Taxation of cross-border dividends in Europe

Introduction

The globalization of capital markets and trade economies on the one hand, and the creation of single market within the European Union on the other hand, have determined an increasing interest of the both the literature and the jurisprudence in the field of international taxation.

This thesis focuses on taxation of cross-border dividends and is founded on the idea that it is no longer possible to separately analyze such topic both from an international tax and a European tax law viewpoint.

The thesis is structured on three main parts, which deal respectively with:

(i) An analysis of the taxation of cross-border dividends under the general tax law principles;
(ii) An analysis of the taxation of cross-border dividends under international tax law principles as well as European law principles;
(iii) An analysis of the taxation cross-border dividends under from an Italian perspective.

As a side remark, we would like to recall that the thesis was submitted in November 2007 and discussed in January 2008.
An analysis of the taxation of cross-border dividends under the general tax law principles

1) Tax treaty rules are based on personal and territorial links. The personal link is represented by the residence of the taxpayer, which triggers worldwide tax liability. The personal link is common to all the treaty rules with no distinction concerning the type of income which is dealt with in a specific rule. Unlike the personal link, the territorial link varies according to the type of income at stake. Each territorial link should express two basic principles of international law: the social attachment, which is more strictly related to the taxation of the non-resident taxpayer in the State of source, and that of economic allegiance, which can be considered a corollary the internation equity principle, insofar as the sharing of the taxing rights between the State of residence and the State of Source is concerned.

2) Art. 10 bases the territorial link on a link of a personal nature, i.e. the residence of the distributing company. Art. 10 OECD can be therefore criticized as it seems not respect the social attachment and well as the economic allegiance principles mentioned above.

3) The overlapping of personal links, of territorial links and of personal and territorial links may give rise to double taxation, which not always may be settled in tax treaties.

4) International tax liability groups at least two different tax liabilities, which are separately regulated by domestic and bilateral tax rules. Domestic and bilateral tax rules have however different roles. Domestic tax law rules defines the taxable event whereas the bilateral tax rules restricts the application of the former rules.

5) From a source State perspective bilateral tax rules may relinquish (either partially or totally) domestic tax liability.

6) From a residence State perspective bilateral tax rules achieve a tax advantage, which may be partial (as in the case of an ordinary tax credit) or total (as in the case of exemption). Unlike tax advantages in domestic situations such advantages based on the application of a double tax convention are grounded on the idea that the income has been taxed in the other contracting State.

7) The elimination of international double taxation substantively differentiate domestic tax liability from international tax liability.

8) The obligation to relieve (juridical) double taxation may stem from domestic or tax treaty rules. In the latter case the elimination of tax liability can even relinquished with no material payment. This is possible in domestic situations as well, where for example domestic law allows the taxpayers to compensate tax liabilities with other credits of the taxpayers. However, in the case of elimination of juridical double taxation no such reciprocal element seems to exist. The source of the obligation to relieve double taxation is the tax treaty itself, which could be seen as an agreement between two parties( the contracting States) other than final beneficiary of the agreement itself (the taxpayer).
Another specific feature of the international tax obligation is the presence of **two States** or active parties as well as **legal relations** between the taxpayer and each of the active party.

**Taxation of cross-border dividends under international tax law**

10) The term **company** must be interpreted in a broad way, i.e. including entities, i.e. persons other than company which are given the same tax treatment as corporate bodies under domestic law. The term “**company**” could therefore include trusts or any investment vehicle to the extent the latter condition is met, regardless of their legal form.

11) The **State where the company has been set up** is not relevant for the purpose of applying art. 10 OECD MC, insofar as such company is resident in another State. Such conclusion holds true notwithstanding the fact that the company maintains its legal personality under the law of the State of constitution.

12) The term **“paid”** must be interpreted broadly. However, in order to consider the dividend “paid” for treaty purposes a **decision of the shareholders’ meeting** is a necessary condition. In this respect the timing of the taxation is a domestic issue which must be dealt with in domestic law of the State of the company distributing the dividends.

13) The tax policy underlying the taxation of dividends under Art. 10 OECD MC should take into account the **taxation of capital gains**. This is not the case in the OECD MC which prevents the State of source to tax the capital gains regardless of the holding percentage. In addition, several (Italian) treaties provides for taxation at source of capital gains realized from the alienation of direct investment. Such policy, which to our understanding is adopted by many other countries, appears to be incoherent if one considers that Art. 10 OECD MC provides for a lower taxation at source in respect of higher holding thresholds (higher than 25%), whereas portfolio dividends are subject to a more burdensome taxation. Asymmetrical policies in Art. 10 and art. 13 may boost abusive practices.

14) A **direct participation** (of at least 25%) in the capital of the distributing company is required in Art. 10.2.a) OECD MC as a condition for the application of the lower tax threshold provide therein.

15) **No participation (either direct or indirect) is required** in other paragraphs of Art. 10 OECD MC. It follows that such article still remains applicable in those cases where the recipient of the dividends has no holding stake in the capital of the distributing company, such as in the case of dividends received by virtue of a usufruct agreement. In such case, however, the application of art. 10.2.a) OECD MC is not prevented insofar as domestic law of the State of source would impute the usufructuary a fictitious capital stake in the distributing company.

16) The term **“holds directly”** does not exclude participation in the capital of subsidiary held through permanent establishments located in a State other than that of both the company receiving the dividends and that paying the dividends.
17) Similar conclusion as under 7) must be reached when the participation is held through a **transparent entity** (such as a partnership). Such entity should in fact be considered a permanent establishment in the State where it is constituted.

18) The term “holds” referred to in art. 10.2.a) is neutral and includes also **rights other than ownership**. Such provision is therefore applicable for example in the framework of securities lending schemes in which the dividends are received by the borrower of the holding stake. The same conclusion holds true in the framework of pledge on shares.

19) The **exclusion of “partnerships”** from the scope of art. 10.2.a) is not clear. The term “other than a partnership” contained therein should be interpreted as to referring to partnerships which do not fall within the definition of “company” provided for in art. 3.1.b) OECD MC and are considered to be resident for treaty purposes.

20) The definition of dividends contained in Art. 10.3 OECD MC consists of three main parts. The **existence of a security** is the underlying element of the first part, which refers to income from shares, jouissance shares or jouissance rights, mining shares, founders’ shares. The existence of a security other than a share appears necessary also for the second part of art. Art. 10.3, which refers to other rights, not being debt-claims, participating in profits”. The second part of art. 10.3 is focused on the difference between the equity owner and the creditor. In this respect, it presupposes a **full participation in the profits** of the company as well as in the **entrepreneurial risk** related to the activities of the company itself. The third part of Art. 10.3 OECD MC has a residual function is not based on the underlying existence of a security. The reference to “other corporate rights” must be interpreted with reference to domestic law of the State of the distributing company. In this respect a remuneration or any other profit is qualified as a dividends insofar as it “is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is resident”. To our understanding it is **not necessary that the remuneration is totally linked to the profits** of the company and, in addition, it is **not necessary** that the recipient of the income of bears the entrepreneurial risk.

21) The third part of Art. 10.3 OECD MC, as interpreted under 11), renders Art. 10 applicable to persons who receive the dividends without being the owners of the underlying capital, i.e. without running the entrepreneurial risk associated to the possibility to lose the capital invested.

22) The reference to “other corporate rights” however may somehow limit the application of art. 10, despite the fact that the profits or the remuneration is qualified as dividends under domestic law of the State of source. The term abovementioned must in fact be interpreted as referring to a corporate right, such as the right of participating in the profits of the company or the voting right. It follows for example that in the case of transfer pricing adjustments operated between sister companies art. 10.3, third part, is not applicable since there is no shareholder relationship between such companies, i.e. neither the right to the profits nor the voting right is at stake.
Taxation of cross-border dividends under European primary law

23) Taxation of cross-border dividends may give rise to problems of compatibility with community and particularly result in discriminatory/restrictive treatments which may violate the freedom of establishment, the free movement of capital or, in case of workers who have the status of shareholders, the free movement of workers.

24) The European Court of Justice has applied two different treaty freedoms in some case law, whereas in some others only one treaty freedom. In general under either approach the result should be the same if one considers that the European Court of Justice has always purported a convergent approach in the interpretation and application of the treaty freedoms. One confirmation of this line of reasoning can be found in the Baars case, in which the Court decided that the failure of Dutch national rules to comply with the freedom of establishment made it unnecessary to analyse further the infringement under the free movement of capital.

25) Nonetheless one should consider that not the same range of justifications applies with respect to different treaty freedoms, particularly those justifications which are expressly dealt with in the treaty. In our opinion the wording of art. 43 and of art. 58.2 of the EC Treaty confirms that the freedom of establishment and the free movement of capital may be applied conjunctively. Indeed, the former provision makes its application subject to the “provisions of the Chapter related to capital,” whereas Art. 58(2) EC Treaty states that the provision of the Chapter IV, namely the one dealing with capital and payments, may not affect those “restrictions on the right of establishment which are compatible with this Treaty”.

26) However, the concurrent application of the application of the freedom of establishment and of the free movement of capital may not exclude that a certain tax treatment may violate one treaty freedom and not the other.

27) The European Court of Justice stated that the freedom of establishment is applicable insofar as the holding in the capital gives the shareholder a definite influence over the company’s decisions and allows him to determine its activities. Such element however may give rise to a number of doubts: the reference to the holding in the capital could be interpreted as to excluding the application of the freedom of establishment in cases where the definite influence is not influenced by the holding in the capital but derives from other element (contractual or de facto control for example).

28) It is uncertain whether the freedom of establishment could apply in respect of profit realized through partnerships, i.e. entities with no legal personality. Art. 48 of the EC Treaty defines the term “companies or firms” as “companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit making”. From art. 48 EC Treaty the legal personality of the company or of the entity appears an indispensable element. From a fiscal point of view, the legal personality element does not always play an important role, as it is possible that partnerships may be treated likewise corporate taxpayers under domestic tax law. In this respect the following scenarios may be possible: (i) the partnership is considered as transparent for tax purposes under the tax law of the
State of establishment (ii) the partnership is considered as opaque under domestic tax law of the State of constitution. In the first scenario art. 43 EC Treaty would still apply, despite the fact that the partnership could not fall within the definition of company provided in art. 48 EC Treaty. The activities of the partnership would give rise to a permanent establishment of the partners in the State where the partnership was established. In the second case art. 43 EC Treaty would not apply since the company would not meet the requirements set out in art. 48 EC Treaty. The distribution of profits should fall in art. 56 EC Treaty exclusively.

29) The analysis of the case law of the European Court of Justice is carried on taking into account the perspectives of the State of residence of the distributing company, which is normally the State of Source under international tax law, and of the State of residence of the shareholder.

The analysis from the State of residence of the distributing company takes into account:

a. the taxation of the distributing company;
b. the taxation of the non-resident shareholder;
c. the taxation of the non-resident shareholder, which is a citizen of the State of the distributing company.

The analysis from the perspective of the State of residence of the shareholder takes into account:

a. the taxation of the shareholder resident therein;
b. the taxation of the shareholder, which is a citizen of that State but is not resident therein.

30) A different treatment of the distributing company based on the residence of the shareholder cannot be examined likewise a classical case of discrimination since the violation of community law depends on the resident of a taxpayer other than that which is discriminated. Such situation should be considered an inbound restriction (or a host State restriction) imposed by the State of the distributing company upon the non-resident shareholder. Still, such approach would focus on a taxpayer which is other than that which is suffering the more burdensome tax treatment. Regardless of the fact that a more burdensome tax treatment would constitute a discrimination or an inbound restriction, the fact that the distribution company is treated less favorably due to the residence of the taxpayer represents is by itself a violation of community law. The more burdensome treatment of the distributing company would certainly render more difficult the access of such company to the capital markets.

31) A “host State restriction” situation arose in the Metallgesellschaft case, which dealt with the advanced payment of corporation tax (ACT) in respect of dividends paid to non-resident parent companies which could not be consolidated under the UK group regime. According to the European Court of Justice the ACT violated community law as it determined a cash-flow disadvantage for the distributing company. In our opinion, cash-flow disadvantages run counter the freedom of establishment, though in the case at stake the pre-payment of corporation tax would have not been due ab origine, since non-resident companies could not benefit of an indirect tax credit, unless otherwise stated in a double tax treaty.
32) Taxation of non-resident shareholders has always been a very delicate issue, which triggers a number of fundamental tax policy considerations. European tax law requires the neutrality in respect of the residence of the shareholder. In our opinion such neutrality has been a consequence of the neutrality in respect of the source of the dividends, which was imposed from the earlier case law (see for example Lenz, Verkoijen, Manninen). In order to ensure the neutrality in respect of the source of the dividends, many European Member States switched from the (indirect) credit system to the exemption system. The exemption of dividends - whether domestic or foreign sourced – has obliged the Member States to achieve the neutrality in respect of the residence of the taxpayer. Dividends paid to non-resident may not be subject to tax insofar as dividends paid to resident companies are exempt.

33) In order to consider non-resident shareholders comparable to resident shareholders it is sufficient for the former to subject to tax in the State of source, i.e. the State of the distributing company.

34) The neutrality in respect of the residence of the taxpayer may run counter the source country entitlement principle. Taxation of non-resident taxpayers therefore raises the question as to whether and to what extent the European Court of Justice has required Member State to give up the source country entitlement in order to ensure the neutrality in respect of the residence of the taxpayer.

35) The first important case on the neutrality in respect of the residence of the shareholder was the Fokus Bank case decided by the EFTA Court. In such decision the EFTA Court obliged the source State to give up the taxing rights upon the non-resident shareholder, as a consequence of the entitlement of such shareholders to an indirect tax credit, which was granted upon domestic distributions exclusively. Later the European Court of Justice dealt with a case involving taxation of non-resident shareholders in the ACT Test Claimants GLO. In our opinion the European Court of Justice rendered a decision which is coherent with the decision in the Fokus Bank case. According to the European Court of Justice the position of the non-resident shareholder was not comparable to that of the resident shareholder since the former where not subject to tax in the source State. By contrast, the resident shareholders and non-resident shareholders become comparable insofar as a double taxation convention provides for a tax credit to be extended to the latter shareholders. In such case distributions of dividends to non-resident shareholder are subject to tax in the source State.

36) Vice versa European law is violated when outbound dividends are taxed and domestic dividends are exempt. Such conclusion was reached in the Denkavit case in which the European court of Justice obliged the State of source to give up the withholding tax levied upon outbound dividends payments. Such withholding runs counter community law as domestic distributions were exempt. Such conclusion was later repeated in the Amurta case.
37) In our opinion the case law on taxation of non-resident shareholders so far analyzed have demonstrated that the neutrality in respect of the residence of the taxpayer requires necessarily the State of source to give up the taxing right upon outbound dividends. However such conclusion remains valid insofar as the non-resident shareholder is subject to tax in the latter State. By contrast, the position of a resident shareholder and that of a non-resident shareholder could not be compared.

38) Different considerations should be carried on in case of taxation of non-resident shareholders with a permanent establishment to which the dividends are attributed.

39) Since the Avoir Fiscal case it was clear that the fact that permanent establishments were subject to territorial taxations was not relevant for the purposes of ascertaining the comparability with resident companies, subject to worldwide taxation. Same conclusion was achieved later in the Saint Gobain case.

40) Though with minor differences, the comparability between permanent establishments and resident companies is settled case law. In the Avoir Fiscal case the Court focused on the similarity of the rules concerning the determination of the taxable base whereas in the Saint Gobain the Court stressed the fact that both resident and non-resident companies were subject to tax upon the same dividends. The European Court of Justice dealt with the taxation of non-resident shareholders with a permanent establishment in the CLT-UFA case, which concerned the application of split-rate system to dividends remitted by the permanent establishment to its head office resident in another State. The European Court of Justice compared such permanent establishment to a subsidiary company resident in the same State and equated a remittance of profits to a dividend distribution. In our opinion this comparison is wrong. Rather than looking at a deemed distribution from the permanent establishment State (equated to subsidiary resident in that State) to its parent company, the Court should have looked at whether permanent establishment profits were distributed by the subsidiary company to its shareholders. In such a case the permanent establishment (or the non-resident company) should be entitled to the same relief for double taxation as that applicable in equal circumstances to resident companies in the permanent establishment State. Insofar as a split-rate system applies regardless of whether the shareholder is effectively taxed, the search for a correct comparison should exclusively focus on the company making the dividend distribution. In other words, in the presence of an actual distribution of profits, had cross-border dividends been paid out through income not taxed in the hands of the distributing company at the lower rate applicable upon distributed profits, then one could claim a breach of fundamental freedoms namely, of the freedom of establishment included in Article 43 EC Treaty.

41) The situation of a citizen of a Member State which is resident in another Member State is never comparable to that of resident of the former State.
42) Comparability between resident taxpayers with domestic dividends and resident taxpayers with foreign dividends stems from the factual circumstance that both taxpayers suffer economic double taxation in respect of the flow of dividends. One could therefore wonder whether and to what extent such comparability should depend on an effective levying of tax in the hands of the shareholder in its State of residence or conversely in the State of the distributing company.

43) In our opinion the effective levying of tax in the hands of the shareholder in its State of residence or conversely in the State of the distributing company is clearly not relevant in respect of schedular system of taxation of dividends. Such system in fact applies regardless of the taxation of the distributing company and provide for a fixed levy of tax applicable without taking into account the personal circumstances of the shareholder. Such conclusion was reached by the European Court of Justice both in Baars and in the Verkoijen Case.

44) In the Baars case the Court of Justice clarified in addition the concept of economic double taxation, which is crucial in order to ascertain the residence of domestic and cross-border situations concerning the flow of transnational dividends. In this respect economic double taxation arises insofar as the taxation in the State of source and that in the State of residence of the shareholder takes into account the same profits, i.e. the same taxable element. Differently no double taxation arises in those case where one tax is levied upon the capital assets, i.e. the holding in the foreign company and the second tax is levied upon the profits.

45) In our opinion if the taxable element plays a crucial role in order to ascertain instances of double taxation, the method of levying the taxes is not likewise relevant.

46) In Kerckhaert-Morres the European Court of Justice has considered the application of a schedular system in the State of residence, without taking into account the levying of tax in the State of source. According to the European Court of Justice the State of residence of the taxpayer has the burden to relieve economic double taxation. Such conclusion was confirmed in the Manninen Case, in which however the Court considered that accidentally also the State of residence of the distributing company could eliminate economic double taxation. If this were the case, the Court concluded that the situation of resident shareholders with foreign dividends would not be comparable to that of resident shareholders with domestic dividends.

47) Unlike Kerckhaert-Morres, in Manninen and Meilicke the Court necessarily took into consideration the taxation of the distributing company in its State of residence. In our opinion the consideration of the other State was needed due to the very nature of the indirect credit system method, i.e. the granting of a credit in respect of the taxes effectively paid by the subsidiary company in its State of residence.

48) In our opinion the credit must be linked to the taxes effectively paid by the distributing company. However, doubts may arise insofar as the State of the subsidiary corporate tax rate is higher than that applicable in the State of the shareholder. In Meilicke case, the European Court of Justice has stated the obligation for the State of residence to grant a credit in respect of the taxes
(higher) effectively levied in the State of the subsidiary. In our opinion such conclusion may give rise to several doubts. Such situation would end up in over-integrating the taxes of the resident shareholder. Such a higher credit would in fact put the resident shareholder receiving foreign source dividends in a better situation that a resident shareholders receiving domestic dividends. The Meilicke case is not in line with the decision of the European Court of Justice in the Gilly case, though in the latter case the Court did not find a breach of community law.

49) The Meilicke decision confirms that the European Court of Justice upheld two different approaches depending on the integration system at stake in the case. As stated above, in Kerckhaert-Morres the Court only took into consideration the situation in the residence State whereas in Meilicke the Court did look at the situation in the State of the distributing company.

50) The Meilicke decision is also not in line with the Fokus Bank decision, in which the EFTA Court obliged the source State to extend to foreign tax credit to non-resident shareholders up to the amount of the withholding tax levied upon outbound distributions; therefore the State of source was not obliged to over-integrate the (withholding) tax applied in the hands of the non-resident shareholder.

51) The situation of a shareholder citizen of a Member State but resident in another Member State is not comparable to that of a shareholder citizen and resident in the former Member State.

52) From the analysis of the case law of the European Court of Justice it appears that one should distinguish between economic double taxation suffered by the final shareholders, in its capacity of individual investor, and economic double taxation resulting from inter-corporate dividend distributions. The elimination of former type of double taxation falls within the sphere of action of the Member State of residence of the individual shareholder whereas the elimination of economic double taxation resulting from inter-corporate distributions may be eliminated by the State of source of dividends, if community law so requires.

53) The pan-European approach considers the effects stemming from the imposition in a State other than that whose domestic law violates community law.

54) The pan-European approach may be taken both from the perspective of the source State and from the perspective of the residence State. In the first case it will aim at ascertaining whether and to what extent the discriminatory treatment related to the State of source may be neutralized by the State of residence. In the second case it will aim at ascertaining whether and to what extent the discriminatory/restrictive treatment in the State of residence may be eliminated by the State of source. Under no circumstances a pan-European approach is aimed at ascertaining factual elements in a State other than that in which the violation of European law arises.

55) As far as taxation of dividends is concerned the European Court of Justice appears inclined to use a pan-European approach in order to ascertain possible breaches of community law.
In the field of dividend taxation the European Court of Justice started using the pan-European approach in the Manninen case.

In our opinion it is possible to distinguish three main categories of pan-European approach:
- a first type pan-European approach considers the elimination of discriminatory/restrictive effects related to denial of a certain tax treatment (e.g. a certain exemption) through the granting of the same treatment in another Member State;
- a second type pan-European approach considers the elimination of discriminatory/restrictive effects related to the denial of a certain tax treatment through the granting of an analogous treatment or through the application of different tax rules that in fact achieve a similar effect.
- a third type pan-European approach considers the elimination of discriminatory/restrictive effects related to a certain tax treatment through the application of a double tax convention.

The European Court of Justice never used a plain vanilla first type approach in the field of dividend taxation, though it did so in other fields such as loss relief (Marks & Spencer).

The European Court of Justice started using the second type pan-European approach in the Manninen case. The Court stated that resident shareholders with foreign income were comparable with resident shareholders with domestic income unless “…the tax legislation of the Member State in which the investments were made eliminated the risk of double taxation of company profits distributed in the form of dividends.”. In the Manninen case the pan-European approach was used at a level of comparability, whereas in other case law (e.g. Marks & Spencer) not dealing with taxation of dividends the Court took a very similar approach at a level of justifications. In our opinion no guidelines can be found in the Schumacker case in which the Court looked at the other State in order to ascertain how much of the income was produced in the State of residence.

The third type pan-European approach was used in the Denkavit and the Amurta case. Such type of pan-European approach is inevitably related to the application of a double tax convention. The application of the same approach was also raised in the Thin Cap GLO case, though in that case did not further analyze its application.

Since from Manninen and later in the Bouanich case the European Court of Justice confirmed the relevance of a double tax convention in order to ascertain the existence of a violation of community law. Such relevance was considered decisive both in the Denkavit and in the Amurta case in order to ascertain whether the discriminatory treatment in the State of source was neutralized by the application of a tax credit in the State of residence granted by virtue of a bilateral agreement.

In our opinion however, there is an important difference between the Bouanich case and the Denkavit case, which might turn into being a deficiency in the application of the third type pan-European approach. In Bouanich the European Court of Justice considered the impact of the application of a double tax convention with respect to the same State to which it was imputed a violation of Community law. In Denkavit the impact of a double tax convention should be
ascertained with reference to a State other than that which is violating community law. In most cases the third type pan-European approach is applicable from a source State perspective, but it is not possible to exclude a priori its application from a residence State perspective, for example, if the double tax convention provides for a tax credit to be granted by the State of source in respect of outbound dividends.

63) After the Amurta case the third type pan-European approach seems to be the only one admitted by the European Court of Justice. The Court concluded as follows “A member State may not rely on the existence of a full tax credit granted unilaterally by another Member State to a recipient company established in the latter Member State in order to escape the obligation to prevent economic double taxation of dividends…”. Such conclusion laid down on the assumption that double tax conventions are binding for the contracting States and cannot be modified unilaterally. In our opinion however such assumption is not always true, particularly when the tax treaty makes reference to the application of domestic law or in any other instances in which the provisions of the treaty are not autonomously applicable.

64) In our opinion it is not clear why the third type pan-European approach was used by the European Court of Justice in cases which dealt with taxation of outbound dividends taxed by mean of a withholding tax. In our opinion the same approach should have been applicable in case where the non-resident maintained a permanent establishment to which the dividends were attributable. This was the situation in the CLT-UFA and Saint Gobain but in both cases the Court did not raise the issue of the tax credit of the (higher) taxes levied in the hands of the State of the permanent establishment in the State where the company owning the permanent establishment was resident.

65) If the approach taken by the European Court of Justice in the Amurta will be confirmed in further judgments, the application of the pan-European approach in general will be severely limited. The first and second type pan-European approach will no longer be applicable and the third type pan-European approach will be applicable in most cases from a source State perspective only. As highlighted above it is not frequent to find instances in which such approach will be applicable from a residence State perspective (one possible instance would be the granting of a credit upon outbound dividends in favor of non-resident taxpayers under the tax treaty).

66) The irrelevance of the first and the second type pan-European approach could lead to some distortions, such as cases of double-non taxation, which might arise if the taxpayer receives the same benefits (e.g. a tax credit) both in the source State and in the State of residence.

67) The case law of the European Court of Justice in which the pan-European approach are far from being settled. As shown, the Court appears reluctant to apply the first and second type pan-European approach, which are both based on the interaction between domestic law of the member States involved. The third type pan-European approach however also poses a number of practical and administrative difficulties. The taxpayer should first demonstrate to be resident in the other Member State in order to ask for the treaty application and second should provide again the proof
related to the lack of credit in such latter State. In our opinion it is too burdensome to require for the second proof since such proof should be given after the discrimination has been ascertained. We believe that the burden of proof should be switched on the taxpayer but solely to the extent it is not possible for the Member State of source to provide such proof through the ordinary instruments of exchange of information.

68) In any case we believe that mechanism of application of the third type pan-European approach implies a cash flow disadvantage for the taxpayer. It seems however that the European Court of Justice is inclined to consider in such situations the cash flow disadvantage a proportionate measure which would allow the Member State to preserve the allocation of taxing rights provided in the double tax treaty.

69) It is doubtful whether and to what extent the application of the third-type pan-European approach would impact on the application of tax treaties. For example one could wonder whether the State of residence would be obliged to exempt the incoming dividends if the State of source gives up taxing the dividends due to the discriminatory effects (not neutralized in the State of residence), which would arise from the levying of the withholding tax.

70) The considerations concerning the practical and administrative difficulties related to the third type pan-European approach as well as the deficiencies of such approach should lead us to the conclusion that the first and the second type pan-European approach should not be abandoned. Unlike the third type pan-European approach, the approaches based on the interaction of domestic law would have immediate application and would solve the problem ab origine. Such approaches would not trigger administrative and practical difficulties, nor would render difficult for the taxpayer the burden of proof.

71) In the light of the above considerations we believe that problems of compatibility with community law should be tested on a case-by-case basis. However, forms of positive integration may be possible though, in our opinion, such goal would be in fact difficult to be achieved.

72) Member States could adopt exemption of intra-company dividends regardless of the application of the parent subsidiary Directive. In addition to that we would propose to tax by mean of a final levy domestic and inbound dividends paid to individuals. Particularly the final levy might be applicable upon inbound dividends could be set by taking into account the level of taxation upon the subsidiary company in its Member State of residence. By contrast outbound dividends paid to individuals should be exempt. Through such a system Member States would collect taxes once upon the companies resident therein. All distributions except for the first would be exempt from tax, as well as outbound distributions to individuals. Such latter distributions are exempt due to the fact that dividends will be taxed in the hands of the final shareholders in their State of residence (as inbound
dividends). The dividends will not escape a second level of taxation. The taxation of the domestic dividends is required in order to avoid possible restrictions due to the taxation of inbound dividends. As stated above the taxation of inbound dividends could be set by taking into account the level of taxation in the State of the subsidiary company. It is however unclear whether such “variable” levy would be in line with EC law, to the extent the levy applicable upon inbound dividends would be higher than that applicable upon domestic dividends. According to the case law of the European Court of Justice (see Kerckhaert Morres) in order to ascertain a discrimination insofar as the application of a fixed levy is concerned one should look exclusively at the taxation in one State, i.e. the State of residence of the taxpayer.

73) The case law of the European Court of Justice (see Scorpio, Fidium Finanz) has severely limited the scope of application of the freedom of services in the relationship with third countries. Art. 50.1 of the EC treaty should not be interpreted as giving the priority to other freedoms other than the freedom of services. One could therefore wonder about the meaning of the term “provision of financial services” referred to art. 57.1 EC Treaty and in other parts of the Directive 88/361, which relates to the free movement of capital (see for example Part. I, VII, VIII and XIII). In our opinion the application of either of the two freedom mentioned above in the specific case of the “financial services” will depend on the territorial scope, i.e. art. 49 is not applicable insofar third countries are concerned.

74) The freedom of establishment is generally not applicable in the relationships with third countries, unless the third country national exercises its right of establishment in the European Union through one of the forms provided for in art. 43 (e.g. by setting up a company in a Member State) (see Halliburton). In the relationships with third countries the free movement of capital applies insofar as other treaty freedoms are not applicable. The free movement of capital applies in situations where domestic law applies with no distinction in respect of the holding in the capital of the subsidiary. We believe that such position is not convincing because two situations which could both raise problems of compatibility with the freedom of establishment may be treated differently insofar as third countries are concerned. For example the setting up of a permanent establishment would be always considered to fall in the scope of the freedom of establishment whereas the owning of a 100% of the capital of the subsidiary could fall either in the scope of the freedom of establishment or - if the discriminatory tax provision applies regardless of the holding percentage- of the free movement of capital applies.

75) It is not clear how comparable situations will be determined in a case where the exercise of the free movement of capital by a national of a Member State, also established in a third state, is hindered by a Member State other than that of its nationality. If possible, the same patterns applicable for fully EU situations will apply in determining the comparability for situations
involving third countries. In ascertaining a breach of Art. 56 EC Treaty with respect to both inbound and outbound situations it is required to take into account the impact of domestic law of the EU Member State as well as that of the third country. Despite supporting the fact that Art. 56 EC Treaty has a similar scope regardless of whether or not a third country is involved, the application of this freedom should take into account a rather different context, particularly when it comes to ascertaining whether a breach may be justified. It is my opinion that, in principle, justifications that are valid for EU situations could also be applicable to situations involving third countries. However, the test of proportionality should follow different standards. I do not believe that justifications other than those already put forward before the ECJ can be found, but I am quite convinced that the degree of importance of certain arguments related to the justifications that are often rejected, such as that of compensatory advantages, is to be reconsidered when applying to third countries.

76) Third state nationals might derive the benefits of the Directives at least indirectly. From a policy viewpoint, it is very likely that a Member State will treat its own residents not worse than non-resident taxpayers. In many states, including Italy, in situations covered by the Directives, residents will not suffer a higher tax burden than non-resident taxpayers that benefit from the favourable regime. If this is the case, then one may argue that the Directive regime also represents national treatment. Third state nationals could then legitimately claim the application of Art.. 56 EC Treaty (if applicable), on the basis of the national treatment granted to resident taxpayers.

77) The ECJ has constantly reiterated the principle that insofar as the Community has adopted common rules, the Member States are deprived from undertaking obligations with non-Member countries that affect those rules. In short, states are free to conclude agreements with third states insofar as the Community has not taken legislative measures in the same field. The ECJ based its position on the necessary parallelism between external competence and internal ones (in foro interno, in foro externo). It is debatable what the repercussions in the field of direct taxes could be.

78) The actions taken by the European Community in the exercise of external powers (see for example the Savings agreement with Switzerland) are aimed at securing the effectiveness of measures within the Internal Market. Certainly though, the extension of the EC Directives (e.g. art. 15 of the agreement above mentioned as far as the extension of the Parent-Subsidiary to Switzerland is concerned) to relations with third countries could not be based on a similar aim, at least directly. Nonetheless, Switzerland would have not concluded the Agreement without such a concession. It follows that the Community would have certainly gone beyond its competence, had no prior consensus of the Member states been granted.

79) However, in my view, also the limitations imposed on Member States to conclude treaties with third countries may to a certain extent be justified. I do not feel entirely convinced that the outcome of the doctrine of “implied powers” can be generalized to the whole field of direct taxation. We believe that a limited doctrine of “implied powers” should apply instead. This would result in the lack of an exclusive competence of the Member States to negotiate agreements concerning tax
matters that have been harmonized at an EU level. Just like in the case of the Swiss-EU Agreement aimed at securing the effectiveness of measures within the Community, any other exercise of external competence should find its basis in the EC Treaty. One could thus wonder whether in the case of LOB clauses a unilateral negotiation carried on by the Commission on behalf of the Community could be accepted insofar as (i) it is necessary to preserve or better achieve one of the aims of the EC Treaty and (ii) it is required by the subsidiarity principle established in Art. 5 EC Treaty. In such a case, the intervention of the Council would be necessary anyway in order to conclude the agreement. In this respect, the position held by the ECJ in the case Republic of France vs. Commission (C-327/91) must be taken in due account. Furthermore, it could be questioned whether and to what extent the Community and the Member States should share the competence to conclude international agreements, as in the case of the Montego Bay Agreement (“Ocean and Law of the Sea”, signed on 10 December 1982). Annex I of such Agreement made it clear that a joint participation of the European Community was required since some of the matters forming part of the convention had been previously transferred to the Community. One could thus wonder whether the Agreement signed with Switzerland on the Savings Directive could rely on a similar basis, at least partially. The answer should be positive if one takes into account the existence of harmonized rules contained in the EC Directives and a further confirmation can be found in the other Agreement concluded with Switzerland regarding the free movement of persons. In this case, a mixed agreement was needed since the possible tax repercussions did not deal, at least not explicitly as in the case of the Agreement on the Savings Directive, with tax matters harmonized through the EC Directives.

80) To sum up, it is my view that the external competence of the Community should be maintained solely in those fields of direct taxes where secondary legislation has already been enacted, provided that the above conditions are met, and namely the exercise of external powers is prejudicial to one of the aims of the EC Treaty. The Member States should recognize the external power of the European Union to conclude international agreements concerning harmonized tax matters, even though not being entirely deprived from their competence to negotiate unilaterally.

81) It is in my view remarkable Opinion 1/03 of 7 February 2006, released by the ECJ with respect to the Lugano Convention. The Court stated that in ascertaining the existence of the external competence to conclude an international agreement and whether that competence is exclusive, it is necessary to take into account not only the areas already covered by the Community rules and by the provisions of the agreement envisaged, but also “the nature and content of those rules and provisions, to ensure that the agreement is not capable of undermining the uniform and consistent application of the Community rules and the proper functioning of the system which they establish”.

From now on, based on this opinion, in order to define the borders of the Community external competence, it has become important to evaluate the future development perspectives of Community law. However, it must be assumed that the ECJ arrived at such opinion since the Lugano Convention contained rules that were able to affect a “unified and coherent system” of regulations for the
recognition and enforcement of judgments. It is thus debatable whether its opinions could be to some extent transposed to direct taxation, which unlike the field of recognition and enforcements of judgments, appears to be not unified and coherent.
Taxation of cross-border dividends under European secondary law

82) The term “company” as used in art. 2 of the Directive refers to entities with a net capital (such as joint stock companies). Other entities may fall within the scope of art. 2 to the extent they are expressly included in the annex of the Directive (e.g. the French “association d’épargne-pension” or the Dutch “Fonds voor gemene rekening”). In our opinion, the term company as used in art. 2 of the Directive has a different meaning as compared to the term company as defined in art. 3.1.b) of the OECD MC. In the framework of Art. 10 OECD MC a participation in the capital is relevant for the application of the 5% WHT provided for in art. 10.2.a);

83) The term company should not be meant to include all entities with legal personality. A partnership with no legal personality or any other similar entity may fall within the scope of the “term company” to the extent it is included in the annex of the Directive and is therefore subject to corporate tax in a member State.

84) The requirements set out in Art. 2 of the Directive may be met in two different Member States. A company may fall within such provision when it is created under the law of a certain Member State and is taxed as a resident in a different Member State;

85) A different conclusion may be reached in respect of the “residual clauses” included in certain letters of the annex. For example letter t) mentions “other companies constituted under Austrian law subject to Austrian corporate tax”. Similar conclusions may be reached with respect to lett. B), which refers to Belgium, lett.f), which refers to Germany, lett. H), which refers to Greece, lett. I), which refers to Spain, lett. P), which refers to Luxembourg, lett. S), which refers to the Netherlands;

86) The presence of residual clauses once again proves that the legal personality of the entity (or of the company) not expressly listed in the Directive is not relevant. The decisive element is constituted by the fact that the entity is subject to corporate tax, whether or not it has legal personality. The irrelevance of the legal personality represents a different with art. 10.2.b), where it is stated that under no circumstances distribution of dividends made by partnerships (i.e. companies with no legal personality) may benefit from the application of the 5% WHT. Such conclusion holds true even if the partnership is treated a fiscally opaque.

87) In our opinion the conclusion reached under 85) may violate community law at least for two reasons. First the fact that the company must be created and be subject to tax in the same Member State influences the right of structuring the business of the companies in Europe and restrict the exercise of the freedom of establishment. Second, the fact that the residual clause have not been included with respect to certain Member States may represent a discrimination based on the nationality of the company, which should be that of the State of constitution.

88) The application of the Directive requires both the parent and the subsidiary to be resident in a Member both under domestic law and art. 4.3 of any tax convention concluded with third States. The provision is based on the underlying assumption that the Directive is aimed at eliminating economic double taxation which takes place in Europe. The residence in a Member State follows
however from the requirements of Art. 2 and particularly from the fact that companies must be subject to one of the corporate tax listed therein, without the possibility of an option or of being exempt;

89) However should a parent company resident in a third State - under art. 4.3 of a double tax treaty - still maintain in Europe a permanent establishment, there would be economic double taxation which the Directive does not take care of.

90) Should a subsidiary company become resident in a third State – under art. 4.3. of a double tax treaty – there would be juridical double taxation in Europe which the Directive does not take care. In such a case the State of the subsidiary may not tax the profits of the company though it still maintains the right to impose a withholding tax upon the payment of outbound dividends.

91) Both in case n. 89) and n. 90) above the double tax convention signed between the parent State and the subsidiary State should reduce eliminate or reduce juridical double taxation. In case 89) the non discrimination provision should impose the permanent establishment State (i.e. the loser State) to credit the withholding tax or to exempt the cross-border flow of dividends. In case 90) the double tax convention between the subsidiary State (i.e. the loser State) and the parent State should remain applicable. The application of such treaty should not be affected by the application of the tie-breaker rule included in the treaty between the two countries of residence of the subsidiary.

92) Art. 2 of the Directive, which defines the term “company of a Member State” requires both the subsidiary and the parent company to be subject to one of the tax listed in the annex. Such requirement supports the idea that the Directive is limited to eliminated effective instances of economic double taxation arisen in Europe. For this reason, we believe that the Directive should remain applicable also in cases where the domestic law of the Member States provides for an option for the company (either parent or subsidiary) to be exempt, if no such option has been exercised.

93) The application of tie-breaker rules impact on the application of the Directive insofar as it is included in the tax treaty signed between a Member State and a Third State. In this respect, the Directive is no longer applicable when the company (either the parent or subsidiary) becomes resident of a third State. The impact of tie-breaker rules is less clear insofar as it is included in a tax treaty signed between two member States.

94) When a parent company has a dual resident status the impact of tie-breaker rules is not relevant insofar as the subsidiary is resident in either States of residence of the parent company. Should the subsidiary be resident in the winner State, doubts might arise in respect of the application of the directive. The payment of dividends could be regarded as a purely internal distribution of dividends in the winner State. In our opinion, however, in the absence of any express relevance of the tie-breaker rule included in the a tax treaty signed between two EU member State, the application of the Directive should not be prejudiced by the application of the above mentioned tie-breaker rule. No doubts should arise if the subsidiary is resident in the loser State, as the distribution of dividends would preserve its cross-border feature.
Different conclusions should be reached if the subsidiary is resident in a State other than the States of residence of the parent company. The loser State of the parent company is not bound by the application of the Directive as it is prevented to tax the dividends. However an opposite conclusion could be reached if the company has a permanent establishment in the loser country and the dividends are attributed to such permanent establishment.

95) Should the subsidiary company be resident in two Member States, under no circumstances the application of the Directive should not be prejudiced as both States of the dual resident would not lose the taxing rights associated to cross-border flow of dividends.

96) The definition of “parent company” is based on the holding requirement with no specific reference to either direct or indirect participation in the capital. One could thus wonder whether it would make sense to exclude cases in which the parent company reaches the holding threshold by cumulating direct and indirect holdings, taking into account in the latter case the multiplication mechanism.

97) The possible exclusion of indirect holdings would reflect the willingness of the Member States to limit the scope of application of the Directive. However, such exclusion would run counter the primary aim of the Directive, i.e. the grouping of companies within the European Union and, in addition, could create problems of compatibility with European law, as it would influence the exercise of the freedom of establishment. For this reason we believe that the reference to the holding in the capital should be interpreted in a way to include indirect holdings.

98) The conclusion under 97) is however subject to the condition that the parent company owns a direct holding, though minimum, in the capital of the first-tier subsidiary. The application of the directive should then be limited to the distribution of dividends made by the first-tier subsidiary to the parent company. As for the dividends paid up to the parent through the subsidiary, the provision of art. 4.1 of the Directive should apply in order to extend the application of the indirect tax credit to the taxes paid by the first tier subsidiary. In addition a different conclusion should be reached in case the indirect participation in the first tier subsidiary is held through a subsidiary resident in a member State.

99) The reference to the holding in the capital of the subsidiary contained in art. 3 of the Directive appears justified in the light of the general aim of the Directive, i.e. the grouping of companies within the European Union. By contrast the option for the Member States to replace such requirement with the voting rights appears less coherent with final goal of the Directive, i.e. the elimination of economic double taxation upon cross-border flows of dividends. Not in all circumstances the flow of dividends follows the voting rights.

100) As spotted in 99) a reference to the participation in the profits would have been more appropriate. The lack of such reference could create some distortions. For example an EU company could grant the usufruct right to a company resident in a third State, while still being the owner of
the holding in the capital of the subsidiary. In such a case, the Directive would still remain applicable, though the dividends would flow to a company resident of a third State.

101) Situations similar to that under 100) might be counteracted through anti-avoidance provisions though in our opinion a reference to the participation in the profits should be included as an additional requirement (and not as alternative as in the case of the voting rights) to the participation in the capital.

102) The possibility for the Member State to provide for an uninterrupted period of at least two years holdings qualifying both to qualify a parent and/or a subsidiary company may give rise to asymmetrical instances of application of the directive. This could be the case where the uninterrupted period is required in the subsidiary State and not in the parent State (or vice versa). In our opinion the application of the Directive may never be subject to reciprocity. In the latter case, it follows that the Directive should bind the subsidiary State despite the fact that the receiving company would not qualify as parent State in its State of residence.

103) The reference in Art. 4.1.a) of the Directive to the term “Nothing in this Directive shall prevent the State of the parent company from considering a subsidiary to be fiscally transparent…” makes it clear that the subject to tax requirement provided in art. 2.1.c) must be ascertained in the State of residence of the subsidiary company. For the purpose of ascertaining the subjective requirement provided in art. 2 it is therefore not relevant how the company is treated in a State other than that of residence.

104) On the basis of art. 4.1.a) one could thus wonder whether and to what extent the Directive is applicable in the reversed case in which the State of the subsidiary company considers the parent company as fiscally transparent. Should the shareholders of such latter company be individuals or a company resident in a third State one should in fact enquire whether the directive remains applicable. The directive does not expressly deals with the case highlighted. In our opinion, however, the application of the exemption from withholding tax, as provided in art. 5, should be maintained. As for 103) it is not relevant how the company is treated in a State other than that of residence.

105) The terms “distribution of profits” and “profits distributed” as used respectively in art. 1.1 and arts. 4.1 and 5 have a different meaning than the term “dividends” as defined in art. 10 of the Directive. As stated above, Art. 10 OECD MC does not focus on the holding requirement except for para. 2.a), where it is required a 25% threshold in order to claim the 5% WHT on outbound dividends. It was stated above that the third part of art. 10 OECD MC may include any remuneration qualified as dividends in the domestic law of the State of source. The concepts of “distribution of profits” and “profits distributed” may not be interpreted without taking into account the fact that art. 3 of the Directive requires a participation in the capital or alternatively the holding of the voting rights. It is therefore indispensable that the parent company owns the status of
“shareholder”. It follows that the mere domestic law characterization as provided in art. 10.3 OECD MC is not effective for the purpose of the directive application.

106) Art. 4 of the Directive grants the Member States the possibility to opt for the exemption or the credit in respect of the profits distributed by the company. The choice between the two systems must however respect the obligations stemming from European law and should necessarily take into account how (economic) double taxation is eliminated in purely internal situations. In this respect the European Court of Justice has stated in the case Test Claimants in FII Group Litigation that both the systems are to be considered as equivalent insofar as the tax rate applicable on inbound dividend distributions was not higher than that applicable upon internal situations and moreover, if the (indirect) tax credit upon inbound situations was not higher than that which would have been given in purely internal situations, should domestic dividends be subject to tax.

107) It is not clear whether and to what extent the Directive would allow the member State of residence of the parent company to apply the tax exemption method or any other method which would take into consideration the foreign profits for the purpose of calculating the worldwide tax base in such latter case. In our opinion even if the Directive does not provide for specific rules, Member States are however bound to apply the system of exemption in a way that such exemption does not suffer any restrictions. In the case mentioned above the exemption cannot therefore be applicable with respect to a partial amount of the dividends. Needless to say however that such conclusion is not affected by the specific provision of art. 4.2. of the Directive, which allows the Member States to fix the management costs related to participation up to an amount not exceeding 5% of the profits distributed by the subsidiary.

108) The indirect tax credit method may give rise to a number of problems concerning the determination of the credit itself. The directive does not provide for detailed rules and seems to leave the Member States the possibility to implement the mechanisms of application according to domestic law. For example, the Directive does not expressly state whether such credit is an ordinary tax credit or a full tax credit or for example whether the tax credit should be calculated by taking into account an overall limitation or a per country limitation. A number of further aspects are likewise not regulated, such as for example the treatment of the excess foreign tax credit, if any, and the possibility to offset foreign losses. In our opinion Member Stats are to regulate all these aspects in accordance with primary law, without rendering useless or excessively difficult for the taxpayers the right to obtain a credit for taxes paid abroad.

109) Even if not expressly stated we believe that the tax credit should not be limited to the taxes paid by the subsidiary (or any lower subsidiary) in its State of residence. Though not in line with the final aims of the Directive, i.e. the elimination of economic double taxation in Europe, it is nowhere stated in the Directive that the tax credit should suffer such limitation. It is therefore possible that the parent State will have to credit taxes paid by the subsidiary (or any lower subsidiary) in a third State, such as in the case in which the dividends are distributed out of profits paid by the subsidiary (or any lower subsidiary) in a third State, such as in the case in which the dividends are distributed out of profits
realized through a permanent establishment in such latter State, which are exempt under the double
tax convention in the State of residence of such subsidiary (lower subsidiary).

110) The conclusion under 29) may be criticized on the basis of the fact that in a slightly different
scenario, in which the permanent establishment is located in Europe and consequently the profits out
of which the dividends are distributed are taxed in a Member State, the directive would not apply
since the distributing company would not a company of a Member State under art. 2.

111) The scope of art. 4.2 of the Directive is far from being clear. Such provision refers in its first
part to “any charges related to the holding and any losses resulting from the distribution of profits…”,
when it comes to state that such costs are not deductible from the taxable base, whereas, in the
second part, it refers to “management costs related to the holding”, when it comes to state that the
fixed amount of such costs deductible from the taxable base may not exceed 5%. In our opinion the
first part of art. 4.2 provides for an *ipso iure* denial of deduction of the loss in value of the
participation which results from the distribution of dividends. The reference to “any charges related
to the holding” is less clear if one interprets such concept with respect to the reference to that of
“management costs” referred to in the second part of art. 4.2. In our opinion management costs may
fall within the scope of the term “any charges related to the holding”. However, the fact that the
second part of art. 4.2 of the Directive is limited to the management costs precludes that the amount
of costs or expenses other than these may be fixed at a rate of 5%.

112) The exemption from withholding tax set out in art. 5 of the Directive should be considered in
the light of the general exemption granted under art. 13.5 OECD MC with respect to capital gains
derived from the alienation of shares or participation in companies. The two provisions offers a
broader scope for exemption of income from capital investment.

113) The term “withholding tax” referred to in arts. 5 and 6 of the Directive must be interpreted
autonomously. The autonomous interpretation must be founded on an economic approach. In this
respect it seems relevant that the tax is levied upon the dividend distribution and that in addition the
final taxpayer is the parent company. However both such conditions may be derogated insofar as the
taxation levied upon the distribution of dividends derogates from corporation income tax.

114) It is uncertain whether art. 5 should apply in case of repayment of a tax credit. In the Océ
Van der Grinten case the ECJ stated that the withholding applicable on the “tax credit to which
distribution of the dividend confers entitlement does not possess the characteristic of a withholding
tax on distributed profits…because it is not imposed on the profits distributed by the subsidiary”. In
addition the Court also clarified that such receipt of the tax credit “does not constitute income from
shares”. Finally in order to support its arguments the ECJ also recalled a general obligation upon the
State of residence (the Netherlands) to grant a credit in accordance to the DTC.

115) Despite the fact that in 2003 the subjective scope of application of the Directive was
extended to permanent establishments there are still a number of situations involving permanent
establishments in which the application itself of the Directive remains doubtful. A possible situation
would be that in which the permanent establishment of the parent company is located in the same State as the subsidiary company. In such case the source State, which is at the same time State of residence of the subsidiary company and State where the permanent establishment is located, could consider the distribution as purely internal. The dividends are in fact paid by a subsidiary therein and are taxed under art. 7 in the same State, as they are attributed to a permanent establishment. In our opinion the State of the subsidiary/permanent establishment may not apply a withholding tax under art. 5 but could tax the dividends under art. 7, therefore on a net basis. Such conclusion should consider the obligations stemming from community law, as it is clear that no tax will be levied upon the dividends attributed to the permanent establishment if purely domestic distributions are exempt from tax.

116) The application of the directive should not be prejudiced in cases where the holding in the capital of the subsidiary is effectively connected to a permanent establishment of the parent company located in a third State. The directive should remain applicable even if the dividends are not taxed in the parent state as they are attributed to the permanent establishment located in a third State.

117) The conclusion under 36) could be criticized if one considers that should the permanent establishment of parent company resident in a third State be located in a Member State the directive would not be applicable.

118) The considerations carried on in the three preceding parts of the thesis were then transposed in the context of a specific legal system, i.e. the Italian one.