been conducted,¹⁹ followed by the legal dogmatic process of interpretation.²⁰

The primary sources for the research are the relevant EU law in force and the OECD MC. Furthermore, articles published by legal scholars, books, commentaries as well as preparatory work of the ATAD has been analyzed. As the ATAD is a reflection of the OECD BEPS project at the EU level, also BEPS Action 3 and 4 final reports have been examined to the extent relevant for this thesis.

The thesis is based on the materials published as of June 1, 2019. Later publications, if any, have not been examined.

1.4. Delimitation

The scope of this thesis is limited to the potential corporate double taxation resulting from the minimum standard stated for interest deduction limitation and CFC rules in the ATAD. The rule on interest deduction limitation and CFC rules have been chosen as at the first glance there seems to be no clear tool to provide relief for the caused double taxation.

This analysis does not include double taxation arising from the implementation of other anti-avoidance measures of the ATAD (i.e. articles 5, 6 and 9) or double taxation resulting from the alternative measures which Member States may choose to apply to achieve higher level of protection for their corporate tax system. The general anti abuse rule (GAAR) has been excluded as the focus of this thesis is on specific anti abuse measures (SAAR). This thesis does also not analyze the exit taxation as article 5(5) of the ATAD requires Member States to accept the value of the assets established by the other Member State and provides therefore a solution for double taxation without the need to apply an additional source of law. Since the recital 30 of ATAD 2²¹ makes explicit reference to the applicability of secondary legislation and its priority in case of conflicts of norms, the hybrid mismatches also fall out of the scope of this thesis.

The analysis of any directive in this thesis is based on the wording of a specific directive as adopted by the Council and does not include possible variations Member States may implement. Since more than 3000 tax treaties around the world, including tax treaties between Member States, follow the OECD

¹⁸ Douma, S. *Legal Research in International and EU Tax Law*. Kluwer-Deventer, 2014, page 35.

¹⁹ *Ibid*, page 18.

²⁰ *Ibid*, page 38.

²¹ Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries. Official Journal L 144, 7.6.2017, pages 1–11.

MC,²² any examination of tax treaties is based on the OECD MC 2017 full version published by the OECD in 2019, except otherwise stated, taking into consideration also the multilateral instrument (MLI). No analysis has been concluded based on any specific tax treaty in force.

1.5. Outline

To achieve the purposes of this thesis, it has been divided into five chapters. After the introductory chapter, chapter 2 analyzes the occurrence of double taxation including some underlying conflicts of classification and qualification. In chapter 3, the double taxation resulting from the rule on interest deduction limitation as well as CFC rules has been analyzed. Chapter 4 focuses on the EU legislation and OECD MC as sources of law to analyze whether they could eliminate double tax burden arising from aforementioned SAARs. Findings of the thesis have been summarized in chapter 5.

²² Tax treaties: update to OECD Model Tax Convention released. OECD press release from 18.12.2017. Available online - <http://www.oecd.org/tax/treaties/tax-treaties-2017-update-to-oecd-model-tax-convention-released.htm> Accessed 18.03.2019.

2. OCCURRENCE OF DOUBLE TAXATION

2.1. Conflicts of Classification

Despite the fact that there is no commonly agreed understanding how, if at all, conflicts causing double taxation and double non-taxation in the context of tax treaty law should be divided or defined,²³ the subsequent analysis is based on the approach used for example by professors Klaus Vogel and Alexander Rust, according to whom the conflicts in question can be divided as conflicts of classification and conflicts of qualification.²⁴

The conflict of classification, as one cause of cross-border double taxation, occurs when states give different interpretation to the facts or provisions of a tax treaty²⁵ and subject the same income therefore simultaneously to different articles of the treaty.²⁶ This could be the case for example as regards the payment of interest of which the creditor shares the risks run by the borrower. In such situation, it should be analyzed in the light of specific facts and circumstances of the payment whether the payment should be treated as interest or dividend.²⁷ Such double taxation, as a consequence of different prerequisites that establish the tax liability, is a result of a classification conflict.²⁸

Since tax treaties include distributive rules which limit the applicability of states' domestic tax law²⁹ but do not provide rules linking the income to a specific taxpayer,³⁰ the decision of attribution of income is left as a matter of domestic law.³¹ The tax treaties do generally not act as arbitrators to determine which state's attribution is correct.³² Therefore, double taxation caused by the conflict of classification is not solved by a tax treaty itself and does not oblige the state of residence to grant relief. Instead states should seek to resolve the question of double taxation through mutual agreement procedure.³³

Mutual agreement procedure requires that states follow rules of interpretation of international agreements, first and foremost, as established by the Vienna Convention on the Law of Treaties, taking into consideration the text of the tax treaty as well as its purpose.³⁴ However, the mutual agreement procedure does not require states to effectively solve the problem of double taxation, unless the states have included mandatory arbitration clause in their tax treaties.³⁵ Nevertheless, even then, the states are

²³ For example, see Lang, M. Qualification Conflicts. Global Tax Treaty Commentaries. IBFD, 2018, section 1.2.

²⁴ Vogel, K., Rust, A. Klaus Vogel on Double Taxation Conventions, 4th edition, edited by Reimer, E., Rust, A., 2015. Introduction at marginal number 120-121, pages 54-55.

²⁵ OECD MC Commentaries on article 23A and B, paragraph 32.5.

²⁶ Äimä, K. Key practical issues to eliminate double taxation of business income. Classification Conflicts: The Cross-Border Tax Treatment of the Profit Share of Limited Partners. IFA Cahiers, Volume 96B, 2011, page 311.

²⁷ OECD MC Commentaries on article 10, paragraph 25.

²⁸ Vogel, K., Rust, A., Klaus Vogel on Double Taxation Conventions., *op. cit.* Introduction at marginal number 121, page 55.

²⁹ *Ibid* at marginal number 30, page 23.

³⁰ Ault, H. J., Issues Related to the Identification and Characteristics of the Taxpayer. Bulletin for International Taxation, 2002. Volume 56, No. 6, page 263.

³¹ Rust, A. Klaus Vogel on Double Taxation Conventions, 4th edition, edited by Reimer, E., Rust, A., 2015. Article 1 at marginal number 16, page 106.

³² *Ibid* at marginal number 60, page 129 and referred article.

³³ OECD MC Commentaries on article 23A and B, paragraph 32.5.

³⁴ United Nations. Vienna Convention on the Law of Treaties, 23 May 1969, United Nations, Treaty Series, vol. 1155, article 31.

³⁵ OECD MC Commentaries on article 25, paragraph 64.

not obliged to provide any relief for double tax burden during the mutual agreement procedure nor compensate the lost opportunity to use the money.³⁶

At the level of EU, the classification conflicts could also be solved to the limited extent by the CJEU. The CJEU would be entitled to eliminate the economic double taxation resulting from the different interpretation of facts or tax treaty provisions in case of unjustified cross-border discrimination. This would be possible only when Member States have provided the CJEU with jurisdiction to rule on a tax treaty.³⁷ However, as the field of direct taxation is not fully harmonized, the Council nor the Commission are able to establish consistent interpretation in a way which would eliminate all classification conflicts within the EU.

2.2. Conflicts of Qualification

In addition to classification conflicts, double taxation could also be a result of a positive qualification conflict where both contracting states of a treaty want to tax the income.³⁸ The conflict of qualification can be understood as a problem of income categorization for treaty purposes³⁹ arising from the use of terms derived from states' domestic legislation⁴⁰ and applying therefore different distributive rules of a tax treaty to the same income.⁴¹ As such terms are not defined by the tax treaty itself, states are applying the meaning the term has in each state's domestic legislation, thereby steering to conflicts caused by the different meaning of the same term.

Double taxation arising from the qualification conflicts caused by different provisions of a domestic legislation is eliminated by article 23A or 23B of the OECD MC. Under the aforementioned provisions, the state of residence is required to apply an exemption or credit method, notwithstanding the qualification conflict.⁴² Nevertheless, actual double taxation is required and the mere existence of qualification conflict is not deemed to be sufficient to oblige the state of residence to eliminate the double taxation under the OECD MC.⁴³

Double taxation arising from the qualification conflicts can be solved, to some extent, also by a tax treaty itself. In particular, where the tax treaty expressly defines specific term.⁴⁴ Furthermore, it has been discussed that qualification conflicts are also solved by the article 3(2) of OECD MC⁴⁵ which specifies that undefined terms in a tax treaty should have the meaning that such term has under the domestic law of the state applying the treaty, unless the context requires otherwise or the tax authorities

³⁶ Ismer, R. Klaus Vogel on Double Taxation Conventions, 4th edition, edited by Reimer, E., Rust, A., 2015. Article 25 at marginal number 28, page 1795.

³⁷ Judgement of 12 September 2017, Austria vs Germany, C-648/15, EU:C:2017:664, paragraph 27.

³⁸ Rust, A. The New Approach to Qualification Conflicts has its Limits. Bulletin for International Taxation, 2003. Volume 57, No 2, page 48.

³⁹ Jones, J.F.A. Qualification Conflicts: The Meaning of *Application* in Article 3(2) of the OECD Model. Festschrift für Karl Beusch zum 68. Geburtstag am 31. Oktober 1993. Edited by Beisse, H., Lutter, M., Närgel, H. New York: de Gruyter, page 43.

⁴⁰ Vogel, K., Rust, A., Klaus Vogel on Double Taxation Conventions., *op. cit.*, Introduction at marginal number 120, page 54.

⁴¹ Gupta, V. K. Conflicts of Qualification and Conflicts of Allocation of Income. Conflicts of Qualification in Tax Treaty Law. Edited by Burgstaller, E., Haslinger, K. Linde, 2007, page 41.

⁴² OECD MC Commentaries on article 23A and B, paragraph 32.3.

⁴³ Lang, M. 2008 OECD Model: Conflicts of Qualification and Double Non-Taxation. Bulletin for International Taxation, 2009. Volume 63, No 5, page 205.

⁴⁴ Vogel, K., Rust, A., Klaus Vogel on Double Taxation Conventions., *op. cit.*, Introduction at marginal number 124, page 56.

⁴⁵ *Ibid* at marginal number 125, page 57.

have agreed on a different meaning. However, it is questionable whether article 3(2) solves the qualification conflict or actually prevents such conflict by determining which state's domestic meaning of the undefined treaty term is applicable.

In situations where the tax treaty does not provide any solution to the qualification conflict, there are three most widely discussed solutions proposed by the scholars: i) *lex fori* qualification, meaning that each state qualifies tax treaty terms according to its own domestic legislation; ii) source state qualification which requires both states to follow the qualification of the state in which the income derives; and iii) autonomous qualification by which both states seek to establish a consistent qualification of a term. The fourth solution also considered, but not widely discussed, is the qualification in accordance with the resident state's legislation.⁴⁶ Argument in favor of the latter one can be found from the traditional systematic approach according to which the taxation in resident state is a rule and taxation in the source state is the exception.⁴⁷

As the domestic law and tax treaty law are two independent legal spheres with their own definitions, states should prefer to establish consistent qualification of a term (i.e. apply autonomous qualification) over other methods while providing solution to a qualification conflict,⁴⁸ irrespective of its possible restrictive impact on states' sovereignty.⁴⁹ However, in practice the combination of different methods may work the best, depending on the purpose of the interpretation.⁵⁰

Within the EU, the qualification conflicts are avoided to the extent the term is defined by the legislation of EU which has become part of domestic legislation of Member States.⁵¹ In the field of direct taxation, the EU has up to now adopted only directives which Member States are obliged to transpose into their domestic legislation. Irrespective of the discretion Member States may have while implementing a directive, they are required to achieve the results envisaged by it and apply the law of EU correctly.⁵² This, however, would be difficult to attain when Member States would be entitled to change the definitions established by the directive during the implementation process. Hence, it could be argued that the EU secondary legislation has eliminated double taxation resulting from a qualification conflict by introducing EU-wide autonomous qualification.

On the other hand, shared competence in the field of direct taxation⁵³ means that qualification conflicts in unregulated areas of direct taxation would still be likely to occur and hinder the internal market. Due to the shared competence and Member States' sovereignty, it is doubtful that the CJEU would require Member States to agree on a consistent qualification of a term in applicable tax treaty. Especially taking

⁴⁶ *Ibid* at marginal number 124, page 56.

⁴⁷ *Ibid* at marginal number 133, page 60.

⁴⁸ *Ibid* at marginal number 127, page 57.

⁴⁹ Pleil, C., Schwibinger, S. Confronting Conflicts of Qualification in Tax Treaty Law: The Principle of Common Interpretation and the New Approach Revisited. *World Tax Journal*, 2018. Volume 10, No 3, page 445.

⁵⁰ Vogel, K., Rust, A., Klaus Vogel on Double Taxation Conventions., *op. cit.*, Introduction at marginal number 136, page 61.

⁵¹ Jones, J.F.A. Treaty Interpretation. *Global Tax Treaty Commentaries*. IBFD, 2018, section 4.5.4.

⁵² TEU article 4(3) and TFEU article 288.

⁵³ TFEU, article 4. TEU, article 5. See also, Szudoczky, R., Weber, D. Constitutional Foundations: EU Tax Competence; Legal Basis for Tax Integration; Sources and Enactment of EU Tax Law. *European Tax Law*. Volume 1 – General Topics and Direct Taxation. 7th Student edition. Edited by Wattel, P., Marres, O., Vermuelen, H. Deventer: Wolters Kluwer, 2018, page 10.

into consideration the CJEU's position regarding its lack of jurisdiction to interpret tax treaties,⁵⁴ unless Member States have provided the CJEU with such jurisdiction.⁵⁵ This, however, should be distinguished from the cases where the CJEU interprets EU secondary legislation and applies OECD MC definitions while doing so.⁵⁶

Therefore, in case of conflict of qualification, one should first seek a solution from a tax treaty. Should the tax treaty provide no solution, the domestic legislation of Member States should be examined. As the tax treaty makes generally no direct reference to the EU law, EU legislation would not be an independent source of law to solve the conflict of qualification. However, once becoming part of the domestic legislation of Member States, EU law would indirectly be the applicable source of law to solve the conflict of qualification.⁵⁷

2.3. The Nature of Double Taxation

Despite the conflict of classification and conflict of qualification being the underlying problem of double taxation, international double taxation is more typically described as juridical and economic double taxation.

Juridical double taxation can be defined as simultaneous exercise of resident and source state's taxing rights on the same taxpayer in respect of the same income for identical period.⁵⁸ Such double tax burden could be a result of three conflicts of taxing rights: i) both states deem the taxpayer as its resident (resident-resident conflict); ii) one state exercises its taxing rights over the income as a resident state while the other state taxes the income as derived from its territory (resident-source conflict); or iii) both states deem the income derived from its territory (source-source conflict).⁵⁹

In addition to juridical double taxation, it is important to distinguish the double tax burden caused by two or more states taxing the same income for the same period in the hands of different taxpayers – economic double taxation. Economic double taxation could result from successive taxation of income which is passed from one person to another, such as taxation of a profit at the level of a company and its shareholders,⁶⁰ or for example from a classification conflict between states.⁶¹

Despite double taxation being hindrance to the development of international trade and investments, it is not forbidden nor contrary to the international law as long as it results from the parallel exercise of domestic legislation of states which itself complies with the international law. Thus, there is also no

⁵⁴ Judgement of 6 December 2007, *Columbus Container Services*, C-298/05, EU:C:2007:754, paragraph 46 and judgement of 16 July 2009, *Damseaux*, C-128/08, EU:C:2009:471, paragraph 22.

⁵⁵ Judgement of 12 September 2017, *Austria vs Germany*, C-648/15, EU:C:2017:664, paragraph 27.

⁵⁶ For example judgement of 26 February 2019, *N Luxembourg 1*, joined cases C-115/16, C-118/16, C-119/16 and C-299/16, EU:C:2019:134. See also, Wattel, P. *Relevance of (Deviations from) the OECD Model and Commentary in ECJ Income Tax Case Law. Departures from the OECD Model and Commentaries. Reservations, observations and positions in EU law and tax treaties.* Edited by Maisto, G. IBFD, 2014, page 102.

⁵⁷ Jones, J.F.A. *Treaty Interpretation.*, *op. cit.*, section 4.5.4.

⁵⁸ OECD MC Commentaries. Introduction, paragraph 1.

⁵⁹ OECD MC Commentaries on article 23A and B, paragraph 3.

⁶⁰ Danon, R. J. *Conflicts of Attribution of Income Involving Trusts under the OECD Model Convention: The Possible Impact of the OECD Partnership Report.* Intertax, 2004. Volume 32, Issue 5, page 215.

⁶¹ Van Raad, K. *General Report. Recognition of foreign enterprises as taxable entities.* IFA Cahiers, Volume 73A, 1988, page 33.

general rule establishing which state should withdraw its taxing rights.⁶² As the double taxation is not desirable, states generally try to solve it unilaterally or through bilateral tax treaties.⁶³

The aforementioned distinction between two types of double taxation is necessary as pursuant to the OECD MC Commentaries, the OECD MC aims to provide relief only for juridical double taxation.⁶⁴ Since the OECD MC attempts to avoid only double taxation covered by its scope, double taxation beyond the scope of the OECD MC has to be accepted.⁶⁵ Thus, the economical double taxation which generally falls outside of the scope of OECD MC is not eliminated by the tax treaty itself but only when agreed by the contracting states.⁶⁶ However, some scholars are of the opinion that the OECD MC excludes only economic double taxation resulting from successive taxation, in other words economic double taxation arising from the classical corporate tax system,⁶⁷ and the OECD MC is also applicable to provide a relief from economic double taxation which is a result of a classification conflict.⁶⁸

Some academics, advocating the aforementioned approach, point out that nothing in the wording of OECD MC distributive articles suggests, except article 10(2) of OECD MC,⁶⁹ that their application would be limited only to juridical double taxation, leaving those articles ineffective in case of economic double taxation stemming from classification conflicts.⁷⁰ Instead of making the application of distributive rules conditional on the allocation of income to the same taxpayer, namely determining the recipient of the income,⁷¹ distributive rules only deal with the allocation of taxing rights between the contracting states.⁷² Furthermore, it has been discussed that the context⁷³ as well as the object and purpose of the OECD MC does not support the interpretation which excludes economic double taxation, other than the one resulting from the classical corporate tax system, from the scope of distributive rules as distributive rules aim to eliminate double taxation irrespective of the divergences existing between states regarding the income attribution.⁷⁴

⁶² Vogel, K., Rust, A. Klaus Vogel on Double Taxation Conventions., *op. cit.*, Introduction at marginal number 11, pages 14 – 15.

⁶³ Monsenego, J. Taxation of Foreign Business Income within the European Internal Market. An Analysis of the Conflict between the Objective of Achievement of the European Internal Market and the Principles of Territoriality and Worldwide Taxation. IBFD Doctorial Series, 2012. Volume 22, page 61.

⁶⁴ OECD MC Commentaries on article 23A and B, paragraphs 1 and 2.

⁶⁵ Lang, M., The Application of the OECD Model Tax Convention to Partnerships., *op. cit.*, page 29.

⁶⁶ OECD MC Commentaries on article 23A and B, paragraph 2. OECD MC provides relief for economical double taxation only as regards transfer pricing adjustments by requiring to make a corresponding adjustment (article 9).

⁶⁷ A system of taxation under which tax is charged on profits realized at the corporate level and again on distribution of the net profits, at the individual shareholder level, with no mitigation of the resulting double taxation. The term is generally limited to the national context, e.g. where the same state taxes both company and shareholder. IBFD Tax Glossary. Available online - https://online.ibfd.org/kbase/#topic=doc&url=/highlight/collections/itg/html/itg_classical_system.html&q=classical&WT.z_nav=Search Accessed 17.04.2019.

⁶⁸ Kuźniacki, B. The Need to Avoid Double Economic Taxation Triggered by CFC Rules under Tax Treaties, and the Way to Achieve It. INTERTAX, 2015. Volume 43, Issue 12, page 764. Danon, R. J., Salomé, H. Avoidance of Double Non-Taxation in Switzerland. Avoidance of Double Non-Taxation. Edited by Lang, M. Linde, 2003, page 400.

⁶⁹ Article 10(2) of OECD MC reads as follows: “This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.”

⁷⁰ Danon, R. J., Conflicts of Attribution of Income Involving Trusts under the OECD Model Convention., *op. cit.* page 216.

⁷¹ Kuźniacki, B., *op. cit.*, page 762.

⁷² Danon, R. J., Salomé, H., *op. cit.*, page 399.

⁷³ Kuźniacki, B., *op. cit.*, page 764.

⁷⁴ Danon, R. J., Conflicts of Attribution of Income Involving Trusts under the OECD Model Convention., *op. cit.*, pages 216-217.

The distinction made by the Commentaries of OECD MC between juridical and economic double taxation has deemed to be irrelevant and, in the light of other references in the Commentaries,⁷⁵ it has been questioned whether narrowing the scope of OECD MC only to the juridical double taxation could really have been the intention.⁷⁶

Based on the above, it can be concluded that the OECD MC aims to, irrespective of the references according to which it is limited only to solve the problem of juridical double taxation, provide relief also in cases of economic double taxation resulting from classification conflicts. The author agrees that providing relief for double taxation cannot operate as the underlying premise of OECD MC in every situation.⁷⁷ However, it is plausible that only economic double taxation arising from the classical corporate tax system should be excluded from the scope of OECD MC. As demonstrated by the scholars, the reverse approach is not supported by the wording, object nor the purpose of OECD MC. Furthermore, the author agrees with professor Vogel that the conceptual distinction between the juridical and economic double taxation is insignificant as the application of a tax treaty depends on the interpretation of a respective treaty and is not affected by the characteristics of a double taxation.⁷⁸ Therefore, the OECD MC would be relevant source of law to provide relief for juridical as well as economic double taxation.

⁷⁵ For example, OECD MC Commentaries on article 10, paragraph 41.

⁷⁶ Danon, R. J., Conflicts of Attribution of Income Involving Trusts under the OECD Model Convention., *op. cit.*, page 217.

⁷⁷ Lang, M., The Application of the OECD Model Tax Convention to Partnerships., *op. cit.*, page 29.

⁷⁸ Vogel, K., Rust, A., Klaus Vogel on Double Taxation Conventions., *op. cit.* Introduction at marginal number 5, page 13.

3. DOUBLE TAXATION RESULTING FROM THE IMPLEMENTATION OF INTEREST DEDUCTION LIMITATION AND CONTROLLED FOREIGN COMPANY RULES OF THE ANTI-TAX AVOIDANCE DIRECTIVE

3.1. Interest Deduction Limitation Rule

Tax deductibility of interests within associated companies compared to non-deductible profit distributions provide taxpayers with an opportunity to optimize their tax base. Decreasing a tax burden of a company in high tax jurisdiction through debt-financing by shareholders or other group members in a low tax jurisdiction has been considered as one of the simplest ways to achieve cross-border profit shifting.⁷⁹ In connection with debt-financing, the OECD has identified three most typical scenarios used by multinational enterprises for cross-border profit shifting: i) high level of external debt is located to group companies in high-tax jurisdictions; ii) internal debt from intragroup loans is used to generate interest deductions which exceed the actual third party interest expenses; and iii) use of interest deductions to generate tax exempt income in high-tax jurisdictions.⁸⁰

To combat the problem of asymmetric treatment of debt and equity for tax purposes, states have implemented thin capitalization rules. Thin capitalization rules typically establish a safe harbor and disallow the deductibility of interest payments between related parties or third parties in back-to-back financing schemes which exceed stated debt-to-equity ratio.⁸¹ Depending on the approach chosen, thin capitalization rules could instead of denying the deduction of an excessive interest re-characterize the excessive amount of interest as a dividend income.⁸²

In order to discourage EU taxpayers to use interest expenses as a way of profit shifting⁸³ and encourage the use of equity instead of debt,⁸⁴ the ATAD establishes interest deduction limitation rule following the best practices developed by the OECD in BEPS Action 4.⁸⁵ Article 4 of the ATAD establishes a fixed ratio and requires Member States to limit the amount of deductible borrowing costs (i.e. interest expenses, economically equivalent costs and other expenses incurred in connection with the raising of funds⁸⁶) in a given tax period. Member States are obliged to limit the deductibility of exceeding borrowing costs at least by 30% of taxpayer's EBITDA which excludes any tax-exempt income. Thereby the interest deduction limitation rule functions as a rule of allocation reinforcing the principle

⁷⁹ Makhmudova, K. Conflicts of Qualification and Thin Capitalisation Rules. Conflicts of Qualification in Tax Treaty Law. Edited by Burgstaller, E., Haslinger, K. Linde, 2007, page 253.

⁸⁰ OECD. Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4. Final Report, OECD/G20 Base Erosion and Profit Shifting Project. OECD Publishing, Paris, 2015, page 11.

⁸¹ Dourado, A. The Interest Limitation Rule in the Anti-Tax Avoidance Directive (ATAD) and the Net Taxation Principle. EC Tax Review, 2017. Volume 26, Issue 3, page 113 and cited article. Makhmudova, K., *op. cit.*, page 264.

⁸² Arnold, B. J. International Tax Primer. Third edition. Wolters Kluwer, 2018, page 118.

⁸³ Van Os, P. Interest Limitation under the Adopted Anti-Tax Avoidance Directive and Proportionality. EC Tax Review, 2016. Volume 25, Issue 5, page 190.

⁸⁴ Lobita, J. C. The ATAD's Interest Limitation Rule – A Step Backwards? European Taxation, 2019. Volume 59, No. 2/3, page 63 and Dourado, A. The Interest Limitation Rule in the Anti-Tax Avoidance Directive (ATAD) and the Net Taxation Principle., *op. cit.*, page 119.

⁸⁵ Ginevra, G. The EU Anti-Tax Avoidance Directive and the Base Erosion and Profit Shifting (BEPS) Action Plan: Necessity and Adequacy of the Measures at EU level. INTERTAX, 2017. Volume 45, Issue 2, page 121.

⁸⁶ ATAD, article 2(1).

of territoriality⁸⁷ and connects the amount of deductible interests with the taxable economic activity of a taxpayer.⁸⁸

Unlike traditional thin capitalization rules, the application of interest deduction limitation rule in the ATAD is not restricted to intra-group or cross-border situations. On the contrary, as a general rule it should apply to all kind of loans – intra-group, third party, between associated and standalone companies as well as loans granted in domestic and cross-border situations,⁸⁹ raising thereby also questions regarding the proportionality of the measure.⁹⁰ Especially as regards third party loans which are provided generally in accordance with the market conditions and do not entail a risk of abuse targeted by the ATAD.

By way of derogation, Member States are entitled to allow deduction of borrowing costs up to EUR 3,000,000 – so called safe harbor, or without limitation in case the taxpayer is a standalone entity not being a part of a consolidated group for financial accounting purposes and has no associated enterprise or permanent establishment,⁹¹ thereby comprising low risk of aggressive tax planning.⁹² Furthermore, Member States may exclude from the scope of interest deduction limitation rule loans which have been granted before 17 June 2016 and have not been modified since the adoption of the ATAD as well as loans which are used to fund specific long-term public infrastructure projects.⁹³ Member States are also entitled to exclude financial undertakings from the scope of interest deduction limitation rule.⁹⁴ To be precise, Member States have in total six alternatives for implementing interest deduction limitation rule stated in the ATAD article 4.⁹⁵ However, since the ATAD lays down only a minimum standard, Member States are not obliged to implement any derogations which would benefit taxpayers.

One of such derogations Member States may implement is a carry forward and carry back mechanism of exceeding borrowing costs. According to the article 4(6) of the ATAD, Member States have three options for introducing such derogation: i) carry forward of exceeding borrowing costs without any time limit; ii) carry forward of exceeding borrowing costs without time limit together with the possibility to carry back non-deductible borrowing costs up to three years; or iii) carry forward of exceeding borrowing costs without time limitation together with the carry forward of unused interest capacity for up to five years.

The abovementioned carry forward and carry back rules for unused interest capacity or exceeding borrowing costs are aimed to provide taxpayer a relief in case the application of interest deduction limitation rule would otherwise cause double taxation.⁹⁶

⁸⁷ Dourado, A. The Interest Limitation Rule in the Anti-Tax Avoidance Directive (ATAD) and the Net Taxation Principle., *op. cit.*, page 117.

⁸⁸ Tell, M. Interest Limitation Rules in the Post-BEPS Era. INTERTAX, 2017. Volume 45, Issue 11, page 752.

⁸⁹ ATAD, recital 7.

⁹⁰ Smit, D. The Anti-Tax-Avoidance Directive (ATAD). European Tax Law. Volume 1 – General Topics and Direct Taxation. 7th Student edition. Edited by Wattel, P., Marres, O., Vermuelen, H. Deventer: Wolters Kluwer, 2018, page 251.

⁹¹ ATAD article 4(3).

⁹² Tell, M., *op. cit.*, page 755.

⁹³ ATAD, article 4(4).

⁹⁴ *Ibid*, article 4(7).

⁹⁵ Ginevra, G., *op. cit.*, page 121.

⁹⁶ OECD. Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4., *op. cit.*, paragraph 159.

3.1.1. Double Taxation arising from Interest Deduction Limitation Rule

The problem of double taxation resulting from the interest deduction limitation rule is mainly connected to the *de minimis* nature of the ATAD. Since the unilateral application of interest limitation rule by one Member State could have cross-border impact, Member States “may”, pursuant to the wording of article 4(6), implement a mechanism for carrying forward and back unused interest capacity or exceeding borrowing costs. This mechanism should ideally eliminate double taxation arising from the limitations to deduct incurred borrowing costs.⁹⁷ However, the ATAD does not provide any further guidance on how Member States should exercise their taxing rights in situation where article 4(6) is not implemented. Without carry forward or back, taxpayer would have no possibility to eliminate double taxation under the ATAD in the future tax periods. Therefore, non-deductible borrowing costs in borrower’s Member State would still be subject to tax in the Member State of a creditor, causing thereby economic double taxation.⁹⁸

Furthermore, even when article 4(6) of the ATAD would be implemented, there would be no certainty that taxpayer would ever be in a position to use the amounts carried forward to the following tax periods.⁹⁹ Taxpayer may never realize enough profit to benefit from the unused interest capacity or exceeding borrowing costs carried forward.

As a consequence of limitation on deductibility of borrowing costs, the taxable base of a borrower is increased irrespective of taxation of the same interest income in the hands of a creditor. Such double tax burden resembles more to economic double taxation than juridical since the same item of income is subject to tax in the hands of different taxpayers – first in the hands of a borrower by reason of non-deductibility and simultaneously in the hands of the creditor as interest income. However, on the side of a borrower, tax is not imposed on the interest income and it is rather the non-deductible borrowing cost of a taxpayer which is subject to corporate taxation. Thus, aforesaid double taxation should not be classified as an economic double taxation resulting from the successive taxation of income intrinsic to classical corporate tax system. Instead, the economic double taxation caused by the interest deduction limitation rule has its origin in a qualification conflict.¹⁰⁰ In the hands of one taxpayer it is deemed to be non-deductible cost being part of taxpayer’s tax base and in the hands of another taxpayer, pursuant to the domestic legislation of that Member State, it qualifies as a taxable interest income. In both Member States, the item of income is subject to corporate income tax according to the legislation of respective Member State.

Moreover, since the rule on limiting the deductibility of borrowing costs in the ATAD apply also in wholly domestic situations where both the borrower and the creditor are located in the same Member State, economic double taxation could also emerge within only one Member State.

Since the ATAD does not oblige Member States to transpose article 4(6), which lays down the principles of carry forward and back, into their domestic legislation, it is evident that the ATAD does

⁹⁷ The following analysis of interest deduction limitation rules is based on the assumption that borrowing costs are not notional.

⁹⁸ OECD. Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4., *op. cit.*, paragraph 159.

⁹⁹ Hoor, O.R., O’Donnell, K., Schmitz Merle, S., EU Commission Releases Draft Directive on BEPS: A Critical Analysis from a Luxembourg Perspective. *European Taxation*, 2016. Volume 56, No. 5, page 193.

¹⁰⁰ Makhmudova, K., *op. cit.*, page 264.

also not require Member States to eliminate double tax burden created by the interest deduction limitation rule. Even though any kind of double taxation is a hindrance to the internal market, the double taxation in question would not be incompatible with other relevant secondary legislation of the EU – such as the Interest and Royalty Directive. This is due to the aim of the Interest and Royalty Directive which is to eliminate only juridical double taxation which would reduce the income of a creditor. Economic double taxation caused by the implementation of ATAD interest deduction limitation rule would therefore be out of the scope of Interest and Royalty Directive and would not restrict the implementation of ATAD.¹⁰¹ Thus, even when the rule on limiting the deductibility of borrowing costs of Member States put double tax burden on a taxpayer, Member States would be acting in compliance with the EU law, provided that those rules do not discriminate taxpayers engaged in cross-border activities. Nevertheless, this does not rule out the conflict with EU primary law as regards the proportionality of interest deduction limitation rule. Considering the scope of this thesis, the aspect of proportionality is, however, not examined any further.

In addition to the economic double taxation, interest deduction limitation rules could also trigger juridical double taxation as irrespective of domestic non-deductibility of exceeding borrowing costs, the payment retains its qualification as interest for tax treaty purpose¹⁰² as well as for the purpose of the Interest and Royalty Directive.¹⁰³ Therefore, the source state (i.e. Member State of a borrower) is entitled to impose a withholding tax on the outbound interest payment in accordance with the OECD MC article 11, provided that the Interest and Royalty Directive is not applicable. The same interest income, however, would most likely be also subject to tax in the state of residence of the creditor which exercises its right to tax the worldwide income of its residents.

3.2. Controlled Foreign Company Rules

According to some scholars and the OECD, the use of low tax jurisdictions for shifting profit to companies without genuine economic activity and reducing the tax burden for example by way of low taxation, tax deferral or different characterization of an income¹⁰⁴ have been used by taxpayers for significant amount of time. In order to combat such practices and achieve capital export neutrality by treating, from the tax point of view, investment income from domestic and outbound investments equally,¹⁰⁵ states have introduced CFC rules. CFC rules function as anti-avoidance measure¹⁰⁶ which allow states to extend the application of their domestic legislation beyond their territory¹⁰⁷ and protect thereby their domestic tax base.

¹⁰¹ Judgement of 21 July 2011, Scheuten Solar Technology, C-397/09, EU:C:2011:499, paragraph 28. Cordewener, A. The Interest and Royalty Directive. European Tax Law. Volume 1 – General Topics and Direct Taxation. 7th Student edition. Edited by Wattel, P., Marres, O., Vermuelen, H. Deventer: Wolters Kluwer, 2018, page 205-206.

¹⁰² Makhmudova, K., *op. cit.*, pages 264 - 265.

¹⁰³ Interest and Royalty Directive article 2(a) does not make the term “interest” dependent on domestic deductibility.

¹⁰⁴ De Broe, L. International Tax Planning and Prevention of Abuse. A Study under Domestic Tax Law, Tax Treaties and EC Law in Relation to Conduit and Base Companies. IBFD, Doctorial Series, 2008. Volume 14, pages 53, 55-57.

¹⁰⁵ Chand, V. The Interaction of Domestic Anti-Avoidance Rules with Tax Treaties (with special references to the BEPS project). Tax Policy Series. Edited by Danon, R. Geneva/Zurich, 2018, page 71.

¹⁰⁶ Dahlberg, M., Wiman, B. General Report. The taxation of foreign passive income for groups of companies. IFA Cahiers, Volume 98A, 2013, page 26.

¹⁰⁷ De Broe, L., *op. cit.*, page 125.

Once the foreign entity has been confirmed to be a CFC, states generally use one of the following approaches to attribute the income under CFC rules to the resident shareholder: i) taxation of shareholder on the basis of the fair value of the shares – market value approach; ii) look through approach under which the CFC is disregarded and income is imputed directly to the shareholder on the basis of the fiction that the shareholder earned the income directly; iii) fictitious dividend approach which attributes deemed dividend to the shareholder of CFC irrespective of the actual distribution by the foreign company; or iv) an approach which treats the CFC as legal entity but attributes the income to its shareholder, thereby disregarding the CFC as the recipient of the income.¹⁰⁸

In the ATAD, all aforementioned approaches are in principle feasible as the ATAD only requires the income to be attributed to the taxpayer, leaving the methods as well as the actual taxation to be decided by the Member States.¹⁰⁹ Minimum standard for the tax treatment of CFCs are established by the articles 7 and 8 of the ATAD, aiming to re-attribute the undistributed income of low-taxed controlled subsidiaries to parent company in the Member State where the parent company is considered to be a resident for tax purposes.¹¹⁰ Those rules are binding even for Member States which already have CFC rules in force.¹¹¹ However, as the scope of the ATAD is limited to taxpayers subject to corporate tax in one or more Member States,¹¹² CFC rules in question do not apply in case the shareholder is a natural person.

Furthermore, the scope of CFC rules could be even narrower when recognizing the interpretation suggested by some scholars who argue that in conjunction with the recital 12 of the ATAD, CFC rules laid down in article 7 should apply only in case the parent company of a CFC is a tax resident in EU Member State.¹¹³ Regardless of the potential limitations on the scope of CFC rules as regards its subjects, the use of the concept of “entity” instead of “company” in article 7 of the ATAD implies that CFC rules in question cover in any case for example trusts and partnerships controlled by an EU resident taxpayer.¹¹⁴

In order for the CFC rules stipulated in the ATAD to become applicable, three conditions must be met: i) there must be a CFC; ii) CFC’s profits must be subject to low taxation; and iii) CFC must receive so called harmful income.¹¹⁵

Pursuant to the article 7 of ATAD, an entity or a permanent establishment is regarded as a CFC when all the following conditions are met: i) the entity or permanent establishment is not subject to tax or its profits are exempted in that Member State; ii) the taxpayer itself or together with associated

¹⁰⁸ Rust, A. CFC Legislation and EC Law. INTERTAX, 2008. Volume 36, Issue 11, page 493.

¹⁰⁹ Moser, T., Hentschel, S. The Provisions of the EU Anti-Tax Avoidance Directive Regarding Controlled Foreign Company Rules: A Critical Review Based on the Experience with the German CFC Legislation. INTERTAX, 2017. Volume 45, Issue 10, page 620.

¹¹⁰ ATAD, recital 12.

¹¹¹ Van Hulle, G. Current Challenges for EU Controlled Foreign Company Rules. Bulletin for International Taxation, 2017. Volume 71, No. 12, section 2.2.

¹¹² ATAD, article 1.

¹¹³ Moser, T., Hentschel, S., *op. cit.*, page 609 and cited articles.

¹¹⁴ Rigaut, A. Anti-Tax Avoidance Directive (2016/1164): New EU Policy Horizons. European Taxation, 2016. Volume 56, No 11, section 3.1.

¹¹⁵ Smit, D., *op. cit.*, page 259.

enterprises¹¹⁶ holds more than 50% of voting rights, capital or is entitled to receive more than 50% of the profits of the entity; and iii) corporate tax paid on the profits of the entity or permanent establishment is lower than 50%¹¹⁷ of which would have been paid in that Member State.¹¹⁸

A carve out is provided for foreign entities and permanent establishments of which the one third or less of the income is considered to be harmful or in case the financial undertakings receive one third or less of their harmful income from transactions with the taxpayer or its associated enterprises.¹¹⁹ Furthermore, Member States are entitled to exclude entities and permanent establishments from being regarded as CFCs in case their accounting profits are less than EUR 750,000 with non-trading income no more than EUR 75,000 or their accounting profits do not exceed 10% of such entity's or permanent establishment's operating costs for the tax period, excluding payments to associated enterprises.¹²⁰

While implementing CFC rules, Member States may choose to apply so-called entity approach (fully fledged CFC rule), transactional based approach (light CFC rule)¹²¹ or apply both of them simultaneously¹²² to determine the tax base of a CFC. Article 7(2) point (a) of the ATAD establishes for that purpose passive income catalogue and in point (b) principal purpose test.¹²³ In both cases, CFC rules of the ATAD target only non-distributed income,¹²⁴ as one of the goals of CFC rules is to prevent taxpayers from deferring their domestic taxation.¹²⁵

Should the CFC carry on substantive economic activity, supported by the staff, equipment, assets and premises, Member States should not deem the income listed in the catalogue to be harmful. However, when the CFC is located outside of the borders of the European Economic Area, Member States are not required to apply the "substantial economic activity test"¹²⁶ and are permitted to include such income in the tax base of the CFC without further analysis.

The method for calculating the income of a CFC depends on whether the CFC received income listed in the passive income catalogue or the arrangement were considered to be non-genuine with an essential purpose of obtaining a tax advantage. The latter requires Member State to take into consideration the assets, risks as well as significant people functions carried out by the CFC and calculate the income of a CFC in accordance with the arm's length principle.¹²⁷ On the other hand, should the CFC receive

¹¹⁶ As defined in article 2(4) of ATAD.

¹¹⁷ Rigaut, A., *op. cit.*, section 3.5.

¹¹⁸ ATAD, article 7(1).

¹¹⁹ *Ibid*, article 7(3).

¹²⁰ *Ibid*, article 7(4).

¹²¹ Smit, D., *op. cit.*, page 261.

¹²² Ginevra, G., *op. cit.*, page 127.

¹²³ Moser, T., Hentschel, S., *op. cit.*, page 613.

¹²⁴ Smit, D., *op. cit.*, page 262.

¹²⁵ Bonn, J. S. CFC Rules and Anti-Tax Avoidance Directive. EC Tax Review, 2017. Volume 26, Issue 3, page 148.

¹²⁶ ATAD, article 7(2) point (a). Regarding the difference between "substantive economic activity" and "genuine economic activity" as stated by the CJEU, see Bonn, J. S. CFC Rules and Anti-Tax Avoidance Directive., *op. cit.*, page 150; and Danon, R. J. Some Observations on the Carve-Out Clause of Article 7(2)(a) of the ATAD with Regard to Third Countries. The Implementation of Anti-BEPS Rules in the EU: A Comprehensive Study. Edited by Pistone, P., Weber, D. IBFD, 2018, section 17.3.1.

¹²⁷ ATAD, article 8(2).

passive income listed in the catalogue, the income included in the tax base of a taxpayer would be calculated in accordance with the rules of taxpayer's Member State.¹²⁸

3.2.1. Double Taxation from Controlled Foreign Company Rules

Besides numerous undefined terms in relation to CFC rules in the ATAD which could lead to double tax burden,¹²⁹ the problem of double taxation can also arise from the attribution of CFC income to a taxpayer. Pursuant to the ATAD, the amount of income included in the tax base of the EU resident taxpayer shall be calculated based on its participation in the CFC as defined in article 7(1) point (a). As described above, participation in the CFC can be determined on the basis of voting rights, capital or profit share, covering thereby both the legal and economic control over the entity.¹³⁰ However, the wording of article 7 does not give any guidance on which criteria should be preferred or used as a “tie-breaker” in case the percentage of voting rights, capital or profit share differ, allowing therefore simultaneous application of all three criteria.

Provided that Member States subject CFC income to tax, use of all three criteria could cause a double taxation¹³¹ as the indirect control referred in article 7(1) point (a) of the ATAD might trigger the application of CFC rules in several Member States at the same time.¹³² This could be the case when the foreign entity is owned by the EU taxpayer through EU tax resident subsidiary and sub-subsidiary which all meet the participation criterion and are deemed to be a CFC in their own Member State. Under such circumstances, several Member States deem the same foreign entity to be a CFC controlled by their tax resident. As a result, all those Member States consider the income of a foreign entity to be attributable to their tax resident and taxable under their CFC rules (Figure 1).

The taxation of the same income on the hands of different taxpayers is caused by the divergences of attribution as both states consider their taxpayer as a recipient of the income. Double tax burden arising from the aforesaid concurrent taxation by various jurisdictions can be categorized as economic double taxation. Since article 8(7) of the ATAD obliges Member State of a taxpayer to provide tax credit only as regards the taxes paid by the entity or permanent establishment, the ATAD does not provide any relief for aforementioned double taxation.¹³³ Economic double taxation in question would arise from the CFC tax liability in jurisdictions of the controlling entities and not from the taxes paid by the CFC itself.¹³⁴

¹²⁸ *Ibid*, article 8(1).

¹²⁹ Govind, S., Zolles, S. The Anti-Tax Avoidance Directive. Introduction to European Tax Law on Direct Taxation, 5th edition. Edited by Lang, M. (Eds), Linde, 2018, page 235.

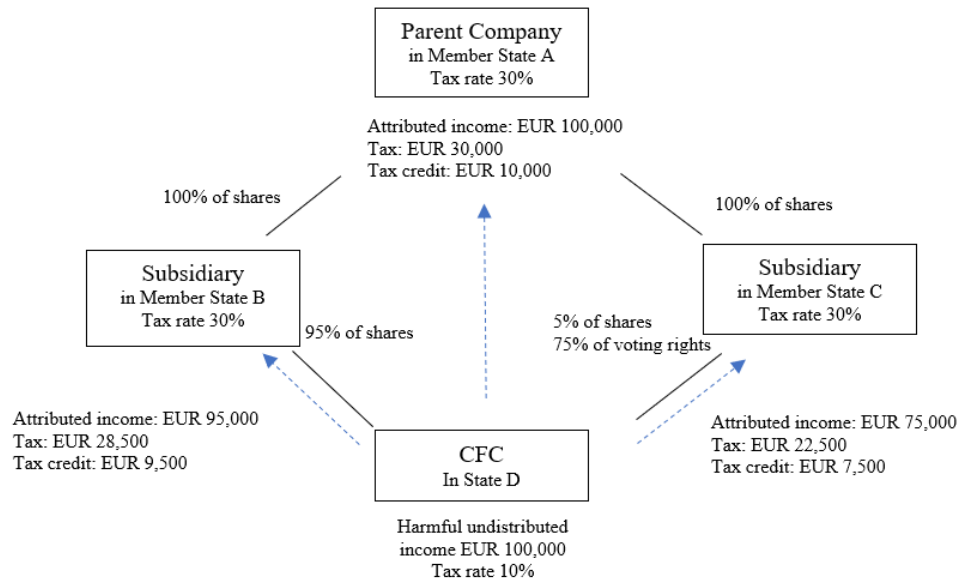
¹³⁰ Ginevra, G., *op. cit.*, page 126.

¹³¹ Moser, T., Hentschel, S., *op. cit.*, pages 611 and 620.

¹³² Van Hulle, G., *op. cit.*, section 2.3.

¹³³ Danon, R. J. Some Observations on the Carve-Out Clause of Article 7(2)(a) of the ATAD with Regard to Third Countries., *op. cit.*, section 17.2.2.

¹³⁴ Van Hulle, G., *op. cit.*, section 2.3.



Total tax on CFC income: EUR 54,000, not EUR 30,000.

Figure 1. Author's illustration.

Another cause of double taxation is connected with the calculation of an effective tax rate (Figure 2¹³⁵). Since the effective tax rate is calculated on a single entity basis, the taxation on the level of controlled subsidiary or sub-subsidiary of the CFC is irrelevant and could trigger double taxation of the income in the hands of the EU parent company.¹³⁶ It would be the situation where the income of a subsidiary of the CFC has been taxed in accordance with the jurisdiction of subsidiary before passing the income to CFC. Notwithstanding the taxation on the level of any subsidiary or sub-subsidiary, even in case of high effective tax rate, Member State calculating the actual corporate tax paid on the profits of the CFC would not be required to take taxes, paid other than the CFC itself, into account. Thus, *de facto* highly taxed income of a CFC received through its subsidiary would be deemed to be low-taxed and subject to CFC regulations, provided that all other conditions are also met. As mentioned above, since the Member States are required to provide relief only in amount of taxes paid by the CFC, there is no obligation under the ATAD to eliminate described economic double taxation.¹³⁷

¹³⁵ The figure is based on the assumption that the Parent-Subsidiary Directive is not applicable as all companies are not located within the EU.

¹³⁶ Smit, D., *op. cit.*, page 260. See also Confédération Fiscale Européenne. Opinion Statement FC 3/2016 on the European Commission's proposal for an Anti-Tax Avoidance Directive of 28 January 2016, page 12. Available online - <http://taxadviser.europa.org/wp-content/uploads/2018/05/CFE-Opinion-Statement-FC-3-2016-on-the-Anti-Tax-Avoidance-Directive.pdf> Accessed 08.04.2019.

¹³⁷ Ginevra, G., *op. cit.*, page 131.

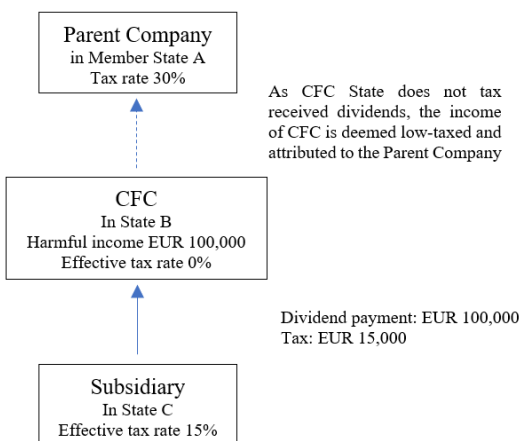


Figure 2. Author's illustration.

In addition to sources of double taxation already mentioned, another potential cause of double taxation is an uncertainty on how the low taxation on the level of CFC resulting from loss carry forward shall be treated by the Member States.¹³⁸ Article 8(1) of the ATAD states that the losses of an entity or permanent establishment shall not be deducted from the tax base of a taxpayer but may be carried forward and be taken into account in the future tax periods, provided that it is allowed by the domestic law of a Member State of a taxpayer. However, the impact of such carry forward to effective corporate tax rate has not been regulated. Therefore, due to the loss carry forward from previous tax period, income of a foreign entity or permanent establishment could be subject to lower effective tax rate in that year of assessment. As a result, the aforesaid income could be considered as a low-taxed income by another Member State and be subject to taxation under the CFC rules. Since the ATAD fails to coordinate the impact of loss carry forward to the calculation of an effective tax rate, the ATAD does not provide any instructions how to solve such potential economic double taxation.

Economic double taxation resulting from the actual profit distribution by the CFC after profits have been attributed to the taxpayer and capital gains from the disposal of shares of a CFC, is prevented by the ATAD itself. Under article 8(5) and (6), Member States are required to deduct amounts which have been previously included in the tax base of a taxpayer, pursuant to the CFC rules, from the tax base when calculating the tax obligation on distributed profit. Moreover, Member States are bound to allow indirect credit as article 8(7) obliges Member States to allow deduction of the tax paid by the CFC.¹³⁹ On the other hand, it is debatable whether withholding taxes paid on CFC's dividends are also credited in the Member State of the taxpayer as the tax is actually paid by the taxpayer and not by the CFC.¹⁴⁰

The problem of dual residency which causes simultaneous application of CFC rules in both states (i.e. by the state of incorporation and by state where the effective place of management is located) is also one source of double taxation.¹⁴¹ However, as the dual residency is not a result of implementation of the ATAD (i.e. the ATAD does not determine the residency of a taxpayer), it has not been analyzed any further in this thesis.

¹³⁸ Moser, T., Hentschel, S., *op. cit.*, page 612 and cited article.

¹³⁹ Smit, D., *op. cit.*, page 263.

¹⁴⁰ Moser, T., Hentschel, S., *op. cit.*, page 621; Smit, D., *op. cit.*, page 263.

¹⁴¹ Van Hulle, G., *op. cit.*, section 2.3.

4. RELIEF FOR DOUBLE TAXATION RESULTING FROM THE INTEREST DEDUCTION LIMITATION AND CONTROLLED FOREIGN COMPANY RULES OF THE ANTI-TAX AVOIDANCE DIRECTIVE

4.1. Relief Under the OECD Model Convention

The primary aim of the OECD MC is to avoid double taxation of income¹⁴² as a hindrance to the international trade and investments.¹⁴³ However, as examined in section 2, it is not settled whether the OECD MC should be interpreted as to eliminate both juridical and economic double taxation or should its scope be limited only to juridical double taxation. Regardless of the approach supported, relevant articles for eliminating double taxation in the context of this thesis are articles 23, 25 and 9 of the OECD MC.

Tax treaties, by establishing allocation rules, limit the applicability of states' domestic tax legislation and prevent states from exercising their taxing rights. Thereby, double taxation is already unilaterally avoided.¹⁴⁴ In case the tax treaty does not provide a complete distributive rule and exclude the taxing right of a state of source, the resident state is required to eliminate double taxation by allowing credit or providing an exemption for income taxed by the source state.¹⁴⁵ Rules for providing tax credit or exempting foreign income are stated in articles 23 A and 23B of the OECD MC.

Pursuant to the articles 23A and 23B, the OECD MC provides relief of double taxation only when the income has been taxed in accordance with the provisions of OECD MC.¹⁴⁶ Income is considered to be taxed in accordance with the OECD MC even when the differences in the domestic legislation lead to the allocation of the income under different treaty provision by source and resident state.¹⁴⁷ That is to say, double taxation resulting from a conflict of qualification due to differences in domestic rules would require resident state to grant relief. There is no obligation for a resident state to provide relief in situations where the double taxation has derived from different interpretation of treaty provisions or facts (i.e. classification conflict).¹⁴⁸ In such case, the source state is deemed to have taxed the income not in accordance with the tax treaty and article 23 would not be applicable.¹⁴⁹

To solve double taxation arising from some qualification conflicts, the OECD so called new-approach could be advantageous. The new-approach provides that when the qualification conflict arises, the interpretation of source state should prevail.¹⁵⁰ Therefore, instead of reaching autonomous qualification, the new-approach obliges state of residence to recognize the qualification of income given by the source state.¹⁵¹ However, the new-approach would not solve qualification conflicts in case of complete

¹⁴² OECD MC preamble and OECD MC Commentaries. Introduction, paragraph 16.1.

¹⁴³ Arnold, B. J., *op. cit.*, page 144.

¹⁴⁴ Rust, A. Klaus Vogel on Double Taxation Conventions, 4th edition, edited by Reimer, E., Rust, A., 2015. Article 23 at marginal number 3, page 1611.

¹⁴⁵ *Ibid* at marginal number 4, page 1611.

¹⁴⁶ OECD MC articles 23A(1) and 23B(1).

¹⁴⁷ OECD MC Commentaries on articles 23A and 23B, paragraph 32.3.

¹⁴⁸ Kienberger, S. Avoidance of Double (Non-)Taxation and Art. 23A and B Paragraph 1 OECD MC. Conflicts of Qualification in Tax Treaty Law. Edited by Burgstaller, E., Haslinger, K. Linde, 2007, page 314.

¹⁴⁹ OECD MC Commentaries on articles 23A and 23B, paragraph 32.5.

¹⁵⁰ OECD MC Commentaries on articles 23A and 23B, paragraph 32.3.

¹⁵¹ OECD MC Commentaries on articles 23A and 23B, paragraph 32.3. Pleil, C., Schwibinger, S., *op. cit.*, page 447.

distributive rules, as the one prerequisite for the new-approach to come into effect is that article 23 of the OECD MC applies.¹⁵² In case the article 23 is not applicable, states should apply article 25 of the OECD MC to resolve double taxation under mutual agreement procedure.¹⁵³ Nevertheless, article 25 of the OECD MC does not compel the authorities of contracting states to reach a consensus and eliminate double taxation.¹⁵⁴

There are three types of mutual agreement procedures under the OECD MC: i) specific case provisions which apply when the taxpayer has not been taxed in accordance with the treaty; ii) interpretative provision to solve difficulties arising from the interpretation and application of a treaty; and iii) legislative provisions to eliminate double taxation in cases not provided for in the treaty.¹⁵⁵ Under the mutual agreement procedure states may start the process after the taxpayer has presented its case or competent authorities have initiated the procedure by themselves under article 25(3).¹⁵⁶ In cases of classification conflict, the procedure is most likely to fall under the article 25(3) which is applicable to resolve difficulties arising from the interpretation and application of a tax treaty and eliminate double taxation not provided for in the treaty. On the other hand, double taxation arising from the qualification conflict and not solved by article 23, would fall under the scope of 25(1) and 25(2), unless there is mere violation of domestic law without any connection to a tax treaty.¹⁵⁷

While for classification conflicts the mutual agreement procedure pursuant to the article 25(3) would be the last resort under the tax treaty, in case of unsolved qualification conflict, article 25(5) requires states to further proceed with the mandatory arbitration process¹⁵⁸ and eliminate double taxation. This, however, would be the case only when states have included mandatory arbitration clause in their tax treaty, otherwise, states in question would unlikely agree on initiating an arbitration process after being unsuccessful to first reach a mutual agreement.¹⁵⁹

Besides article 23 and 25 of the OECD MC, article 9 provides relief for specific cases of double taxation. The scope of article 9 is rather limited as it only deals with double taxation resulting from the cross-border profit adjustments between associated parties.¹⁶⁰ In order to eliminate double taxation caused by a qualification conflict under which the same item of income is subject to tax in the state of source as well as in the state of residence, article 9(2) requires the other state to make a corresponding adjustment and decrease the tax base of a taxpayer in accordance with the primary adjustment. However, the other state has such obligation only when it considers the primary adjustment to be correct in principle and as regards the amount.¹⁶¹ Should the states disagree, they should consult each other and

¹⁵² Vogel, K. Conflicts of Qualification: The Discussion is not Finished. Bulletin for International Taxation, 2003. Volume 57, No 2, page 43.

¹⁵³ OECD MC Commentaries on articles 23A and 23B, paragraph 32.5.

¹⁵⁴ OECD MC Commentaries on article 25, paragraph 37.

¹⁵⁵ Jones, J.F.A. et al. The Legal Nature of The Mutual Agreement Procedure Under the OECD Model Convention – I. British Tax Review, 1979. Vol. 1979, Issue 6, pages 334-335.

¹⁵⁶ Ismer, R., *op. cit.*, Article 25 at marginal number 4, page 1780.

¹⁵⁷ *Ibid* at marginal number 27, page 1788.

¹⁵⁸ The wording of article 25(5) of the OECD MC refers only to paragraphs 1 and 2 of article 25 and not to paragraph 3.

¹⁵⁹ Weninger, P. The Role of Arbitration in Resolving Qualification Conflicts under Tax Treaties. Conflicts of Qualification in Tax Treaty Law. Edited by Burgstaller, E., Haslinger, K. Linde, 2007, page 357.

¹⁶⁰ OECD MC Commentaries on article 9, paragraph 5.

¹⁶¹ OECD MC Commentaries on article 9, paragraph 6.

if necessary, start a mutual agreement procedure to endeavor to solve the double taxation.¹⁶² The actual elimination of double taxation is not required by the OECD MC nor is state required to relieve any double taxation from non-arm's length adjustments.¹⁶³

Based on the aforementioned, in order to eliminate the double taxation resulting from the implementation of the ATAD under the OECD MC, such double taxation should have connection with the OECD MC distributive rules – the income must be taxed in accordance with the OECD MC or by violating the provisions of the OECD MC in order to fall under article 25.

4.1.1. Interest Deduction Limitation Rule

Taking into consideration that the interest deduction limitation rule allow a Member State to deny the deduction of exceeding borrowing costs and increase the taxable base of a taxpayer, it could be concluded that by limiting deductible borrowing costs, this Member State simultaneously adjusts the interest rate of a loan¹⁶⁴ and thereby the profits attributable to its tax resident. In case a Member State denies deduction of exceeding borrowing costs arising from a cross-border loan granted between associated parties, the adjustment falls within the scope of article 9 of OECD MC.

The OECD expressed its position regarding the applicability of article 9 to thin capitalization rules already in 1986.¹⁶⁵ According to the OECD, article 9 is not only relevant to determine whether the interest rate is an arm's length rate but also whether a *prima facie* loan can be regarded as a loan.¹⁶⁶ The latter function of article 9 is, however, disputable and not supported by all scholars.¹⁶⁷

As the interest deduction limitation rule of the ATAD does not foresee the recharacterization of a loan in case of exceeding borrowing costs, there is no doubt about the applicability of article 9 of OECD MC. Compared to the other articles in OECD MC, article 9 is an exception as it does not allocate taxing rights between states but addresses the problem of economic double taxation¹⁶⁸ by introducing a mechanism of corresponding adjustment.¹⁶⁹ Thus, in order to avoid economic double taxation from qualification conflict which arises when the Member State of a borrower denies the deduction of borrowing costs and the Member State of a creditor subjects the interest income to tax, the Member State of the creditor should make the corresponding adjustment and reduce the taxable profit attributable to its tax resident (i.e. creditor). However, the corresponding adjustment is not made automatically. The Member State of the creditor is obliged to make the corresponding adjustment only when it agrees with the primary adjustment in principle and as regards the amount.¹⁷⁰ Should the Member State of the creditor disagree with the primary adjustment, there is no obligation to adjust the tax base of the taxpayer and provide relief under article 9(2). Moreover, increasing the tax base of a

¹⁶² *Ibid*, paragraph 11 and on article 25, paragraph 10.

¹⁶³ Kofler, G. Klaus Vogel on Double Taxation Conventions, 4th edition, edited by Reimer, E., Rust, A., 2015. Article 9 at marginal number 7, page 597.

¹⁶⁴ *Ibid* at marginal number 103, page 669.

¹⁶⁵ OECD. Thin Capitalisation (adopted by the OECD Council on 26 November 1986). Reproduced in the Volume II of the full version of the OECD Model Tax Convention at page R(4)-1, paragraphs 27-32.

¹⁶⁶ OECD MC Commentaries on article 9, paragraph 3.

¹⁶⁷ Kofler, G., *op. cit.*, Article 9 at marginal number 103, page 669 and 670.

¹⁶⁸ Lang, M. Introduction to the Law of Double Taxation Conventions (Second Revised Edition). IBFD, 2013, paragraph 475.

¹⁶⁹ OECD MC Commentaries on article 9, paragraph 5.

¹⁷⁰ OECD MC Commentaries on article 9, paragraph 6.

resident taxpayer is not conflicting with the OECD MC as the OECD MC focuses only on the taxation of the recipient of the income and not on the situation of a payor.¹⁷¹

Provided that the double taxation is not solved under the article 9(2), Member States should endeavor to solve the problem of double taxation through mutual agreement procedure.¹⁷² However, mutual agreement procedure would not oblige Member States to effectively eliminate double taxation, unless Member States have agreed on mandatory arbitration. Nevertheless, neither of the aforementioned tools for providing relief for double taxation would be available in case the interest deduction of a domestic loan or loan granted between unrelated parties is denied.

In addition to aforesaid economic double taxation, interest deduction limitation rule can also cause juridical double taxation. As the non-deductibility of borrowing costs in a Member State do not affect its categorization for tax treaty purpose,¹⁷³ the Member State of a borrower as a source state is entitled to tax the outbound interest payment in accordance with the article 11 of OECD MC and levy withholding tax. The same interest income, however, would most likely be also taxed by the Member State of a creditor as a resident state. Nevertheless, the aforesaid juridical double taxation would be solved under the OECD MC since the state of residence would be obliged to exempt the foreign income of its resident (i.e. the creditor) or credit the tax withheld in source state in accordance with the article 23 of OECD MC, provided that the double taxation is not notional.¹⁷⁴

4.1.2. Controlled Foreign Company Rules

It has been agreed that the CFC rules do not conflict with tax treaties as they do not limit states' right to tax their own residents, on the contrary, they permit states to tax their residents on income attributable to them based on their participation in foreign entities.¹⁷⁵ Furthermore, CFC rules, under which the income of a foreign entity is included in the tax base of a resident taxpayer, do not affect the allocation on taxing rights between states but only change the moment at which the resident state is entitled to exercise its taxing right.¹⁷⁶ Thus, as CFC rules function as an income attribution rules, they are not addressed by tax treaties and it depends only on domestic legislation to whom the income is attributed.¹⁷⁷

Since the CFC rules generally do not trigger simultaneous taxation of income by the state of residence and state of source on the hands of the same taxpayer but tax the profits of CFC on the hands of CFC as well as on the hands of its shareholder, CFC rules can trigger economic double taxation to the extent the state of shareholder does not provide any relief.¹⁷⁸ Based on the analysis in section 3.2.1., it can be

¹⁷¹ Makhmudova, K., *op. cit.*, page 264.

¹⁷² OECD. Thin Capitalisation., *op. cit.*, paragraph 67.

¹⁷³ Makhmudova, K., *op. cit.*, pages 264 - 265.

¹⁷⁴ Lang, M. 2008 OECD Model: Conflicts of Qualification and Double Non-Taxation., *op. cit.*, page 205.

¹⁷⁵ OECD MC Commentaries on article 1, paragraph 81.

¹⁷⁶ Blum, D. W. Controlled Foreign Companies: Selected Policy Issues – or the Missing Elements of BEPS Action 3 and the Anti-Tax Avoidance Directive. INTERTAX, 2018. Volume 46, Issue 4, page 309.

¹⁷⁷ Rust, A. National Report Germany. CFC Legislation. Domestic Provisions, Tax Treaties and EC Law. Edited by Lang, M. et al. Linde, 2004, page 267.

¹⁷⁸ De Broe, L., *op. cit.*, page 580.

concluded that also CFC rules in the ATAD cause economic double taxation to the extent Member State of a shareholder (i.e. EU taxpayer) does not exempt the foreign income or provide credit.

In order to analyze whether the OECD MC provides any relief for economic double taxation resulting from the CFC rules, it is first necessary to agree on the approach taken. As examined in the section 2.3., the OECD MC could be interpreted as eliminating in addition to juridical double taxation also economic double taxation, other than resulting from the classical corporate tax system. Supporting the latter interpretation, the following analysis focuses on the economic double taxation arising from the implementation of CFC rules of the ATAD for which the ATAD provides no relief.

Pursuant to the commentaries on articles 23A and 23B, it could be argued that the position of the OECD is that in case the state of residence of a shareholder attributes the income of a CFC to its resident shareholder, it is also obliged to take into consideration the tax paid by the CFC and provide the shareholder with tax credit, to the extent the tax was paid in accordance with the tax treaty.¹⁷⁹ In other words, as the corporate status of a CFC is ignored to determine the taxable profit of a shareholder, it should likewise be ignored for the purposes of providing foreign tax credit.¹⁸⁰

As the domestic CFC rules are not inconsistent with the OECD MC, they do not affect the distributive rules and states' right to tax the income attributed to the shareholder pursuant to article 7, 10 or any other special distribution rule.¹⁸¹ Nevertheless, it has been discussed under which provisions and to what extent states should eliminate double taxation triggered by the CFC rules. Prevailing, so-called OECD approach obliges the state of residence of a shareholder to grant tax credit under article 23B without distinguishing the type of income earned by the CFC, shareholder's participation in the business activity or where the income was derived.¹⁸² Another approach, presented by professor Alexander Rust, suggests that the state of residence should generally grant an indirect tax credit for taxes paid by the CFC. However, there is no obligation to provide indirect tax credit when the CFC only derives passive income. By receiving only passive income, the CFC does not create a permanent establishment for its shareholders and therefore, the CFC state as source state would have not been entitled to tax the shareholders had such passive income been attributed to the shareholders directly.¹⁸³ Thus, there is no taxation in accordance with the tax treaty in the source state which would trigger the application of article 23 B of the OECD MC by state of residence of the shareholder.

Based on the analysis in section 3.2.1., double taxation deriving from the implementation of CFC rules of the ATAD can arise from: i) participation criteria; ii) effective tax rate; and iii) loss carry forward. Following the so-called OECD approach, the resident state of a shareholder shall provide foreign tax credit notwithstanding the type of income CFC received, shareholder's involvement in the business activities or from which state the income was derived.¹⁸⁴ Depending on the attribution method Member State chooses to apply (e.g. look through approach, deemed dividend approach¹⁸⁵), the income of a

¹⁷⁹ OECD MC Commentaries on articles 23A and B, paragraph 69.2.

¹⁸⁰ Kuźniacki, B., *op. cit.*, page 768.

¹⁸¹ Rust, A. National Report Germany., *op. cit.*, page 267.

¹⁸² Kuźniacki, B., *op. cit.*, page 769.

¹⁸³ Rust, A. National Report Germany., *op. cit.*, page 270.

¹⁸⁴ Kuźniacki, B., *op. cit.*, page 769.

¹⁸⁵ For more detailed overview see section 3.2.

shareholder of a CFC would most likely be taxed pursuant to article 7, 10 or 21 of the OECD MC and once taxed by the source state in accordance with the tax treaty, the resident state of the shareholder, in principle, is obliged to provide relief for double taxation. However, the state of residence would be required to provide relief under article 23 of the OECD MC only as regards the taxes paid by the CFC and not by subsidiaries or sub-subsidiaries of the taxpayer or CFC. Furthermore, as Member State would credit only the actual tax paid by the CFC, the impact of loss carry forward on the calculation of an effective tax rate would not be taken into consideration. Therefore, OECD MC article 23 would not provide any relief for double taxation in question resulting from the CFC rules of the ATAD.

Furthermore, article 25 of the OECD MC would also not solve the double taxation in question as the double taxation would arise from the domestic CFC rules which are not addressed by the tax treaty. Therefore, there is no taxation not in accordance with the tax treaty in case of which the article 25 of OECD MC would become applicable.

Should one support another approach mentioned above, there would be no requirement to provide any tax credit as regards the income listed in article 7(2) point (a) of the ATAD. In case article 7(2) point (b) of the ATAD is applied, the foreign tax credit would be denied only when CFC receives passive income which would not have granted the source state a taxing right would it have been derived directly by the shareholders of CFC. Nevertheless, even in case of other than passive income, the state of residence would be obliged to credit only taxes paid by the CFC, not by subsidiaries or sub-subsidiaries of the taxpayer or CFC. Thus, also the application of the non-OECD approach could lead to situation where the state is not obliged to eliminate the double taxation.

The aforementioned problem of double taxation could be solved when the state of residence of EU parent taxpayer as well as Member States of its subsidiaries and sub-subsidiaries would apply the exemption method. However, by applying the exemption method, the CFC rules become meaningless as the income would be tax exempt irrespective of the taxation at the level of CFC or its subsidiaries.

4.2. Relief Under European Union Legislation

Pursuant to the preamble of the ATAD, its main purpose is to combat abusive practices in EU and ensure that tax is paid where profits are generated without undermining the functioning of the internal market through double taxation.¹⁸⁶ Regardless of the aim of avoiding creating double tax burden to taxpayers, the ATAD does not oblige Member States to effectively eliminate aforesaid burden. Therefore, taxpayers are compelled to seek the elimination of double taxation elsewhere.

Irrespective of the lack of general provision in EU legislation requiring Member States to eliminate double taxation,¹⁸⁷ the CJEU has confirmed the elimination of double taxation to be an aim of EU law.¹⁸⁸ However, since the EU legislation does not define taxing jurisdiction, it also does not determine

¹⁸⁶ ATAD, recital 1 and 5.

¹⁸⁷ Helminen, M. The Principle of Elimination of Double Taxation under EU Law – Does it Exist? Principles of Law: Function, Status and Impact in EU Tax Law. Edited by Cécile Brokelind. IBFD, 2014, Chapter 17.2. and case law cited.

¹⁸⁸ For example judgement of 12 May 1998, Gilly, C-336/96, EU:C:1998:221, paragraph 15.

which Member State has the right to tax the income and which one should be responsible for providing a relief from double taxation.¹⁸⁹

Up to now the CJEU has applied EU primary law to provide relief for double taxation in cases where economic double taxation results from discriminatory domestic legislation.¹⁹⁰ Juridical double taxation resulting from disparities or parallel exercise of taxing rights has generally¹⁹¹ been found to fall outside of the scope of Treaty of Functioning of European Union (TFEU) and despite of being a restriction of free movement, compatible with EU primary law.¹⁹²

Based on the analysis in section 3.1.1., it could be concluded that double taxation resulting from the interest deduction limitation and CFC rules of the ATAD could be characterized as economic as well as juridical double taxation. Since the EU primary law does generally not provide any relief for juridical double taxation resulting from the parallel exercise of taxing rights of Member States or from disparities, it is apparent that EU primary law would not eliminate juridical double taxation caused by the implementation of the ATAD. As regards the economic double taxation, EU primary law would oblige Member State to eliminate double tax burden provided that the domestic legislation of a Member State would disadvantage a taxpayer engaged in cross-border activities.

In case EU primary law does not provide any relief for double taxation, the taxpayer may turn to the Arbitration Convention¹⁹³ and the Dispute Resolution Directive to seek relief of double taxation. However, considering that the scope of the Arbitration Convention is limited to disputes related to profit attribution to permanent establishment and transfer pricing adjustments between Member States, its application to resolve double taxation resulting from the ATAD could be limited. Nonetheless, it has been pointed out that the Arbitration Convention could provide relief when application of the provisions based on the ATAD lead to non-arm's length conditions imposed on transactions between related parties.¹⁹⁴

Since there is no hierarchy between the Arbitration Convention and Dispute Resolution Directive, the taxpayer may choose from 1 July 2019 which one to apply.¹⁹⁵ Unlike the Arbitration Convention, the scope of Dispute Resolution Directive is not limited to transfer pricing adjustments and profit attribution disputes. The Dispute Resolution Directive would be applicable to solve any dispute arising from “*the interpretation and application of agreements and conventions that provide for the elimination*

¹⁸⁹ Wattel, J., Conceptual Background of the CJEU Case Law in Direct Tax Matters., *op. cit.*, page 316.

¹⁹⁰ For example, judgement of 13 November 2012, Test Claimants in the FII Group Litigation, C-35/11, EU:C:2012:707, paragraph 38 and case law cited.

¹⁹¹ The CJEU have found juridical double taxation resulting from the discriminatory withholding taxes to fall within the scope of TFEU, see for example judgement of 8 November 2007, Amurta, C-379/05, EU:C:2007:655.

¹⁹² Wattel, J., Conceptual Background of the CJEU Case Law in Direct Tax Matters., *op. cit.*, page 316.

¹⁹³ Arbitration Convention is not part of EU legislation; however, it is part of *acquis communautaire* and is therefore analyzed under this section of the thesis. Regarding legal status of Arbitration Convention, see Hinnekens, L. The Uneasy Case and Fate of Article 293 Second Indent EC. INTERTAX, 2009. Volume 37, Issue 11, page 604.

¹⁹⁴ De Graaf, A., Visser, K-J., ATA Directive: Some Observations Regarding Formal Aspects. EC Tax Review, 2016. Volume 25, Issue 4, page 208.

¹⁹⁵ Pistone, B. The Settlement of Cross-Border Tax Disputes in the European Union. European Tax Law. Volume 1 – General Topics and Direct Taxation. 7th Student edition. Edited by Wattel, P., Marres, O., Vermuelen, H. Deventer: Wolters Kluwer, 2018, page 178.

of double taxation of income and, where applicable, capital”.¹⁹⁶ Assuming, thus, that Member States have concluded a tax treaty.¹⁹⁷

Double taxation, solved by the Dispute Resolution Directive, is defined as imposition of taxes by two or more Member States in respect of the same income or capital,¹⁹⁸ adopting thereby a broad concept and including both economic as well as juridical double taxation.¹⁹⁹ Despite the rather broad scope of the Dispute Resolution Directive and its aim to effectively resolve disputes leading to double taxation,²⁰⁰ it does not require Member States explicitly to achieve such outcome.²⁰¹ Furthermore, Member States would not be obliged to provide any relief of double taxation during the settlement period and the taxpayer would be liable to bear its own costs related to the settlement,²⁰² creating thereby significant financial burden.

Pursuant to the wording of article 1 of the Dispute Resolution Directive, all disputes arising from tax treaties concluded between Member States fall within the scope of the Dispute Resolution Directive.²⁰³ However, it is questionable whether double taxation resulting from the ATAD and disputes on such double taxation would be resolved under the Dispute Resolution Directive.

First, the ATAD is adopted based on the article 115 of TFEU as a directive and would be binding to the Member States as to the result to be achieved.²⁰⁴ By applying literal interpretation and using the ordinary meaning of “agreement” and “convention”, both terms could be defined as an arrangement between parties.²⁰⁵ A directive or its transposition into domestic legislation, however, could not be understood as an “agreement” or “convention”. Furthermore, taking into consideration the context of the Dispute Resolution Directive, it is evident that only arrangements like tax treaties and similar agreements between Member States could be understood as agreements and conventions covered by the Dispute Resolution Directive. This approach is also supported by the recital 2 of Dispute Resolution Directive and the preparatory work of Dispute Resolution Directive²⁰⁶ which both explicitly limit the scope of Dispute Resolution Directive with double taxation agreements between Member States and

¹⁹⁶ Dispute Resolution Directive, article 1.

¹⁹⁷ Pit, H. M. Dispute Resolution in the EU. The EU Arbitration Convention and the Dispute Resolution Directive. IBFD, Doctorial Series, 2018. Volume 42, page 1242.

¹⁹⁸ Dispute Resolution Directive, article 2(1)(c).

¹⁹⁹ Govind, S., Turcan, L. The Changing Contours of Dispute Resolution in the International Tax World: Comparing the OECD Multilateral Instrument and the Proposed EU Arbitration Directive. Bulletin for International Taxation, 2017. Volume 71, No. 3/4, section 3.2.

²⁰⁰ Dispute Resolution Directive, recital 2.

²⁰¹ Pistone, B., *op. cit.*, page 179.

²⁰² Dispute Resolution Directive, article 12(1).

²⁰³ Govind, S. The New Face of International Tax Dispute Resolution: Comparing the OECD Multilateral Instrument with the EU Dispute Resolution Directive. EC Tax Review, 2018. Volume 27, Issue 6, page 310.

²⁰⁴ TFEU, article 288.

²⁰⁵ Oxford dictionary provides the following definitions: agreement – “a negotiated and typically legally binding arrangement between parties as to a course of action”; convention – “an agreement between states covering particular matters, especially one less formal than a treaty”. Available online - <https://en.oxforddictionaries.com/>. Accessed 20.03.2019.

²⁰⁶ Council of the European Union. Note on Dispute Resolution Mechanisms – Proposal for a Council Directive on Double Taxation Dispute Resolution Mechanisms in the European Union, General approach. 12 May 2017, 9011/17, paragraph 8.

Arbitration Convention. Also disputes arising from the MLI have been considered to fall under the scope of Dispute Resolution Directive.²⁰⁷

Therefore, disputes of double taxation arising from the implementation of ATAD would not directly fall under the scope of the Dispute Resolution Directive. Thus, the aforesaid problem of double taxation could be solved by the Dispute Resolution Directive provided that the exercise of taxing rights under the ATAD would comply with a tax treaty signed between Member States and the double taxation could be derived from such treaty. On the other hand, double taxation resulting from the implementation of ATAD could fall under the scope of Dispute Resolution Directive in case Member State has implemented the Dispute Resolution Directive more beneficially for taxpayers by extending its scope also to double taxation other than arising from agreements and conventions.²⁰⁸

4.2.1. Interest Deduction Limitation Rule

Based on the analysis in section 3.1.1., limitation on deductibility of borrowing costs could trigger economic double taxation resulting from the qualification conflict in case the deductibility of borrowing costs in one Member State is denied and received interest payment in another Member State is treated as taxable income. The ATAD recommends Member States to implement carry forward and carry back rules to eliminate double taxation, however, Member States are not obliged to follow the suggestion. Therefore, the economic double taxation arising from the implementation of interest deduction limitation rule is likely to occur.

Taking into consideration the wording of recital 7 and article 4 of the ATAD, it is evident that the application of interest deduction limitation rule is not limited to cross-border situations. On the contrary, deduction of exceeding borrowing costs would be limited equally in domestic and cross-border situations without any discrimination based on the source of a debt or location of a taxpayer.²⁰⁹ Since there would be no discrimination between cross-border and domestic treatment of interest deduction limitation, the interest deduction limitation rule based on the article 4 of ATAD would comply with the article 49 of TFEU. Therefore, it is unlikely that the CJEU would find EU primary law applicable to eliminate economic double taxation resulting from the limitation on deductibility of borrowing costs introduced by Member States while implementing the ATAD.

However, double taxation arising from the interest deduction limitation rule would fall into the scope of the Arbitration Convention to the extent the deduction of borrowing costs is denied on cross-border loan granted between associated parties. Since the interest deduction limitation rule of the ATAD does not recharacterize the loan into equity but only limit the amount of deductible interest, this rule, in principle, adjust the interest rate applied between associated parties. Pursuant to the article 1 of the Arbitration Convention, disputes regarding the adjustments of profits of associated parties in different Member States are in the scope of the Arbitration Convention. The applicability of the Arbitration

²⁰⁷ Govind, S., Turcan, L. Cross-Border Tax Dispute Resolution in the 21st century: A Comparative Study of Existing Bilateral and Multilateral Remedies. *Derivatives & Financial Instruments*, 2017. Volume 19, No. 5, section 2.2.2.

²⁰⁸ Debelva, F., Luts, J. The European Commission's Proposal for Double Taxation Dispute Resolution: Turning the Tide? *Bulletin for International Taxation*, 2017. Volume 71, No. 5, section 3.1.2.

²⁰⁹ Bizioli, G. Taking EU Fundamental Freedoms Seriously: Does the Anti-Tax Avoidance Directive Take Precedence over the Single Market? *EC Tax Review*, 2017. Volume 26, Issue 3, page 173.

Convention to thin capitalization rules has been confirmed also by the Commission²¹⁰ as well as by the Council.²¹¹

Therefore, in case of cross-border loan between associated parties, the taxpayer may rely on the Arbitration Convention to force Member States to eliminate the double taxation resulting from the implementation of the interest deduction limitation rule of the ATAD.²¹² However, as the Arbitration Convention only covers situations between associated parties within the EU, double taxation resulting from the non-deductibility of borrowing costs of domestic loans, loans granted between non-related parties or with one party outside of the EU, falls outside the scope of the Arbitration Convention.

As analyzed in section 4.2., the Dispute Resolution Directive would provide relief for aforesaid double taxation only when the dispute would derive from the interpretation or application of a tax treaty or when Member States have expanded the scope of the Dispute Resolution Directive.

Based on the analysis in section 4.1.1., it can be concluded that the economic double taxation in question derives from the interpretation and application of article 9 of the OECD MC as Member State denying the deduction of exceeding borrowing costs thereby also adjusts the profit attributable to its tax resident. As article 9(2) foresees making of corresponding adjustment in case the other Member State agrees with the primary adjustment, article 9(2) of the OECD MC avoids double taxation arising from the interest deduction limitation rule. Nevertheless, when the other Member State disagrees with the adjustment, double taxation would not be avoided, and the taxpayer would be entitled to submit a complaint and start proceedings to eliminate double taxation under the Dispute Resolution Directive.²¹³

Similarly to the Arbitration Convention, the Dispute Resolution Directive is also applicable only in situations concerning the non-deductibility of borrowing costs of a cross-border loan granted between associated parties as the scope of the Dispute Resolution Directive is limited to disputes between Member States.²¹⁴ Hence, without the recharacterization of the loan, only article 9 of OECD MC would be applicable. Therefore, double taxation arising from the interest deduction limitation in connection to a domestic loan, a loan between non-related parties or with one party outside of the EU, no relief is provided under the Arbitration Convention nor the Dispute Resolution Directive.

Some scholars see a solution for economic double taxation arising from the interest deduction limitation rule in implementing adjustment mechanism under which the Member State of a creditor would adjust the profits in amount of exceeding interest income in case the Member State of a borrower limits the interest deduction.²¹⁵ In theory, the idea could resolve the problem of double taxation, even in case of non-related parties. Nevertheless, in practice it would most likely face in addition to the increased

²¹⁰ Commission of The European Communities. Communication from The Commission To The Council, The European Parliament And The European Economic And Social Committee on the work of the EU Joint Transfer Pricing Forum in the period March 2007 to March 2009 and a related proposal for a revised Code of Conduct for the effective implementation of the Arbitration Convention (90/436/EEC of 23 July 1990). 14.9.2009. COM(2009) 472 final, paragraphs 18 and 20.

²¹¹ Revised Code of Conduct for the effective implementation of the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises. Official Journal C 322, 30.12.2009, pages 1–10, paragraph 1.2.

²¹² Pursuant to the article 7(1) and article 14, states are obliged to eliminate double taxation.

²¹³ Dispute Resolution Directive, article 3.

²¹⁴ *Ibid*, article 1.

²¹⁵ Lobita, J. C., *op. cit.*, page 62.

administrative burden the same difficulties as abovementioned transfer pricing adjustments under the article 9 of OECD MC – Member States would often not agree on the amount which needs to be adjusted. Mainly because the Member State required to make downwards adjustment of a tax base of its resident would lose tax revenue and would prefer not to make any adjustments. Since the allocation of a tax base fall under the jurisdiction of Member States, the EU law cannot require Member States to adjust the tax base of their residents in accordance with tax consequences in another Member State.²¹⁶ Therefore, the aforementioned solution would eliminate economic double taxation only when Member States would voluntarily cooperate and agree on the adjusted amount, resembling thereby to article 9(2) of the OECD MC.

In addition to economic double taxation, interest deduction limitation rule of the ATAD could also result in juridical double taxation. A qualification conflict leading to juridical double taxation arises when the income retains its categorization as interest income for tax treaty purpose²¹⁷ and permits thereby the state of source to impose, in principle, a withholding tax pursuant to the article 11 of OECD MC. The same income, however, would most likely be also subject to tax in the state of residence which imposes taxes on the worldwide income of its residents.

Regardless of the limited impact on economic double taxation as examined in section 3.1.1., the Interest and Royalty Directive avoids, to certain extent, potential juridical double taxation arising from the implementation of interest deduction limitation rule. The Interest and Royalty Directive restrains, under certain conditions, the source state from imposing taxes, such as a domestic withholding tax, on interest payments made between associated companies or permanent establishments of different Member States. Nevertheless, in case the interest payment does not fall into the scope of Interest and Royalty Directive, the source state is not prohibited to subject the interest payment to tax in accordance with its domestic legislation and the tax treaty concluded between those Member States.

Furthermore, as the same income would most likely be subject to tax in the state of residence of creditor, the problem of double taxation emerges. In case the OECD MC does not provide a relief, the taxpayer would be entitled to start dispute settlement under the Dispute Resolution Directive as such disagreement would fall within the scope of the directive. However, due to its limited scope, the Arbitration Convention would not be applicable.

4.2.2. Controlled Foreign Company Rules

As examined in section 3.2.1., the implementation of CFC rules of the ATAD could cause economic double taxation when Member States attribute the income of a CFC to their resident taxpayers, regardless of taxation of the same income in other than CFC state. According to the ATAD, Member States are required to eliminate economic double taxation caused by the actual distribution of dividends of CFC and the disposal of shares of CFC. However, pursuant to the ATAD, Member States are not required to provide relief for any other double taxation resulting from the implementation of CFC rules.

²¹⁶ See for example judgement of 10 June 2015, X AB, C-686/13, EU:C:2015:375, paragraph 33.

²¹⁷ Makhmudova, K., *op. cit.*, pages 264 - 265.

As described above, under the EU law a taxpayer may seek a solution for the problem of double taxation from primary law, the Arbitration Convention and Dispute Resolution Directive. Following the interpretation of the case law of CJEU, CFC rules are in compliance with EU primary law when i) CFC rules are applied only in case the CFC did not engage in genuine economic activity (carve-out); and ii) CFC rules apply equally to domestic and cross-border situations.²¹⁸

Based on the wording of CFC rules in the ATAD, it appears that CFC rules compel Member States to introduce a carve-out for companies with substantial economic activity. However, as CFC rules are not intended to be applied in domestic situations, they could be seen as discriminating taxpayers engaged in cross-border activities. On the other hand, some scholars have claimed that the CFC rules could be seen as merely allocating taxing rights and having therefore no interference with fundamental freedoms.²¹⁹ It has also been discussed that the CJEU would probably not assess the CFC rules of the ATAD in the light of EU primary law, instead, the CJEU would conduct its analysis based on the ATAD itself.²²⁰ Regardless of the approach taken by the CJEU, CFC rules discriminating cross-border activities could be justified on the grounds of overriding reasons of public interests²²¹ and be thereby compatible with EU primary law.²²² Therefore, it is unlikely that the economic double taxation resulting from the implementation of CFC rules would be solved under the EU primary law. Nevertheless, this conclusion would be debatable in case the income of a CFC is not subject to low taxation but there is no taxation in the state of CFC. Under such circumstances, the application of CFC rules would not result in double taxation and analysis regarding the relief under the EU primary law would not be necessary.

The double taxation in question would be consistent also with relevant EU secondary legislation – namely the Parent-Subsidiary Directive. It has been discussed that the scope of CFC rules could be limited by the Parent-Subsidiary Directive²²³ as the Parent-Subsidiary Directive prohibits taxation of dividends derived from direct investment within EU, even in case of deemed dividends.²²⁴ Thus, in case the CFC income would be qualified as profit distribution under the Parent-Subsidiary Directive, the Member State of the shareholder (i.e. parent company) would be required to exempt such distribution or provide tax credit. This, however, is in accordance with the article 8(5) of ATAD which obliges Member States to provide indirect tax credit. Nevertheless, neither the ATAD nor the Parent-Subsidiary Directive prohibit or provide relief for the economic double taxation arising from i) participation criteria; ii) effective tax rate; or iii) loss carry forward.

Taking into consideration the limited scope of the Arbitration Convention, it is also doubtful whether the double taxation resulting from the application of domestic CFC rules is covered by the Arbitration

²¹⁸ Ginevra, G., *op. cit.*, page 129.

²¹⁹ Dourado, A. P. The EU Anti Tax Avoidance Package: Moving Ahead of BEPS?, *op. cit.*, page 441.

²²⁰ Ginevra, G., *op. cit.*, page 129. Also, Wattel, P., Brokelind, C. Free Movement and Tax Base Integrity. European Tax Law. Volume 1 – General Topics and Direct Taxation. 7th Student edition. Edited by Wattel, P., Marres, O., Vermuelen, H. Deventer: Wolters Kluwer, 2018, page 342-343.

²²¹ Judgement of 12 September 2006, Cadbury Schweppes, C-196/04, EU:C:2006:544, paragraph 47.

²²² For example see judgement of 26 February 2019, X GmbH, C-135/17, EU:C:2019:136 regarding the comparability of CFC regulation with EU primary law.

²²³ Aigner, H-J., Scheuerle, U., Stefaner, M. General Report. CFC Legislation. Domestic Provisions, Tax Treaties and EC Law. Edited by Lang, M. et al. Linde, 2004, page 52.

²²⁴ Helminen, M. Is There a Future for CFC-regimes in the EU? INTERTAX, 2005. Volume 33, Issue 3, page 119.

Convention. First, the aim of Arbitration Convention is to eliminate double taxation in connection with the adjustment of profits of associated enterprises in their commercial or financial relations.²²⁵ CFC rules, however, do not adjust the profits resulting from related party transactions, instead they change the moment of taxation by the resident state.²²⁶ Moreover, the double taxation resulting from transfer pricing adjustments is typically caused by structural adjustments, which, however, tax authorities cannot make under CFC rules.²²⁷ Therefore, the double taxation resulting from the CFC rules is not comparable to double taxation arising from transfer pricing adjustments, thus, the Arbitration Convention is not proper source of law to eliminate such double taxation.

In addition to aforesaid, disputes of double taxation could also be solved by the Dispute Resolution Directive. Pursuant to the article 1, all disputes between Member States which arise from the interpretation and application of tax treaties are in the scope of the Dispute Resolution Directive. Thus, in order for the double taxation to be solved by the Dispute Resolution Directive, such double taxation must derive from a tax treaty.

As analyzed in section 4.1.2., domestic CFC rules are not conflicting with tax treaties and therefore state is entitled to attribute income to its resident taxpayers pursuant to domestic legislation, irrespective of any tax treaty in force. Therefore, provided that the income of a CFC would be taxed under article 7, 10 or any other distribution rule of the OECD MC,²²⁸ the dispute arising from such taxation could be within the scope of Dispute Resolution Directive. Nevertheless, the Dispute Resolution Directive would not oblige Member State to provide relief for double taxation caused by i) participation criteria; ii) effective tax rate; or iii) loss carry forward as pursuant to the OECD approach, examined in section 4.1.2., the state of residence would be required to credit only taxes paid by the CFC and not by subsidiaries or sub-subsidiaries of the CFC. Thus, the double taxation under dispute would not arise from the interpretation and application of a tax treaty, which by following the OECD MC article 23B, would not require tax credit beyond taxes paid by the CFC and would therefore not be within the scope of the Dispute Resolution Directive. Hence, the Dispute Resolution Directive would not be an applicable source of law to eliminate double taxation caused by CFC rules of the ATAD.

²²⁵ Arbitration Convention, preamble and article 4.

²²⁶ Blum, D. W., *op. cit.*, page 309.

²²⁷ Kuźniacki, B., *op. cit.*, page 766.

²²⁸ Rust, A. National Report Germany., *op. cit.*, page 267.

5. CONCLUSIONS

Due to the *de minimis* nature of the ATAD and Member States' increased number of opportunities to tax, its implementation is leading to the conflict of norms and thereby also to potential double taxation. Pursuant to the recital 5 of the ATAD, the drafters were aware of the potential double tax burden, nevertheless, as regards the rule on interest deduction limitation and CFC rules, in majority of cases there is no obligation to eliminate double taxation under the ATAD. In cases the ATAD does not provide relief for double taxation itself, it is up to a taxpayer to identify the correct source of law on the basis of which the double taxation could be eliminated.

Double taxation resulting from the interest deduction limitation rule of the ATAD has its origin in qualification conflict. Economic double taxation derives when the Member State of a borrower denies the deduction of borrowing costs while the Member State of a creditor still taxes the received interest income. The ATAD foresees a mechanism of carry forward and back of non-deductible borrowing costs or unused interest capacity. However, the provision is not mandatory for Member States to implement.

Should there be no carry forward and back mechanism, the economic double taxation could be solved under the article 9 of OECD MC as by denying the deduction of borrowing costs, the Member State is deemed to adjust the profits of its resident. Nevertheless, should the Member State of the creditor disagree with the corresponding adjustment, Member States can seek solution under a mutual agreement procedure. In case the mutual agreement procedure turns out to be unsuccessful, Member States are obliged to continue with the arbitration, provided that the tax treaty includes the clause of mandatory arbitration.

Juridical double taxation arising from the fact that domestic interest limitation rule does not prohibit the taxation of income under article 11 of the OECD MC, is usually solved by the article 23 of OECD MC. Within the EU, the aforementioned juridical double taxation would be avoided in case the payment falls under the Interest and Royalty Directive which prohibits the imposition of withholding taxes on outbound interest payments.

In addition, disputes of double taxation resulting from the rule on interest deduction limitation could also be solved under the Arbitration Convention as a dispute arising from transfer pricing adjustment, or under the Dispute Resolution Directive as a dispute deriving from the interpretation and application of a tax treaty. Since the deduction of borrowing costs is limited equally in domestic and cross-border situations, EU primary law would not provide any solution for double taxation.

However, it is important to note that article 9 of the OECD MC, the Arbitration Convention and the Dispute Resolution Directive deal only with cross-border loans granted between associated parties. Therefore, double taxation resulting from the interest deduction limitation on a loan granted domestically or between non-related parties, no solution for double taxation is available. Furthermore, as regards the Arbitration Convention and the Dispute Resolution Directive, also loans where one party is located outside of the EU are out of the scope. Therefore, the problem of unsolved double taxation resulting from the interest deduction limitation rule of the ATAD would require a further research on

how the implementation of this rule without mandatory carry forward and back rules would not conflict with the principles of international taxation.

Besides interest deduction limitation rule, economic double taxation could also arise from the implementation of CFC rules which aim to re-attribute the undistributed harmful income of a CFC to its parent company in the EU. Pursuant to the CFC rules of the ATAD, Member States are not required to provide any relief in case the double taxation results from the i) application of participation criteria by several Member States; ii) determination of an effective tax rate; or iii) loss carry forward. The same conclusion applies also as regards the OECD MC which does not require Member States to credit taxes paid by the subsidiaries or sub-subsidiaries of the CFC or its parent company.

Furthermore, despite the potential discriminatory nature of the CFC rules, it is unlikely that the EU primary law would solve the problem of economic double taxation resulting from the implementation of CFC rules. The double taxation in question would also not be in breach with the EU secondary legislation such as the Parent-Subsidiary Directive.

Since the double taxation in question would not derive from structural adjustment like in case of transfer pricing adjustments, the Arbitration Convention would not be applicable source of law to solve the problem of double taxation. Furthermore, as the scope of Dispute Resolution Directive is limited to disputes arising from the interpretation and application of tax treaties, the Dispute Resolution Directive would be applicable only to solve the disputes regarding distributive rules under which the CFC income is taxed and questions regarding tax credit in amount of taxes paid by the CFC. However, disputes regarding the tax credit in amount of taxes paid by the subsidiaries or sub-subsidiaries of the CFC or its parent company would fall out of the scope.

To conclude, the OECD MC would be a reliable source of law to solve the juridical double taxation resulting from the implementation of interest deduction limitation rule of the ATAD. The OECD MC, the Arbitration Convention and the Dispute Resolution Directive would be correct sources of law to provide relief for economic double taxation resulting from the rule on interest deduction limitation. However, their applicability would be limited to situations where the deduction of borrowing costs is denied on cross-border loan between related parties. Examined double taxation deriving from the implementation of CFC rules of the ATAD would not be solved under any source of law scrutinized in this thesis. Thus, a further research is necessary to ascertain the ways Member States could implement CFC rules of the ATAD without causing double taxation.

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