



# EU-Japan Centre for Industrial Cooperation – Seminar EU Corporate Tax policy, 2 December 2003

European Commission - DG Taxation and Customs Union

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## **Parent-Subsidiary Directive, Merger Directive and Interest and Royalty Directive**

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# The scopes of the Directives

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## PARENT – SUBSIDIARY DIRECTIVE

- 90/435/CEE of 23 July 1990
- Dividend payments between
- associated companies
- resident in different Member States receive a
- favourable tax treatment if several conditions are fulfilled.



# The scopes of the Directives

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## INTEREST AND ROYALTY DIRECTIVE

- 2003/49/EC of 3 June 2003
- Interest and Royalty payments between
- associated companies including branches
- resident in different Member States
- receive a favourable tax treatment (no withholding taxes)
- if several conditions are fulfilled.



# The scopes of the Directives

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## MERGER DIRECTIVE

- 90/434/CEE of 23 July 1990
- Company restructuring operations involving companies
- resident in different Member States receive a
- favourable tax treatment (tax deferral) if several conditions are fulfilled.



# Parent-Subsidiary Directive

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## Present rules:

- Company of a Member State (Art. 2)
- Status of “parent company” and status of “subsidiary” (Art. 3) (25% threshold)
- Taxation of distributed profits received by parent company (Art. 4)
- Taxation of profit distribution by subsidiary (Art. 5)



# Parent-Subsidiary Directive

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## Upcoming changes:

- Company of a Member State – more Member States and more types of companies
- Status of “parent company” and status of “subsidiary” - new threshold of 10%
- Taxation of distributed profits received by parent company or permanent establishment
- Taxation of profit distribution by subsidiary – unchanged
- Implementation – 01.01.2005/01.05.2004



# Parent-Subsidiary Directive

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- **Company of a Member State is:**

Any form of company listed in the annex to the Directive

and

resident in a Member State for tax purposes

and

is subject to corporation tax.

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# Parent-Subsidiary Directive

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## ▪ **Parent company is:**

Company of a Member State

and has a minimum holding (direct holding!) of 25% in a  
Company of another Member State

or (option for Member States)

has a minimum holding of 25% of voting rights in a  
Company of another Member State

## **Option for Member States**

to introduce a minimum holding period of two years



# Parent-Subsidiary Directive

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## ▪ **Subsidiary is**

Company of a Member States

and which is owned directly at least 25% by a Company of another Member State

or (option for Member States)

in which a company of another Member State holds at least 25% of the voting rights.

## **Option for Member States**

to introduce a minimum holding period of two years



# Parent-Subsidiary Directive

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- Taxation of profits received by Parent company

## Alternative A (exemption system)

- No taxation of such profits

## Alternative B (credit system)

- taxation of such profits but deduction of full taxes paid by subsidiary relating to such profits



# Parent-Subsidiary Directive

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- Taxation of profits distributed by a subsidiary

Exempted from withholding tax

(in Member State of residence of the subsidiary  
Art.5 and in Member State of residence of parent  
company Art.6)



# Parent-Subsidiary Directive

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- Conflict: Double Tax Convention versus Parent-Subsidiary Directive
  - Double taxation agreements cannot override the provisions in the Directive  
but
  - “This Directive shall not affect the application of domestic or agreement based provisions designed to eliminate or lessen economic double taxation of dividends,... “ (Art. 7 (2))
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# Merger Directive

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- “Mergers”, “Divisions”, “Transfer of Shares” and “Exchange of Shares” in which
- companies from two or more Member States are involved receive a favourable tax treatment (tax deferral of capital gains) while at the same time
- ensuring ultimate taxation by the Member State at the time of disposal.



# Merger Directive

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## Present rules:

- Company of a Member State (Art. 3)
- “Merger”(Art. 2)
- “Division”(Art. 2)
- “Transfer of Assets” (Art. 2)
- “Exchange of Shares”(Art. 2)
- Principles (Art. 4 to 9)



# Merger Directive

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## Upcoming changes:

- Company of a Member State – more Member States and more types of companies
- “Partial Division” (Art. 2)
- “Transfer of registered office” - new title
- Principles (Art. 4 to 9) – new valuation rules



# Interest and Royalty Directive

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## Scope:

Payments of interest and royalties arising in a Member State shall be exempt from any taxes imposed on those payments (whether by deduction at source or by assessment), provided that the beneficial owner of the interest and royalties is a company of another Member State or a permanent establishment of another Member State of a company of a Member State.



# Interest and Royalty Directive

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- Definition of interest and royalty (Art. 2)
- Definition of “company”, “associated company” and “permanent establishment” (Art. 3)
- Anti abuse rules (Art. 5)
- Transitional rules (Art. 7)
- Implementation (Art. 8, 9 and 10)



# Interest and Royalty Directive

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- **Definition of interest and royalty (Art. 2)**

**Interest** (in line with definition from OECD model double taxation convention):

"interest" means income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from bonds or debentures, including premiums and prizes attaching to such bonds or debentures. Penalty charges for late payment shall not be regarded as interest;



# Interest and Royalty Directive

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- Definition of interest and royalty (Art. 2) continued

## **Royalty:**

"royalties" means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic, scientific work, including cinematograph films and software, any patent, trade mark, design or model, plan, secret formula or process, or for the use of or the right to use industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience; payments for the use of, or the right to use, industrial, commercial or scientific equipment shall be regarded as royalties.



# Interest and Royalty Directive

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- Definition of “company”, “associated company” and “permanent establishment” (Art. 3)

## **Company:**

same as for the Parent-Subsidiary and Merger Directive



# Interest and Royalty Directive

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- Definition of “company”, “associated company” and “permanent establishment” (Art. 3) (continued)

## **Associated company:**

One company is an “associated company” of a second company if, at least,

- (i) the first company has directly or indirectly a minimum holding of 25% in the capital of the second company, or
- (ii) the second company has directly or indirectly a minimum holding of 25% in the capital of the first company, or
- (iii) a third company has directly or indirectly a minimum holding of 25% both in the capital of the first company, and in the capital of the second company.



# Interest and Royalty Directive

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- Definition of “company”, “associated company” and “permanent establishment” (Art. 3) (continued)

*Option for Member States* - to replace the criterion of a minimum holding in the capital with that of a minimum holding of voting rights

## **Permanent establishment**

a fixed place of business situated in a Member State through which the business of a company of another Member State is wholly or partly carried on.



# Interest and Royalty Directive

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## ■ Anti abuse rules (Art. 5)

This Directive shall not preclude a Member State from taking appropriate measures to combat fraud or abuse.

A Member State may withdraw the benefit of or refuse to apply this Directive in the case of any transaction which has as its principal objective or as one of its principal objectives tax evasion or tax avoidance.

Note: Impact of ECJ case law on anti abuse rules



# Interest and Royalty Directive

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- Transitional rules (Art. 7)

## Greece and Portugal

No application of the provisions of the Directive during an 8 years transitional period for interest and royalty payments

Maximum withholding tax of 10% for the first 4 years and 5% for the final 4 years.



# Interest and Royalty Directive

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## ■ Transitional rules (Art. 7) - continued

### **Spain**

No application of the provisions of the Directive during a 8 years transitional period for royalty payments only ending 31.12.2008

Maximum withholding tax of 10% for the transitional period.



# Interest and Royalty Directive

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- Transitional rules (Art. 7) - continued

## Other Member States

Have to credit their resident companies receiving interest and royalty payments the withholding taxes levied by Spain, Greece and Portugal.



# Interest and Royalty Directive

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- Implementation (Art. 8, 9 and 10)
  - Final date for implementation - 01.01.2003 (all laws, regulations and administrative provisions have to be brought into force)
  - Member States have to communicate text of main provisions to the Commission
  - Review after three years of operation of the Directive



# Interest and Royalty Directive

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- Implementation (Art. 7, 8 and 9) continued

The Directive shall not limit domestic or agreement based provisions designed to eliminate or mitigate double taxation of interest and royalties.



# EU-Directives – Future Initiatives

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## OUTLOOK

- There will be tabled a proposal to amend the Interest and Royalty Directive within the next months. The main content of the proposal will be an update of the list of companies annexed to the Directive.
- The Merger Directive is discussed at the level of the Council and there is no further amendment proposal in this area in the Commission work programme for 2004.
- There is a probability that a proposal for the cross-border loss off-set of groups of companies/within companies with branches in other MS will be presented in 2004.
- The very complicate and difficult to read Directive on Capital Duty will be redrafted and with possible amendments proposed as a "recast" of the Directive to Council.