A Commentary to Alexander Rust's Papers "CFC Legislation and EC law" and "Necessity of a reform of the German CFC legislation"

CFC LEGISLATION AND EC LAW

1. CAN THE SOLUTIONS OF THE OECD PARTNERSHIP REPORT BE TRANSFERRED TO THE CFC CONTEXT?

- The Application of the OECD Model Tax Convention to Partnerships, paras. 1 and 2:
  - "This first report by the Working Group, which the Committee adopted on 20 January 1999, focuses exclusively on partnerships. The Committee recognises, however, that many of the principles discussed in its report may also apply with respect to other non-corporate entities (…)."
  - "references to "partnerships" in this report cover entities that qualify as such under civil or commercial law as opposed to tax law. Thus the term "partnership", as used in this report, does not imply anything about the tax treatment of the relevant entity and should not be confused with a reference to entities, whether partnerships or not, which are treated as transparent for tax purposes."

1. CAN THE SOLUTIONS OF THE OECD PARTNERSHIP REPORT BE TRANSFERRED TO THE CFC CONTEXT?

- Is there a methodological analogy between a partnership and a controlled foreign company which is only tax transparent for the resident State, under non-commercial or civil law criteria set by the latter?

II. CAN THE DISCRIMINATION OF APPLYING A LOOK-THROUGH APPROACH TO FOREIGN COMPANIES BE JUSTIFIED ON THE GROUNDS OF PREVENTION OF ABUSE?

- Case C 201/05 (CFC and Dividend Group Litigation), of 23 April 2008, ruling 3:
  - "Articles 43 EC and 48 EC must be interpreted as precluding the inclusion in the tax base of a resident company established in a Member State of profits made by a controlled foreign company in another Member State, where those profits are subject in that State to a lower level of taxation than that applicable in the first State, unless such inclusion relates only to wholly artificial arrangements intended to escape the national tax normally payable.
  - Accordingly, such a tax measure must not be applied where it is proven, on the basis of objective factors which are ascertainable by third parties, that despite the existence of tax motives, that controlled foreign company is actually established in the host Member State and carries on genuine economic activities there".

III. CAN THE DISCRIMINATION OF APPLYING A LOOK-THROUGH APPROACH TO FOREIGN COMPANIES BE JUSTIFIED ON THE GROUNDS OF COHESION?

- May the Case C-319/02 (Manninen), of 18 March 2004, broad concept of cohesion (drafted for dividends), justifying a charge on one taxpayer offset by a relief for another - which is not more than the other side of the coin of one of the accepted methods of avoidance of double taxation in article 4 (1) of the Parent-Subsidiary Directive -:
  - be applied to "fictitious passive income", being that deemed income or flow "the same income or the same economic process" as required therein?

IV. CAN THE DISCRIMINATION OF APPLYING A LOOK-THROUGH APPROACH TO CFC BE JUSTIFIED ON THE GROUNDS OF A BALANCED ALLOCATION OF TAXING POWERS BETWEEN MEMBER STATES?

- Reference was made in Case 231/05 (Oy AA), of 18 July 2007, to the fact that the possibility of a tax-deductible cross-border group contribution would mean that taxpayers could freely choose the Member State in which they wanted to pay taxes. This could risk the balanced allocation of taxing powers between Member States.

- The possibility of taxing passive fictitious income at the discretion of the home Member State would mean that the latter would choose the host Member States in which income was deemed to be generated. Could this risk the balanced allocation of taxing powers between Member States?

V. CAN THE DISCRIMINATION OF APPLYING A LOOK-THROUGH APPROACH TO FOREIGN COMPANIES BE JUSTIFIED ON THE GROUNDS OF PROPORTIONALITY?

- Is it proportionate to apply a tax-transparence legislation:

  (i) to 1% shareholders, given the absence of control, the ability-to-pay principle and the cost-compliance requirements of information gathering?

  (ii) to passive income taxed at a rate lower than 25%?

V. CAN THE DISCRIMINATION OF APPLYING A LOOK-THROUGH APPROACH TO FOREIGN COMPANIES BE JUSTIFIED ON THE GROUNDS OF PROPORTIONALITY?

- Even if one accepts that more stringent criteria are applicable to the full enjoyment of low tax rates for passive income and financial activities [Case C-88/03 (Azores), of 6 September 2006], is it not a disguised – *rectius* confessed - restriction to fundamental freedoms to apply a tax-transparence legislation:

  (i) that even though symmetrical (taxes income and imputes losses) is not a group taxation regime;

  (ii) works especially to the detriment of taxpayers with foreign holdings, neutralising tax advantages that are inherent to the common market?