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# European and International Tax Moot Court Competition - 2011/2012

# Memorandum for the applicant Memorandum for the defendant

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Il presente lavoro nasce dalla partecipazione dell'Università Luiss Guido Carli alla European and International Tax Moot Court Competition organizzata dalla European Tax College Foundation di Lovanio.

Si tratta di una competizione che simula un processo, in cui le delegazioni di alcune università europee ed americane si affrontano su uno specifico tema di diritto tributario internazionale e/o comunitario. Simulando tanto la fase scritta quanto il contraddittorio orale dinanzi all'autorità giudiziaria di un ipotetico Stato, le differenti squadre hanno proceduto, in questa edizione, all'analisi di un caso avente ad oggetto la problematica della compatibilità tra una convenzione internazionale contro la doppia imposizione ed il diritto dell'Unione europea, in particolare la libertà di circolazione dei capitali. In questo contesto sono stati affrontanti i temi delle clausole LoB di limitazione dei benefici convenzionali e della nomina di un rappresentante fiscale.

I paragrafi da 1 a 4 della Sezione V del *Memorandum for the applicant* ed i paragrafi da 1 a 4 della Sezione V *Memorandum for the defendant* sono stati redatti dalla dott.ssa Maria Angelica Ferdinandi.

I paragrafi da 5 a 6 della Sezione V del *Memorandum for the applicant* ed i paragrafi da 5 a 6 della Sezione V *Memorandum for the defendant* sono stati redatti dal dott. Alessandro Blatti.

I paragrafi da 7 a 8 della Sezione V del *Memorandum for the applicant* ed i paragrafi da 7 a 8 della Sezione V *Memorandum for the defendant* sono stati redatti dal dott. Leonardo Pinta.

Il dott. Alessio Persiani ed il dott. Federico Rasi hanno assistito gli studenti nella preparazione dei lavori e nella successiva fase orale.

I lavori sono stati diretti dal Prof. Giuseppe Melis e dal Dott. Eugenio Ruggiero quali *team coach* della delegazione LUISS.

**MEMORANDUM FOR THE APPLICANT**

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# MEMORANDUM FOR THE APPLICANT

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# III. Statement of facts

Closed Skied ( hereinafter also ‘**X’**) is a company resident in State B.

X’s shares are not listed in any stock exchange. All its shares are equal in capital and voting rights.

X’s shareholding is held as follows:

1. 40% by Mark Schweps (M), an individual resident in State B;
2. 20% by Daily Nail Company (N), resident in State C, not listed in any stock exchange, and whose corporate capital is entirely held by Fin Caps Glow Company (O), a company resident in State B, with a corporate capital owned by individuals of different countries, among which residents of State A, B, and C, for a stake of 70%, with the remaining 30% being listed on stock exchange of State B.
3. 20% by Vest&Gard (Q), with a statutory seat in State E, where the board of directors meets four times per year. However Q’s employees, and managers make strategic and financial policy decisions in State F. Q’s shares are listed on the stock exchange of State A, and primarily of State F.

Main scope of its business relates to manufacturing of weatherproofing products for roofs. Within the relevant market X has been for the last year’s the world’s leader.

In 2009 X decided to invest in Fogglia (hereinafter also ‘**Y**’) a company resident in State A, by purchasing a 9% stake therein. Fogglia operates as a producer of a self-sticking surface based on high density aluminum foil, used both for roofing and waterproofing.

Among these activities, very recently Fogglia started to sell, in State A, some of the products of X. Sale of those products was not successful in State A’s market, being the resulting volume of sales amounting to less than 5% of Fogglia’s business activities.

Nonetheless, being it a successful year for its global business, Fogglia decided to reward its shareholders with a very substantial dividend, that to be distributed in year 2011. Fogglia’s shareholders are mostly all resident of State A. However, X has its registered office and effective place of management in State B since its incorporation on November 5, 2002.

In the same year (2011), X did not distribute any income and opted for reinvesting all its profits internally, whilst in the previous years it had distributed from 5% up to 40% of its profits on a yearly basis.

X filed a request for tax refund with State A’s tax authority in respect of dividends distributed from the 2010 profit. Refund was requested for the difference existing between the tax withheld at the time of distribution (at State A’s domestic rate of 20%) and the amount due pursuant to the Double Tax Convention (DTC) in force between State A and State B.

Following such filing, X was not satisfied by the decision of State A's tax authority, claiming that X's request for tax refund had to be rejected for non fulfilment of the relevant conditions for being granted tax benefits as set forth by the Double Tax Convention (DTC) in force between State A and State B, and for non compliance with the State A's domestic law requiring non residents to appoint a tax representative whenever they wish to file any request of tax refund and or benefit.

Notwithstanding the above, X hereby appeals rejection of the due refund as issued by State A's tax authority.

# IV. Issues

1. The freedom at stake;

1.1. Closed Skies is entitled to the treaty benefits;

1.2. Overlapping between free movement of capital and freedom to establishment;

1.3. The ‘*definite influence’* criterion;

1.4. The ‘*indirect consequence*’ criterion

1.5. The ‘*purpose of the legislation concerned’* criterion;

1.6. Article 63 TFEU applies;

1.7. Non applicability of the Parent Subsidiary Directive;

2. Compatibility of the LOB clause with Article 63 TFEU.

2.1. Discrimination and restriction to the free movement of capital;

2.2. The Council Directive n. 88/361/EEC;

2.3. Ownership test under Article 1 of the Protocol;

2.4. The action of the M.S. must be exercised consistently with community law;

2.5. Repeal of Article 293 EC Treaty and its consequences on elimination of double taxation;

2.6. Relation between DTC and EU Treaties;

2.7. The solution provided by the Vienna Convention and Law Treaties;

2.8. Supremacy of the EU Treaty with respect to DTCs;

2.8.1. The Saint Gobain case;

2.8.2. The Open Skies case;

2.9. The LOB clause entails a discrimination between ‘*qualified’* and non ‘*qualified person’;*

3. The discrimination cannot be justified under the so called ‘rule of reason’;

3.1. Non applicability of the principle of territoriality;

3.2. Non acceptability of justification regarding the difficulty in obtaining information;

3.3. Non proportionality test;

4. Protocol conditions’ for the access to treaty benefits;

4.1. Qualified person;

4.2. Beneficial owner;

4.3. POEM;

4.4. Relation between Article 63 TFEU and Parent Subsidiary Directive;

4.5. Transfer Pricing;

4.5.1. Arm’s Length Principle;

4.5.1.1. Profit split method;

5. On the discriminatory nature of the tax representative pursuant to:

    5.1. a lack o views of the mutual assistance directive;

    5.2. the ECJ rejection of unjustified formalities/requirements for non residents;

6. Absence of proportionality and non existence of a justification by the Tax Authority;

    6.1. Supremacy of DTC' clauses in respect of national laws;

# V. Arguments

## 1. General remarks

1. This document aims at proving that the denial made by the Tax Administration of State A is unfounded; firstly because of the inconsistency of the LOB clause contained in the Protocol with EU Law; secondly in respect of the compliance of our position with clauses set forth by the DTC; in conclusion because the requirement of a tax representative for non resident taxpayers by domestic law of State A is a mere procedural issue that cannot prevent granting the due tax refund.

## 2. The freedom at stake

2. Following the reasoning in steps that the ECJ normally uses and considering that Closed Skies, as a EU resident company holding shares in another company resident in a different M.S., is surely entitled to the Treaty's benefits, the first important step is to determine which is the freedom applicable to the present case.

3. The issue of overlapping[1] of Treaty's freedoms becomes fundamental in those cases involving a non-EU situation but, as we will see later, it is also important in the light of possible justifications that a M.S. can offer to preserve its national discriminatory legislation. In many cases it is very difficult to assess if the situation falls within the scope of the freedom of establishment or within the scope of the free movement of capital. Even though the distinction between the scope of the provision is very subtle, the ECJ has established some criteria in order to draw a line between the applicability of the two provisions.

4. The Court addresses the issue of overlapping in several cases and essentially provides the interpreters with different tests to be applied in order to verify which freedom is at stake. The first relevant case is the Baars judgment[2] in which the ECJ uses the '*definite influence*' criterion. Under paragraph 22, the fact that the holding of the capital of a company resident in another M.S. gives Mr. Baars '*definite influence over the company's decisions and allows him to determine its*

[1] V. E. Metzler, *The relevance of the fundamental freedoms for direct taxation,* in *Introduction to European Law,* eds. Michael Lang et al., 2008, pp. 35 et seq.

[2] C-251/98 C. Baars v Inspecteur der Belastingen Particulieren/Ondernemingen Gorinchem.

*activities*' entails the fact that he is exercising his freedom of establishment in that other M.S., thus Article 49 TFEU applies. Furthermore, in FII case[3] the Court clarifies that the threshold above which the holding of shares involves '*definite influence*' is deemed to be the holding of at least 10% of the capital of the company. A second test is provided by the Court in the Bachmann case[4] where the movement of capital from a State to another was found to be the mere '*indirect consequence*' of the fact that Mr. Bachmann wanted to exercise his right of establishment, granted by the Treaty. Having in mind this substantial criterion the Court overruled the formalistic criterion provided in FII, when, in the Glaxo case[5], recognized that, notwithstanding the fact that the holding amounted to more than 10% of the capital, the main purpose of the shareholder was to gain from the capital speculation, thus Article 63 TFEU applied.

5. The Holbock case[6] provides for an even more precise test, when, in paragraph 22, the Court solves the issue of overlapping of Treaty's freedoms looking at the '*purpose of the legislation concerned*', i.e. the national legislation that was claimed to be in breach of the Treaty. As the Court finds in the subsequent paragraph, clearly referring to the Baars' criterion, '*the Austrian legislation in the present case is not intended to apply only to those shareholdings which enable the holder to have a definite influence on a company's decisions and to determine its activities*.' Indeed the Austrian legislation simply discriminated against inbound dividends, taxing them at an higher rate than domestic ones, irrespective of the extent of the shareholding which Mr. Holbock had in the Swiss company.

6. Looking at the 9% shareholding of Closed Skies in the light of criteria provided above, we can say that both from a formal and a substantial standpoint the freedom at stake is the free movement of capital, thus Article 63 TFEU applies. Indeed, even if, considering the recent sale by Fogglia of some products manufactured by Closed Skies, one wish to recognize a connection between the activities of two companies, one must also consider that Closed Skies' investment in Fogglia occurred in 2009 and that the connection between their activities is 'very recent' (presumably 2011). Thus we can say that the intention of Closed Skies at the time of the investment in Fogglia was merely to move its capital from State B to State A, enlarging its investment portfolio and making some capital gains. The 'purpose of the legislation' test also confirm this view because

[3] C-446/04 Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue.
[4] C-204/90 Hanns-Martin Bachmann v Belgian State.
[5] C-182/08 Glaxo Wellcome GmbH & Co. KG v. Finanzamt München II.
[6] C-157/05 L. Holböck v. Finanzamt Salzburg-Land.

the LOB provision of the Protocol attached to the DTC between States A and B applies no matter the extent of the shareholding: in fact Closed Skies would be discriminated against no matter the amount of shares held. This is because the purpose of such a clause is to limit the refund on the base of some ‘ownership tests’, irrespective of the extent of the holding.

7. Moreover, before going into the different arguments about the legitimacy of such a clause, we must recall the fact that the Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation of parent and subsidiaries companies is not applicable to our case since Closed Skies’ holding does not meet the minimum 10% of capital required by the Directive. Of course this must be seen as a further clue as to the applicability of the free movement of capital to the present case.

## 3. The LOB clause under the Protocol annexed to State A-State B Double Tax Convention constitutes a discrimination prohibited under Article 63

8. Once we determined that the freedom at stake in the present case is the free movement of capital, we must analyze the LOB clause included in the DTC Protocol in the light of the freedom concerned, thus assessing its compatibility with Article 63 TFEU. This analysis clearly leads to a negative outcome.

9. Indeed Article 63 (1) clearly states that ‘all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited’, thus outlawing both discriminative and restrictive national provisions. In fact, not only a national provision expressly distinguishing between domestic and foreign operators, but also a provision indiscriminately applicable to both domestic and foreign operators may constitute a breach of EU law, as long as it hinders the internal market.

10. The scope of Article 63 is even more clear in the light of the Council Directive n. 88/361/EEC which was designed to implement Article 67 TEC, thus giving the single market its full financial dimension: Article 1 of the Directive expressly states that, in accordance with the annexed classification, Member States shall abolish any restriction on movements of capital.[7]

11. Therefore, it is necessary to ascertain whether rules such those included in the LOB clause at issue in the present case constitute an obstacle to the movement of capital thus liberalized. The result of such an assessment is clearly negative.

[7] C-484/93 Svensson & Gustavsson, especially paragraph 6.

12. Indeed, the provision contained in Article 1 of the Protocol restricts the benefits of the Convention only to those residents of the Contracting State who fulfill some ownership tests provided for by the Lob clause, thus being classified as ‘qualified persons’ for the purpose of the Convention.

13. Established ECJ case law pointed out that even though, in the absence of unifying or harmonizing measures adopted in the Community, Member States remain competent to determine the allocation of taxing rights with the purpose to eliminate double taxation, they still have to exercise their taxation powers consistently with Community law. Clearly this is not what State A did as for as the LOB clause at issue.

14. Indeed, the goal to eliminate international double taxation is recognized at EU level by the former Article 293 of the EC Treaty (repealed by the Treaty of Lisbon) under which the Community required Member States to enter into negotiations with a view to the abolition of double taxation within its territory: this goal can be pursued both unilaterally by the single Member State’s national legislation and by means of bilateral Double Tax Conventions. However, after the repeal of Article 293 by the Treaty of Lisbon, the elimination of double taxation cannot anymore be seen as a goal left to negotiation among M.S. but ‘*a goal of the EU as such*[8]’.

15. Therefore ‘*the EU objective to eliminate double taxation can be applied more widely*’[9] and the scope of Article 115 TFEU becomes broader, while the possibility of State’s negotiation is left with less space.

16. In this scenario, while negotiating Tax Treaties, Member States are clearly free to determine the different connecting factors on the basis of which they allocate taxing rights between themselves. Nevertheless they must do so without disregarding EU rules, including also Article 63 TFEU, entailing the free movement of capital and payments.

17. The latter statement deals with the issue of the relationship between Double Tax Conventions concluded by M.S. and EU Treaties, which has been addressed by the ECJ in several cases. We recognize that this issue must be solved again in favour of the supremacy of the EU Law.

18. The issue clearly involves only those DTCs concluded after the entering into force of the Treaty, since, in those cases, if the DTC’s provisions are in contrast with the EU Treaty, the conflict should be solved in the light of the general principle of international law under Article 30 of the Vienna Convention on the Law of the Treaties which states that ‘*the earlier treaty applies only to the extent that its provisions are compatible with those of the later treaty*.’

19. However, this is not the solution embraced by the ECJ, especially considering principle of cooperation provided for by Article 4(3) TEU, according to which the M.S. ‘*shall take any*

[8] See H. Hofmann, G. C. Rowe, A. Turk, Administrative Law and Policy of the European Union, p.84

[9] See E.C.C.M. Kemmeren, Editorial: after repeal of Article 293 EC Treaty under the Lisbon Treaty: the EU objective to eliminate double taxation can be applied more widely, in EC Tax Review, 2008, p. 156

*appropriate measure, general or particular, to ensure fulfillment of the obligations arising out of the Treaties or resulting from the acts of the institutions of the Union*'. The same paragraph also provides for a negative obligation in order to '*facilitate the achievement of the* Union's tasks and refrain from any measure which could jeopardize the attainment of the Union's objectives.' Indeed, the supremacy of the EU Treaty with respect to DTCs has been stated by the ECJ in several cases.

20. The first relevant judgment is the Saint Gobain case[10], in which the DTC between Germany and France restricting some tax concessions to German companies or companies subject in Germany to unlimited tax liability, thus excluding from it a permanent establishment in Germany of a company having its seat in France, was found in breach of the freedom of establishment granted by Treaty. Indeed, in the Court reasoning, the refusal to grant the concession makes less attractive for a French company to have holdings through German branches and thus restricts the freedom to choose the most appropriate legal form for the pursuit of activities in another M.S.

21. The Open Skies case[11] offered the Court the chance to deal more specifically with the issue at stake in the present situation, i.e. the legitimacy of limitation of benefit clauses contained in DTC entered into by a M.S[12].

22. The case involved the infringement proceedings against several M.S. who entered into DTCs with the US in the field of transportation in order to restrict international traffic rights to the national flag carriers of the Countries concerned. This purpose was reached through a LOB clause, which limited the benefit of the conventions to those transportation companies resident in the contracting M.S., subject to the condition of fulfillment of an 'ownership and control' test. Recalling the Saint Gobain case, the Court held that:

'the *principle of national treatment requires a Member State which is a party to a bilateral international treaty with a non-member country for the avoidance of double taxation to grant to permanent establishments of companies resident in another Member State the advantages provided for by that treaty on the same conditions as those which apply to companies resident in the Member State that is party to the treaty'.*

23. Since the LOB clause at issue permitted to the U.S. to withdraw, suspend or limit the benefit of the Convention with respect to an airline designated by Germany but of which a substantial part of the ownership and effective control was not vested in that M.S. or in German nationals, the Court held that there was no doubt that

*'airlines established in the Federal Republic of Germany of which a substantial part of the ownership and effective control is vested either in a Member State other than the Federal Republic*

[10] C-307/97 Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v Finanzamt Aachen-Innenstadt.

[11] C-476/98 Commission of the European Communities v. Federal Republic of Germany.

[12] The issue is addressed by T. O'Shea, *Limitation on benefit (LOB) clauses and the EU,* in *International Tax Report,* October 2008, p. 1 and November 2008, p. 1.

*of Germany or in nationals of such a Member State (`Community airlines') are capable of being affected by that clause.'*

24. Therefore the ECJ stated that the Community airlines suffered a discrimination in comparison
with the German ones and that this discrimination entirely sourced from the LOB clause contained in the DTCs, which was found in breach of the freedom of establishment granted by the Treaty.

25. Exactly as in the Open Skies case, the provision contained in the Protocol clearly enshrines a discrimination between those companies resident in M.S. B which fulfill the ownership requirements provided by the LOB clause and those companies, as Closed Skies, which are resident in the same M.S. B but do not fulfill those requirements, thus are not 'qualified persons' for the purpose of the Convention. There is no doubt that companies as Closed Skies established in M.S. B of which a substantial part of the ownership and effective control is vested either in a Member State other than B or in nationals of such a Member State are capable of being affected by that clause. Indeed if Closed Skies met the requirements provided by the Protocol, thus substantially being held or managed by a resident of either Contracting State, it would have been entitled to the benefit of the Convention and enjoyed the 5% refund of the tax withheld on dividends distributed by Fogglia.

26. Therefore, especially considering the fact that Closed Skies' shareholders are all citizens of the European Union, resident in different Member States (namely Member States C, D, E) we can see that those citizens' right to freely move their capital towards M.S. B and to be granted there the same treatment as M.S. B's residents is clearly frustrated by the LOB provision at issue.

27. In fact, the situation under which two State B's resident companies are entitled to the benefit of the Convention, depending on the result of the ownership test provided by the Treaty, is a discrimination constituting an obstacle to the free movement of capital. This is because, on the one hand, the company itself would refrain from moving capitals towards State A since it knows that, once State A would withhold the tax on distributed dividends, it would not benefit from the refund. On the other hand, others European investors would refrain from moving their capitals to Closed Skies, as they know that, as for as dividends distributed by Fogglia, the company receives a worse treatment if compared to purely national companies.

## 4. The discrimination cannot be justified under the so called 'rule of reason'

28. Notwithstanding the fact that the LOB provision at issue clearly entails a discrimination prohibited under Article 63 TFEU, the defendant could allege some justifications by an overriding requirement of general interest, among those recognized by the ECJ under the so called 'rule of reason'. However, this is not possible in the present case.

29. As for as the justification concerning the allocation of taxing rights, i.e. the principle of territoriality, in the Saint Gobain case the Court did not accept it, clearly stating that '*as far as the*

*exercise of the power of taxation is concerned, the M.S. nevertheless may not disregard Community rules.'* Moreover in the Avoir Fiscal case[13], dealing with a restriction to the freedom of establishment, the Court held that '*the right conferred by Article 52 of the Treaty are unconditional and a M.S. cannot make respect for them subject to the contents of an agreement concluded with an another M.S. In particular, that Article does not permit those rights to be made subject to a condition of reciprocity imposed for the purpose of obtaining corresponding advantages in other M.S.*'

30. Also the justification regarding the difficulties in obtaining information from State B, given the absence of the provision corresponding to Article 26 OECD Model in the applicable DTC, cannot be accepted. Indeed in those cases concerning EU M.S. the Court always refers to the EU Directive on the mutual assistance on the exchange of information[14], which is applicable in all M.S. and obliges them to cooperate with each other.

## 4.1 – Even if a justification would be acceptable the discrimination is not proportionate to the objective envisaged

31. Furthermore, even though a justification would be accepted, the relevant national provision must be tested in the light of the proportionality test.

32. This is important as for as the prevention of tax avoidance which is what the LOB clause is apparently aimed at. Indeed in the Lasteyrie du Saillant case[15] the ECJ held that the relevant provision of the French legislation '*is not specifically designed to exclude from a tax advantage purely artificial arrangements aimed at circumventing French tax law.*' This is exactly the case with the LOB provision at issue in the present case since it is aimed generally at any situation in which a company resident in State B is held by other subjects resident in other States not part of the DTC. But such an ownership '*does not, in itself, imply tax avoidance'*, and the relative test entails a mere presumption of avoidance. This is not proportionate to the objective envisaged -namely tackle tax treaty shopping- because it goes beyond what is necessary to attain it, being possible to achieve it by measures that are less restrictive of the free movement of capital. In particular, the Protocol does not match the anti-abuse principles shaped by the ECJ when it comes to justify discriminatory national provisions: the clause should be designed in such a way to discriminate only abusive conducts and to allow verifying the artificiality on case-by-case basis.

33. Therefore we strongly argue that, as a first point, the Provision of the Protocol enshrines a discrimination prohibited by Article 63 TFEU, which cannot be justified under the rule of reason and, anyway, is not proportionate to the alleged aim of tackle treaty shopping's abusive practices.

[13] C- 270/83, paragraph 26

[14] Indeed, whenever a M.S. tried to justify a discrimination with this argument, the Court always denied this justification, referring to 77/799/EEC.[15] C-09/02, paragraph 49. See also ICI case, paragraph 26.

[15] C-09/02, paragraph 49. See also ICI case, paragraph 26.

34. After the exam of the provisions of the Protocol under the EU law we aim also to demonstrate that Closed Skies complies with the Protocol conditions' for the access to treaty benefits, in particular regarding to paragraph 2 and 4.

## *5. Paragraph 2 of the Protocol*

35. In fact the provision of the paragraph 1 under this Protocol provides that a company shall be entitled to the benefits of the Convention if it is a '*qualified person'* as defined under paragraph 2, thus meeting the requirements under paragraph 2.

36. A company shall be a '*qualified person*' if it meets the requirements under paragraph 2, in particular regarding to subparagraph c) or subparagraph d). As Closed Skies' shares are not listed in any stock exchange, less than 50% of their aggregate vote and value is not owned by five or fewer companies resident in one of the Contracting States, of course it does not comply with the requirements under subparagraph c).

### 5.1 – Qualified person

37. Nevertheless we want to demonstrate that Closed Skies is a '*qualified person*' under paragraph 2, subparagraph d) through an analysis of the structure of shareholders. In particular we claim that Closed Skies is a '*qualified person*' because more than 50% of the aggregate voting power and value is owned by residents of the Contracting States entitled to benefits under clause i) of subparagraph c). In order to demonstrate this we claim that Mr. Mark Schweps and Fin Caps Glow own more than 50% of shares required by this provision.

38. As there is no doubt that the 40% held by an individual (Mr. Mark Schweps), resident in the Contracting State B, fulfills the requirements, an in depth reasoning is required for the remaining 10% required by the clause ii) of subparagraph d).

39. In particular we aim to prove that the 20% held by Daily Nail Company and its relation with Fin Caps Glow satisfies the requirements under this provision. Firstly, we want to link Fin Caps Glow with the provision under clause i) subparagraph c) and consecutively its relation with clause i) of subparagraph d).

40. In particular, the Protocol contains a particular limiting clause for indirect ownership that constitutes a discrimination under Article 63 TFEU. In fact as the 20% of Closed Skies is held by Daily Nail Company, resident in State C, and the 100% of Daily Nail Company is held by Fin Caps Glow, resident in the Contracting State B, the beneficial owner of the participation in Closed Skies is Fin Caps Glow, while the legal owner is Daily Nail Company.

## 5.2 – Beneficial owner

41. The OECD Commentary on Arts. 10, 11, 12 contains some general guidance on the interpretation of the term Beneficial owner. In particular Para. 2 of the Commentary on Arts. 10 states that: '*The term 'beneficial owner' is not used in a narrow technical sense, rather, it should be understood in its context and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.*' The term '*beneficial ownership*' appears in OECD Model, in Article 10(2) relating to dividends, it was introduced to counteract treaty abuse through the use of intermediaries that could secure a more favourable tax treatment.

42. In this particular case the beneficial owner of the 20% of shares owned by Daily Nail Company is the company Fin Caps Glow resident in the same Contracting State of Closed Skies but it is discriminated by the provision of the Protocol for the reason of the indirect ownership through another company resident in another Member State. In fact this provision of the Protocol discriminates between an intermediate owner resident of the Contracting State and an intermediate owner non resident.

## 5.3 – Relevant trend in ECJ law over 'discriminatory'

43. The European Court of Justice (hereinafter also 'ECJ') tended in many cases[16] to define discrimination either as treating similar cases differently or, treating different cases similarly. According to the position of the ECJ we claim two different discrimination in this case: firstly Fin Caps Glow is discriminated because it is treated as a non-resident company of the Contracting States. Even if those LOB clauses were intended to prevent 'treaty shopping' they are discriminative because they do not make an adequate distinction between resident indirect ownership and a non resident indirect ownership. Therefore they treat different cases similarly. Moreover this provision of the Protocol constitutes a strong limitation of the right of the Fin Caps Glow to acquire or constitute a company in another Member State because this will led to receive worst tax conditions, in direct violation of both Art. 49 and 63 TFUE.

[16] C-279/93, *Finanzamt Köln-Altstadt v. Roland Schumacker*, para. 30. Michael Lang, '*Recent Case Law of ECJ in Direct Taxation: Trends, tensions and Conditions*' EC Tax Review 18, no. 3 (2009): 98.

44. Nevertheless it is possible, looking at the structure of the shareholders of Closed Skies, to note a different position and situation in the existing relation between Closed Skies and Fin Caps Glow and Closed Skies and Vest&Gard. In particular we want to demonstrate that Fin Caps Glow, as a resident company, is discriminated against by this provision because it is treated similarly to a non resident company like Vest&Gard.

45. In fact Vest&Gard has its Place of Effective Management (hereinafter also 'POEM') outside the Contracting States[17] and owns a direct participation through its statutory seat in State E and the beneficial owner this time is not inside one of the Contracting States.

## 5.4 – POEM

46. As the last version of the OECD Model adopted as tie-break rule the POEM to locate the residence of a company, we wish report the definition as provided in the last OECD Commentary[18]: '*The place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made. All relevant facts and circumstances must be examined to determine the place of effective management. An entity may have more than one place of management, but it can have only one place of effective management at any one time.*'

47. While in this case the LOB clauses work properly excluding from the 50% requested by the provision external shareholders companies and individuals located outside the Contracting States, the same cannot be said for the Fin Caps Glow position.

## 5.5 – Relevant trend in ECJ case law over the 'jurisdiction'

48. As stated above as for as the legitimacy of LOB clauses, the ECJ recognizes under the so called '*rule of reason*', the existence of some justification by an overriding requirement of general interest, such as the coherence of the tax system, the control of tax avoidance, or efficiency of tax audits. In particular, in the Bachmann case, the ECJ accepted the argument of the '*coherence of a tax system*', but afterwards took a restrictive view of such a justification, in particular in the

[17] Vest&Gard POEM is in State F and according to the last OECD Model (the same of the DTC) that the State where it must be placed the residence of the company.

[18] OECD Commentary p.88, 89.

following decisions, in particular in the Wielockx*[19]* case and in Manninen*[20]* case. Also in the Mark&Spencer*[21]* case relies on a similar justification. In particular in this case the Court stated that: '*A restriction is permissible if it pursues a legitimate objective compatible with the Treaty as justified by imperative reasons in the public interest. It is further necessary in such a case, that its application be appropriate to ensuring the attainment of the objective thus pursuaded and not go beyond what it is necessary to attain it[22].*'

49. In the Baars*[23]* case the ECJ refused to take into account a 'justification' for discrimination based on the '*fiscal cohesion*' of a tax system (i.e. justifying a difference of treatment by the need to preserve the coherence of a tax system[24]).

50. As just remarked by this case both the discrimination against Fin Caps Glow and Closed Skies are unnecessary for the LOB perspective because they are both resident in the Contracting States, and they can be both classified as beneficial owner. Closed Skies is the beneficial owner of the inbound dividends incoming from Fogglia in State A. On the other hand, as said before, Fin Caps Glow is the beneficial owner of the Daily Nail Company.

51. In Cadbury-Schweppes case[25] the ECJ held that the UK Controlled Foreign Company (CFC) legislation violated EC law to the extent that it effectively prevented UK companies from exercising their right to establish a subsidiary in another Member State of the European Union. The Court stated that only totally artificial arrangements could be penalized by CFC legislation[26].

## 5.6 – Parent Subsidiary Directive

52. Similarly, the ECJ in case C-170/05, Denkavit*[27]* case, said that discrimination by a Member State against subsidiaries of non-resident EU parent companies may be considered to be incompatible with EC Treaty. The Denkavit case was overruled[28] by the Parent-Subsidiary

[19] ECJ, 11 August 1995, Case C-80/94, Wielockx.

[20] ECJ, 7 September 2004, Case C-/319/03, Manninen.

[21] ECJ, 13 December 2005, Case C-446/03, Mark&Spencer.

[22] Paragraph 35.

[23] ECJ, 13 April 2000, Case C-251/98, Baars.

[24] T. Pons, *The Denkavit Internationaal Case and its consequences: the limit between Distortion and Discrimination?,* European Taxation, May, 27.

[25] C-196/04, *Cadbury-Schweppes PLC.*

[26]Eric Osterweil, *Are LOB Provisions In Double Tax Conventions contrary to EC Treaty Freedoms?*, EC Tax Review 2009/5.

[27] C-170/05, *Denakavit International BV.*

[28]T. Pons, *The Denkavit Internationaal Case and its consequences: the limit between Distortion and Discrimination?,* European Taxation, May, 27

Directive of 23 July 1990. The effect of the directive is to abolish withholding tax on outbound dividends to companies that hold a qualified minimum stake in the distributing company. In particular, a 10% threshold is required by the Directive.

53. Even if Closed Skies participation of 9% in Fogglia seems to exclude the possibility to apply the Parent-Subsidiary Directive to our case it must be noted the position held by the ECJ in Manninen, Bouanich and Meilicke[29]cases. In particular it seems that ECJ does not wish to interpret differently the principles applicable to the freedom of establishment and those applicable to the free movement of capital[30].

54. The Opinion of Advocate General Geelhoed in the ACT Group Litigation concerning the scope of Articles 49 and 63 TFUE also makes it clear that the principles applies in the Denkavit case should be applicable in the same way under Art. 63 TFEU. Art. 63 seems therefore to be a solid basis on which an EU company owning more than 5% (in a company in another Member State) to challenge the withholding tax[31].

55. Therefore we claim that Closed Skies is directly discriminated by the LOB clause as for as the indirect ownership of its shareholders because it introduces an excessive restrictive limitation to the freedom granted by the TFEU. The application of the Protocol provision as under exam brings to the paradox to introduce an obstacle to the same resident of the Contracting States, when the reason for introducing a DTC is to counteract treaty abuse and double taxation. There is no doubt that LOB clauses and, in general, anti avoidance rules are not *per se* inconsistent with EU law but, like in this case, a case-by-case analysis[32] of conformity to freedom of establishment and free movement of capitals has to be done.

## 6. Paragraph 4 of the Protocol

56. We aim now to demonstrate that Closed Skies shall obtain the tax benefits under this Convention even without being a '*qualified person*'. In particular the paragraph 4 states that a '*non-qualified person*' can obtain the benefits of this Convention if the competent authority determines that the acquisition of such person did not have, as a main purpose the aim to obtain benefits from

[29] C-319/02, Manninen, ECJ, C-265/04 Bouanich, and C-292/04 Wienand Meilicke.

[30] C-35/95, Verkooijen.

[31]T. Pons, *The Denkavit Internationaal Case and its consequences: the limit between Distortion and Discrimination?,* European Taxation, May, 27

[32] K. Vogel, D. Gutmann, A. P. Dourado, *Tax treaties between Member States and Third States: 'reciprocity' in bilateral tax treaties and non-discrimination in EC law*, in Ec Tac Review 2006/2.

this Convention. In order to demonstrate that Closed Skies meets the condition of this provision we claim the exam of the existing relation between Fogglia' and Closed Skies' activities.

## 6.1 Arm's length principle

57. In fact the sale of Closed Skies' products in State A was made in respect of the arm's length principle. OECD adopted this principle in its Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations of 1995 (hereinafter '1995 OECD Guidelines'). It puts associated and independent enterprises on a more equal footing for tax purposes, it avoids the creation of tax advantages or disadvantages that would otherwise distort the relative competitive positions of either type of entity.[33] It is generally based on a comparison of the conditions in transactions between independent enterprises. According to OECD Guidelines[34], the only profit methods that satisfy the arm's length principle are those that are consistent with profit split method or transactional net margin method. In particular the profit split method seeks to eliminate the effect on profits of special conditions made or imposed in a controlled transaction by determining the division of profits that independent enterprises would have expected to realize from engaging in the transaction or transactions. The profit split method first identifies the profit to be split for associated enterprises from the controlled transactions in which the associated enterprises are engaged. It splits those profits between the associated enterprises on an economically valid basis that approximates the division of profits that would have been anticipated. The contribution of each enterprises is based upon a functional analysis and valued to extent possible by any available external market data[35].

58. As it was noted the prices charged by Closed Skies to Fogglia were somewhat higher that prices charged to independent customers, this was because the latter would purchase bigger volumes while the two companies expected (as it was) a restricted volume of sales. Closed Skies used the available market data from Fogglia and both companies agreed to adopt the profit split method. It can also then be noted that the arm's length principle was fully respected as the two companies acted as two independent enterprises avoiding tax advantages.

59. In conclusion, the analysis of the sales of Closed Skies' products in State A through Fogglia demonstrates that Closed Skies only want to access to a foreign market (State A) without receiving

[33] See paragraph 1.7 of the 1995 OECD Guidelines.

[34] See paragraph 3.1 of the 1995 OECD Guidelines.

[35] R. Franzè, *Transfer Pricing and Distribution Arrangments: From Arm's Lenght to Formulary Apportionments of Income, Intertax*, Volume 33, Issue 6/7 2005.

any particular tax advantage and this fully complies  with the requirement set in the paragraph 4.

## 7. On the discriminatory nature of the tax representative

60. Domestic law of State A determines that non residents have to appoint a tax representative whenever they want to claim any tax benefit. As such, we argue this requirement introduces a discriminatory treatment for non resident taxpayers, that is in conflict with the broad reach of Article 63 indicated above.

61. In particular, we hereby appeal the rejection of the Tax Authority of State A in respect of our request for tax refund, being that not presented by a resident fiscal representative, but directly by the taxpayer represented by a lawyer of State A, not formally designated as a tax representative.

62. Below we shall represent how the requirement of a tax representative for non resident taxpayers by domestic law of State A is a mere procedural issue that cannot prevent granting the due tax refund.

### 7.1 Relevant trend in ECJ case law over the tax representative

63. With regard to its discriminatory nature, a procedural obstacle such as the requirement of a tax representative for non resident taxpayers of State A may imply additional financial charges for non residents; however, even if offered free of charge, the mere imposition of a mandatory additional requirement represents a discriminatory impediment to non resident taxpayers of State A, and their EU guaranteed freedom to move capitals – it being admissible only if considered as an option, available for non resident taxpayers, to decide whether to appoint or not a tax representative in the State of source.

64. A recent judgment of the ECJ sheds light over the aforesaid discriminatory nature of the tax representative requirements as provided for by domestic law of State A. In Commission v. Portugal[36], the European Commission successfully challenged a Portuguese rule that required non resident taxpayers to appoint a tax representative in Portugal. The Commission mainly sought a

[36] C-267/09 European Commission v Portuguese Republic. See, EU Focus 2011, *Tax representative requirement breaches Treaty but not EEA Agreement*, EU Focus 2011, 284, 30-31; Mosbrucker, Anne-Laure, *Représentation fiscal*, Europe 2011 Juillet Comm. nº 7 p.23.

declaration that by approving and maintaining in force statutory provisions contained in Article 130 of the Code of Personal Income Tax, Portugal failed to fulfil its obligations under the Article 63 of the TFEU [37], being such provisions discriminatory against non residents.

65. The ECJ held that requiring appointment of a tax representative obliges taxpayers to take action and to bear the costs of remunerating that representative. Such burden was deemed to effectively create for non resident taxpayers an obstacle that may result into a discouragement from investing capital in Portugal, being therefore prohibited within the scope of Article 63 of the TFEU (§37).

66. In addition, the above requirement shows a disproportion in respect of the general justifications that may be applicable in such specific circumstances. The *general interest* that State A may claim is mainly that of *ensuring effective fiscal control* and *fulfilment of tax obligations*, being these not to be understood as *de plano* acceptable justifications. Generally, such grounds have been purported by M.S. for introducing some kind of restriction to the European fundamental freedoms. In this case the ECJ shall always be in charge to verify whether such measures may qualify as *reasonable* and *proportionate* justifications warranting introduction of restrictions to the achievement of the Internal Market[38].

67. In particular, State A's recourse to a mandatory requirement of a tax representative does not adequately match with the *general interest* justifications meant to *ensure effectiveness of fiscal control* and *fulfilment of tax obligations;* any issue relating to information access and underpinning State A's statutory provision on tax representative could effectively be solved by applying directives 77/799/EEC[39] and 2008/55/EC (the mutual assistance directives) or using modern means of communications.

68. In particular, State A and State B are members of the European Union, therefore subject to EU laws and directive. We cannot ignore the efficient and consistent series of directives relating to the mutual assistance and cooperation in the tax field, especially with regard to recovery of taxes, and correct assessment of taxes, both aiming at enhancing states with effective tools for exchanging

[37] C-101/05 Skatteverket v A concerning the scope thereof.

[38] Justifications' admissibility shall be examined below. However, circumstances as envisaged in Article 58(1) of the EC Treaty have overtly been used as overriding examples of a superior general interest, that being capable of justifying a restriction on the exercise of freedom of movement guaranteed by the Treaty.

[39] See note 10.

relevant information[40]. In this context, State A’s tax representative rule cannot long be recognized as legitimate and lawmakers should poke that out of the national system. Maintenance of such requirement is undoubtedly ignoring consideration of the available tools for the exchange of information within the European Union, that contravening what the ECJ has been upholding in all judgments referring to the assessment of constraints to, among the others, the guaranteed free movement of capitals.

69. This rationale was confirmed in the aforesaid judgment, wherein the Commission disputed the clear-cut existence of a disproportion between the said constraints for non residents and achievement of the mentioned aims[41].

70. In particular, the Commission argued that Directives 77/799/EEC and 2008/55/EC are sufficient tools for M.S. to ensure effectiveness of fiscal supervision and to prevent tax avoidance (§39). In respect thereof, the Court, though agreeing that fiscal supervision and prevention of tax evasion could be a general interest justification for the national rules constraining one of the fundamental freedoms set forth by Art. 26 TFEU, upheld the Commission’s argument, by stating that “*a general presumption of tax avoidance or tax evasion cannot justify a fiscal measure which compromises the objectives of the Treaty*”[42], that therefore excluding, as hereby argued, that a mere use of such justifications by State A may be considered as sufficient in preventing full achievement of an Internal Market.

71. The above conclusion should be read in connection with the further ECJ’s explanation that the obligation to appoint a tax representative was not an appropriate/necessary measure to deal with the practical problems as identified by Portugal concerning direct contact with non resident

[40] Council Directive 77/99/EEC concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation and taxation of insurance premiums (OJ L 336 27.12.1977, 15) as amended several times, the latest being by Council Directive 2006/98/EC (OJ L 363, 20.12.2006, 129). However new improvements will be effective as to the assistance (exchange of information mechanism), after adoption by the Council of Ministers for Economic Affairs and Finance on February 15 2011 of a new directive, that will apply as from January 1 2013 (except for automatic exchange of information applicable as from January 1 2015). In respect thereof, see Council Document 5846/11 of February 4 2011 + ADD 1 COR 1 – I/A item note on adoption, available on the Council’s website consilium.europa.eu; for the finalized text of the Directive 2011/16/EU on administrative cooperation in the field of taxation and repealing Directive 77/99/EEC, see the published document in OJ L 64 of March 11 2011, 1.

[41] See, *inter alia*, C-101/05 A [2007] ECR I 11531, § 55, and Joined Cases C-155/08 and C-157/08 *X and Passenheim-van Schoot* [2009] ECR I-5093, § 45.

[42] See *supra* at para. 42 and 46 stating that “the obligation to appoint a tax representative goes beyond what is necessary to achieve the objective of preventing tax evasion and that, consequently, the Commission’s assertion that such an obligation constitutes an unjustified restriction on the free movement of capital provided for by Article 56 EC is well founded”.

taxpayers. In this respect the ECJ held that non residents can always provide tax authorities with an address in another Member State for all required notifications; yet, if physical presence of a taxpayer is essential, it may be sufficient "*to give him the option of being represented by a tax representative, rather than imposing a general obligation*"[43].

72. In light of the above well founded reasoning, we argue that requirement of a tax representative as provided for by State A's domestic legislation apparently creates an unjustified discrimination, that being borne by any non resident taxpayer applicant claiming for a tax benefit.

73. In such circumstances, this procedural requirement, following the ECJ's holding in Commission v. Portugal, should be eliminated as to avoid similar obstacles to international investments in the European Union.

74. We argue also that State A's statutory rule on tax representatives should be read in association with a line of cases[44] concerning other restrictive residence requirements for non residents, as outlawed by the Court to ensure abidance by the fundamental freedoms guaranteed by the European treaties[45]. In particular, with regard to other kind of unjustified residence requirements, in Commission v. Netherlands[46], the ECJ established that the relevant residence requirement in that circumstances, imposing registration of a ship in the Netherlands, provided that the members of the corporate constituencies of the EU company owning the ship were EU/EEA nationals, was capable to "*alter the structure of their share capital or of their boards of directors; and such changes may entail serious disruption within a company and also require the completion of numerous formalities which have financial consequences*".

75. Therefore, such unjustified discrepancies for non resident taxpayers moulds a pattern of *formalities* that is not acceptable under the European legal framework. Measures dealing with restrictions to the achievement of an Internal Market, as said above, are acceptable but need to be

[43] Id. at 47.

[44] See, *inter alia*, C-182/83 *Fearon and Company*, C-131/01*Commission v. Italy*. In relation to social welfare allowances the ECJ has generally accepted that a residence requirement is appropriate in order to guarantee existence of a link between the applicant and the relevant market, that to be compliant with the proportionality test and not going beyond what is necessary to achieve the aim of the national rules. In this respect see, C-192-05 *Tas-Hagen*, C-406/04 *De Cuyper*, C-138/02 *Collins*, C-258/04 *Ioannidis*, C-337/97 *Meussen*, *Commission v.* C-111/91 *Luxembourg*, C-57/96 *Meints*.

[45] T. O' Shea, *ECJ Pokes Holes in Portugal's Tax Representative Rule*, Tax Notes Int'l, June 27, 2011, p. 1006.

[46] C-299/02 Commission v. Netherlands.

properly justified. Our claim is that State A’s authorities have failed in duly justifying such restrictive measure falling within the scope of Article 63 of the TFEU, causing additional expense and increase of the related compliance burdens on non resident taxpayers to arise. There is no acceptable juridical reason to maintain such regime, especially with reference to the actual possibility offered by modern communications, and therefore with no effective necessity as to such requirement.

## 7.2 Absence of proportionality and non existence of a justification by the Tax Authority

76. As indicated above a restriction of a treaty freedom is permissible if aiming at serving a general interest, therefore, guaranteeing achievement thereof and not exceeding the bounds of what is absolutely necessary (proportionality test). Provided that generally one of the justifications used to meet the said requirement is that meant to ensure *effectiveness of fiscal supervision,* We hereby argue that assessment of proportionality following adoption of such justification have to be measured with the degree whereby the state has the opportunity to effectively exchange information.

77. State A is not relying on the available tools provided by the mutual assistance directives, inserting a further burden that restricts the free movement of capital and contravenes the European Union principles.

78. Use of a general interest justification, in a system wherein the mutual assistance directives are effective, requires verification of the objective information that cannot otherwise be obtained, and consideration over the reasonableness of the measure adopted. In that respect, it is noteworthy that, in ECJ proceedings, Member States often invoke “to ensure the effectiveness of fiscal supervision” when arguing the lack of effective means for the exchange of information. Directive 77/799/EEC (and 2008/55/EC in the years to come) means that this justification is not accepted for situations involving cross border movement within the EU[47].

[47] E. Nijkeuter, *Exchange of Information and the Free Movement of Capital between Member States and Third Countries*, EC Tax Review 2011-5, p. 232 et seq., it is its firm belief that also new Directive 2011/16/EU will not make this justification more acceptable

79. The ECJ jurisprudence has further applied such broad justifications in case *A*[48], by stating that if a Member State makes the allocation of a tax benefit dependant on the fulfilment of conditions, and if this fulfilment can only be verified obtaining information from the competent authorities of a third country, only in that event, the Member State may, in principle refuse to allocate the benefit, should obtaining the information from the country in question prove impossible, in particular because no treaty with this third country obligating it to provide information exists[49].

80. Pursuant to the above it follows that being both State A and State B part of the European Union and subject to the application of the mutual assistance directives, to justify the restrictive measure of a tax representative as to achieve effectiveness of fiscal supervision results as disproportionate, *not being impossible* for State A to obtain information from the European State of residence of the Applicant.

81. In addition, not being impossible, such further requirement would result into a mere administrative inconvenience that cannot justify an obstacle to a fundamental freedom[50].

82. The ECJ is right to apply such strict standards with respect to mere administrative inconveniences asserted by the European countries. The creation and full achievement of an internal market is a fundamental objective of the European Union to which all Member States have committed themselves, and they can therefore be expected to go to great lengths to achieve this objective.

83. It would be a paradox to deem such national measure as legitimate under the present circumstances. However, if this merely national rule were accepted as a substantial justification to the restriction of the free movement of capitals, in case of conflict with the existing refund available to the Applicant under the relevant DTC, application of such special bilateral provision should howsoever be guaranteed.

84. Therefore, *ut supra,* State A's rule imposing a requirement to appoint a tax representative cannot be held as other than a national procedural restraint, discriminating non resident taxpayers in

[48] See *supra*.

[49] Id at finding 63. See also C-318/07 *Persche,* at § 69.

[50] C-334/02 *Commission v. France* at §. 29, C-315/02 *Lenz* at §. 48.

breach of the European Union laws, being it also understood that, the Tax Authority’s denial of the refund, due under the special and enforceable clauses of the DTC as entered into by and between State A and State B, cannot automatically derive or be determined by the application of such merely procedural *national* rule that be clearly preventing the Applicant from obtaining full acknowledgment of its rights under the relevant clauses of the DTC.

### *8. Conclusion*

85. Therefore, we strongly claim that the denial made by the Tax Administration of State A is unfounded. This is because the LOB contained in the Protocol is inconsistent with EU Law; in a subordinate order, because Closed Skies fully complies with the requirements provided by the Protocol annexed to the DTC; finally because the tax representative requirement under the domestic law of the State A cannot prevent granting the due tax refund.

## VI. TABLE OF ABBREVIATIONS

| | |
|---|---|
| DTC…………… | Double tax convention between State A and State B |
| EU........................ | European Union |
| ECJ...................... | European Court of Justice |
| LOB..................... | Limitation of benefits |
| M.S...................... | Member State |
| OECD ………… | Organization for Economic Co-Operation and development |
| TEC..................... | Treaty of the European Community |
| TEU..................... | Treaty on European Union |
| TFEU................... | Treaty on the functioning of the European Union |

European Tax Moot Court Competition 2011/2012

# MEMORANDUM FOR THE DEFENDANT

Registration number: G/001

# I. List of sources

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# II. Statement of facts

Closed Skied ( hereinafter also '**X**') is a company resident in State B.

X's shares are not listed in any stock exchange. All its shares are equal in capital and voting rights. X's shareholding is held as follows:

4. 40% by Mark Schweps (M), an individual resident in State B;
5. 20% by Daily Nail Company (N), resident in State C, not listed in any stock exchange, and whose corporate capital is entirely held by Fin Caps Glow Company (O), a company resident in State B, with a corporate capital owned by individuals of different countries, among which residents of State A, B, and C, for a stake of 70%, with the remaining 30% being listed on stock exchange of State B.
6. 20% by Vest&Gard (Q), with a statutory seat in State E, where the board of directors meets four times per year. However Q's employees, and managers make strategic and financial policy decisions in State F. Q's shares are listed on the stock exchange of State A, and primarily of State F.

Main scope of its business relates to manufacturing of weatherproofing products for roofs. Within the relevant market X has been for the last year's the world's leader.

In 2009 X decided to invest in Fogglia (hereinafter also '**Y'**) a company resident in State A, by purchasing a 9% stake therein. Fogglia operates as a producer of a self-sticking surface based on high density aluminum foil, used both for roofing and waterproofing.

Among these activities, very recently Fogglia started to sell, in State A, some of the products of X. Sale of those products was not successful in State A's market, being the resulting volume of sales amounting to less than 5% of Fogglia's business activities.

Nonetheless, being it a successful year for its global business, Fogglia decided to reward its shareholders with a very substantial dividend, that to be distributed in year 2011. Fogglia's shareholders are mostly all resident of State A. However, X has its registered office and effective place of management in State B since its incorporation on November 5, 2002.

In the same year (2011), X did not distribute any income and opted for reinvesting all its profits internally, whilst in the previous years it had distributed from 5% up to 40% of its profits on a yearly basis.

X filed a request for tax refund with State A’s tax authority in respect of dividends distributed from the 2010 profit. Refund was requested for the difference existing between the tax withheld at the time of distribution (at State A’s domestic rate of 20%) and the amount due pursuant to the Double Tax Convention (DTC) in force between State A and State B.

Following such filing, X was not satisfied by the decision of State A’s tax authority, claiming that X’s request for tax refund had to be rejected for non fulfillment of the relevant conditions for being granted tax benefits as set forth by the Double Tax Convention (DTC) in force between State A and State B, and for non compliance with the State A’s domestic law requiring non residents to appoint a tax representative whenever they wish to file any request of tax refund and or benefit.

X filed the present appeal pleading that the DTC protocol included an anti-abuse provision which could not be applied, being all transactions and activities intrinsically genuine. Moreover, and *inter alia*, that the provisions of the protocol constituted a clear breach of EU law.

# III. Issues

7. The freedom at stake;
   - 7.1. Closed Skies is entitled to the treaty benefits;
   - 7.2. Overlapping between free movement of capital and freedom to establishment;
   - 7.3. The ‘*definite influence’* criterion;
   - 7.4. The ‘*indirect consequence*’ criterion
   - 7.5. The ‘*purpose of the legislation concerned’* criterion;
   - 7.6. Article 63 TFEU applies;
   - 7.7. Non applicability of the Parent Subsidiary Directive;
8. Compatibility of the LOB clause with Article 63 TFEU;
   - 8.1. Repeal of Article 293 EC Treaty and its consequences on elimination of double taxation;
   - 8.2. The absence of harmonization in direct taxation;
   - 8.3. M.S. are free to determine the connecting factors of fiscal jurisdiction;
   - 8.4. M.S. exclusive power to negotiate a DTC;
   - 8.5. The scope of the LOB clause: to limit the benefits of the Convention only to person referred to in it.
   - 8.6. The ECJ refusal to go into the ‘horizontal comparison’;
   - 8.7. The argument of the ‘*overall balance*’;
   - 8.8. The argument of reciprocity in GATT jurisprudence;
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        - 10.3.1.1. Profit split method;

11. Legitimacy of the tax representative rule;
    - 11.1. Non comparability of resident and non resident under State A legislation: other functions to be attributed to a tax representative;
    - 11.2. Non discriminatory nature of the tax representative rule;
    - 11.3. Satisfaction of the proportionality test;
    - 11.4. burden of proof;
    - 11.5. compatibility between DTC and the tax representative rule;

# IV. Arguments

## 1. General remarks

1. The purpose of this document is to prove that the decision of the Tax Administration of the State A to deny the tax refund to Closed Skies is sound and well-grounded. The analysis will cover in first place the consistency of the LOB clause contained in the Protocol with EU Law; in second place because Closed Skies did not fulfill the requirements of the Protocol annexed to the DTC; in conclusion also because the tax refund request was not presented by a resident fiscal representative.

## 2. The freedom at stake

2. Following the reasoning in steps that the ECJ normally uses and considering that Closed Skies, as a EU resident company holding shares in another company resident in a different M.S., is surely entitled to the Treaty's benefits, the first important step is to determine which is the freedom applicable to the present case.

3. The issue of overlapping[51] of Treaty's freedoms becomes fundamental in those cases involving a non-EU situation but, as we will see later, it is also important in the light of possible justifications that a M.S. can offer to preserve its national discriminatory legislation. In many cases it is very difficult to assess if the situation falls within the scope of the freedom of establishment or within the scope of the free movement of capital. Even though the distinction between the scope of the provision is very subtle, the ECJ has established some criteria in order to draw a line between the applicability of the two provisions.

4. The Court addresses the issue of overlapping in several cases and essentially provides the interpreters with different tests to be applied in order to verify which freedom is at stake. The first

[51] See V. E. Metzler, *The relevance of the fundamental freedoms for direct taxation,* in *Introduction to European Law*, eds. M. Lang et al., 2008, pp. 35 et seq.

relevant case is the Baars judgment[52] in which the ECJ uses the '*definite influence*' criterion. Under paragraph 22, the fact that the holding of the capital of a company resident in another M.S. gives Mr. Baars '*definite influence over the company's decisions and allows him to determine its activities*' entails the fact that he is exercising his freedom of establishment in that other M.S., thus Article 49 TFEU applies. Furthermore, in FII case[53] the Court clarifies that the threshold above which the holding of shares involves '*definite influence*' is deemed to be the holding of at least 10% of the capital of the company.

5. A second test is provided by the Court in the Bachmann case[54] where the movement of capital from a State to another was found to be the mere '*indirect consequence*' of the fact that Mr. Bachmann wanted to exercise his right of establishment, granted by the Treaty. Having in mind this substantial criterion the Court overruled the formalistic criterion provided in FII, when, in the Glaxo case[55], recognized that, notwithstanding the fact that the holding amounted to more than 10% of the capital, the main purpose of the shareholder was to gain from the capital speculation, thus Article 63 TFEU applied.

6. The Holbock case[56] provides for an even more precise test, when, in paragraph 22, the Court solves the issue of overlapping of Treaty's freedoms looking at the '*purpose of the legislation concerned*', i.e. the national legislation that was claimed to be in breach of the Treaty. As the Court finds in the subsequent paragraph, clearly referring to the Baars' criterion, '*the Austrian legislation in the present case is not intended to apply only to those shareholdings which enable the holder to have a definite influence on a company's decisions and to determine its activities*.' Indeed the Austrian legislation simply discriminated against inbound dividends, taxing them at an higher rate than domestic ones, irrespective of the extent of the shareholding which Mr. Holbock had in the Swiss company.

7. Looking at the 9% shareholding of Closed Skies in the light of criteria provided above, we can say that both from a formal and a substantial standpoint the freedom at stake is the free movement of capital, thus Article 63 TFEU applies. Indeed, even if, considering the recent sale by Fogglia of some products manufactured by Closed Skies, one wish to recognize a connection

[52] C-251/98 C. Baars v Inspecteur der Belastingen Particulieren/Ondernemingen Gorinchem.
[53] C-446/04 Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue.
[54] C-204/90 Hanns-Martin Bachmann v Belgian State.
[55] C-182/08 Glaxo Wellcome GmbH & Co. KG v. Finanzamt München II.
[56] C-157/05 Winfried L. Holböck v. Finanzamt Salzburg-Land.

between the activities of two companies, one must also consider that Closed Skies' investment in Fogglia occurred in 2009 and that the connection between their activities is 'very recent' (presumably 2011). Thus we can say that the intention of Closed Skies at the time of the investment in Fogglia was merely to move its capital from State B to State A, enlarging its investment portfolio and making some capital gains. The 'purpose of the legislation' test also confirm this view because the LOB provision of the Protocol attached to the DTC between States A and B applies no matter the extent of the shareholding: in fact Closed Skies would be discriminated against no matter the amount of shares held. This is because the purpose of such a clause is to limit the refund on the base of some 'ownership tests', irrespective of the extent of the holding.

8. Moreover, before going into the different arguments about the legitimacy of such a clause, we must recall the fact that the Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation of parent and subsidiaries companies is not applicable to our case since Closed Skies' holding does not meet the minimum 10% of capital required by the Directive. Of course this must be seen as a further clue as to the applicability of the free movement of capital to the present case.

## 3. The LOB clause is consistent with the free movement of capital

9. Once we determined that the freedom at stake in the present case is the free movement of capital, we must analyze the Lob clause included in the Double Tax Treaty between State A and B in the light of that freedom and thus assess its compatibility with Article 63 TFEU. This analysis clearly shows a positive outcome.

10. In fact settled ECJ case law demonstrates that in the absence of unifying or harmonizing measures in the field of direct taxation adopted within the EU, Member States remain competent to determine the allocation of taxing rights, with the purpose to eliminate double taxation[57].

11. The importance of this goal is recognized also at EU level by the preexisting Article 293 of the EC Treaty (repealed by the Treaty of Lisbon) under which the Community required Member

[57] See for instance C-336/96, Gilly, paragraphs 24 and 30; C-307/97, Saint Gobain, paragraph 57; C-376/03, D. paragraph 52 and C-265/04, Bouanich, paragraph 49.

States to enter into negotiations with a view to the abolition of double taxation within its territory. The repeal of the Article clearly shows that the goal to encourage the creation of a net of rules set by the different DTCs with the aim to eliminate double taxation was already reached and recognized by the EU as a useful instrument for the internal market.

12. Indeed this objective can be reached both through unilateral system of relief provided by the national legislation and by bilateral negotiation of Double Tax Conventions.

13. In both cases, when Article 293 was still in force, the Court held that the provision 'is not intended to lay down a legal rule directly applicable as such, but merely defines a number of matters on which the Member States are to enter into negotiations with each other so far as it is necessary.' The abolition of double taxation is merely indicated as an objective of any such negotiations, thus Article 293 did not have direct effect, i.e. did not confer on individuals any rights on which they could rely before national Courts[58].

14. Moreover, in the same judgment, answering to the question if the Treaty's provision about free movement of workers was infringed by the particular allocation of taxing right between France and Germany provided under the applicable DTC, the Court held that whilst the abolition of double taxation within the Community is one of the objective of the Treaty, the fact that no unifying or harmonized measure has been adopted at Community level entails that '*the Member States are competent to determine the criteria for taxation on income and wealth*' and that, for this reason, the DTC concluded between France and Germany '*applies a number of connecting factors for the purpose of allocating jurisdiction between the contracting parties*'. Thus, the differentiations provided by the DTC, which resulted for Ms. Gilly in an unfavourable treatment, even if based on nationality, cannot be regarded as constituting a discrimination prohibited by the Treaty but a mere disparity[59], caused by the absence of Community harmonization of direct taxes.

15. Even if the ECJ, in several cases, has highlighted that the exercise of this freedom of negotiation must be consistent with the Treaty's provision, it constantly states that, in the negotiation of DTC, Member States remain free to allocate taxing power among themselves, determining the connecting factors for the allocation of fiscal jurisdiction.

[58] See C-336/96 Gilly, paragraph 14.

[59] See A. P. Dourado, *Is it Acte Claire? Genaral Report on the role played by CILIFT in direct taxation*, in *The Acte Clair and the EC direct tax Law* (Dourado, Borges eds.), 2008, p. 40.

16. Therefore, even if there is no doubt that this power must be exercised consistently with EU Law, State A has an exclusive power to negotiate the content of the A-B Tax treaty and this exclusive power also regards the LOB clause included in the Protocol, as long as it does not infringe EU law.

17. Indeed the LOB clause has simply the function to limit the benefit of a tax refund recognized by State A against the tax withheld on outbound dividends distributed to companies resident in State B, only to those companies resident in State B that are recognized as ‘qualified person’ under the clause itself, thus satisfying some ownership conditions which prove that the company itself is held or managed by person resident in the other Contracting State and not out of the Convention network.

18. The question arises if, under its freedom to negotiate Tax Conventions in order to eliminate international double taxation, State A is allowed to do so with respect to another M. S. without granting the same protection to all others M.S.: indeed, what the DTC is saying through the LOB provision at issue is that the refund will be granted to a company resident in State B which is controlled or managed by a State B’s resident person but it would not be granted if the same controlling/managing person is not resident in State B.

19. As one can easily see, what the Treaty is basically saying through its LOB clause is that the benefit of the Convention only regards the natural or legal persons referred to in it, which is something that is recognized at a ECJ case law level[60] .

20. In C-376/03, D. case the Court was asked if it was lawful for a M.S to extend the fiscal advantages granted by its national legislation only to its own residents to the residents of another M.S. party to a DTC, without extending them to residents of the other M.S. In its answer the ECJ stated that ‘*the scope of a bilateral tax convention is limited to the natural or legal persons referred to it and refused to go into the ‘horizontal comparison*’ between Mr. D and a person resident in a third Country with which the Netherlands entered in a DTC.

[60] See, for instance, C-376/03 D. paragraph 54.

21. It is really important to notice that, in paragraph 62 of the D. case, the Court held that a rule such as that contained in the Belgium-Netherlands DTC, under which a certain fiscal advantage is granted to the residents of the States part of the Convention, '*cannot be regarded as a benefit separable from the remainder of the Convention, but it is an integral part thereof and contributes to its overall balance*'.

22. The argument of reciprocity is affirmed by the Court even in other circumstances: this is the case with the MFN clause issue, where the Court simply refuses to go into horizontal discrimination[61]. Concerning the WTO Agreements, the Court shares the same approach: in C-14/06, Portugal challenged the decision of the EU Council to conclude Memoranda with India and Pakistan on market access for textile products, as being inconsistent with the GATT 1994 and some WTO Agreements. The Court, holding that the Agreement did not have direct effect within the Community, stated that '*the agreement establishing the WTO, including the annexes, is still founded, like GATT 1947, on the principle of negotiations with a view to 'entering into reciprocal and mutually advantageous arrangements'.*[62]

23. The ACT Group Litigation case[63] offered the Court the possibility to clarify this issue, in particular with respect to the LOB clause contained in the DTC concluded by the UK, pursuant to which it denied a credit to a company resident in the other contracting M.S. because that company was controlled by a company resident in a third State. In paragraph 88 the Court extended to the LOB clause the same conclusion reached in the D. case as for as DTC in general, holding that '*the fact that those reciprocal rights and obligations apply only to persons resident in one of the two contracting M.S. is an inherent consequence of bilateral tax conventions*.' Indeed the Court found that the residents of the two different M.S., one of which entered into a DTC with the UK were not in an objectively comparable situation and therefore the different treatment resulted in a mere disparity, consistent with the Treaty provisions.

[61] See K. Vogel, D. Gutmann, A.P. Dourado, Tax treaties between Member States and third States: 'reciprocity' in bilateral tax treaties and non-discrimination in EC Law, EC Tax Review, 2006, n.2.

[62] See also joined cases C-300/98 and C-392/98, Perfumes Dior where the ECJ confirms the definition of the WTO Agreement as 'a treaty based on reciprocity and mutual advantages', what excluded the option for the defendant to claim its right under WTO.

[63] C-374/04, Test Claimants in Class IV of the ACT Group Litigation v. Commissioners of Inland Revenue.

## 4. Even if the LOB clause would be found to be discriminatory, it is still justified under the so called rule of reason

24. In a subordinate order, even if the Court would find the LOB clause at issue entailing a discrimination in breach of the EU Law, some justifications by an overriding requirement of general interest, under the so called 'rule of reason', would have to be accepted.

25. Firstly we must consider that settled case law recognize the relevance of the territoriality principle when it comes to assess the allocation of taxing rights provided for a DTC. In the D. case[64] the ECJ, recalling the Gilly case, accepted the argument of the DTC's overall balance, and stated that the single provision '*cannot be regarded as a benefit separable from the remainder of the Convention, but is an integral part thereof*', thus reflecting that give and take internal balance on which the DTC is built.

26. Secondly we must consider the general aim of a LOB clause which is to avoid treaty shopping, i.e. the use by residents of third states of legal entities established in a Contracting State with the main purpose to obtain the tax benefits deriving from the DTC between that State and another. In the OY AA case[65], recalling the Marks and Spencer precedent in the area of cross border losses, the Court accepted a combination of justifications between the principle of territoriality and the risk of avoidance. Indeed the possibility for a non-qualified company to benefit from the refund provided by the DTC would undermine the system of allocation of the power to tax between the Contracting States. On the side of the prevention of tax avoidance such a possibility entails the risk that purely artificial arrangements may be created in State B with the only purpose to benefit from the refund.

27. Finally we must recall the need to guarantee the effectiveness of fiscal supervision, since, given the absence of exchange of information under the relevant DTC, it would be really difficult, if not impossible, for State A to collect the necessary information in State B.

[64] C-376/03 D. v Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen.
[65] C-321/05 Hans Markus Kofoed v. Skatteministeriet.

### 4.1 – If a discrimination exists, it is proportionate to the objective envisaged

28. While indicating the justifications applicable to the present case, we must bear in mind the proportionality test that is carried out by the Court, as a third step, once it recognizes the existence of a justification under the rule of reason.

29. With this respect we strongly claim that the LOB clause at issue is absolutely proportionate to the declared aim of tackling the issue of treaty shopping practices and does not go beyond what is necessary to attain it. Indeed it constitutes the less restrictive ways of the Treaty's freedom in order to avoid the abusive conducts of the States which are not part of the applicable DTC.

Therefore, we claim that the LOB provision at issue does not constitutes a discrimination prohibited under Article 63 TFEU. In a subordinate order, we claim that, even if such a discrimination would deemed to exists, it is still justified under the so called rule of reason and it is absolutely proportionate to the aim of tackling abuses.

30. We now aim to prove that Closed Skies do not fulfill the requirements under the Protocol annexed to the DTC in force between A and B. In particular Closed Skies is not a '*qualified person*' as requested by paragraph 2 nor satisfies the provision of paragraph 3 and 4.

## *5. Paragraph 2 of the Protocol*

31. The provision under paragraph 1 of this Protocol provides that a resident shall be entitled to the benefits under this Convention if it is a '*qualified person*'. Paragraph 2 states that in order to be a '*qualified person*' a company must comply with the requirements there stated. In particular, a direct link between the company and the Contracting State is required. Then we have to analyze the shareholders structure of the company under exam.

## 5.1 - Clause i) and ii) of Subparagraph c)

32. As Closed Skies' principal class of shares is not traded in any stock exchange of the Contracting State, the fulfillment of the provision under paragraph 2, clause i) of the subparagraph c) is automatically excluded. Looking at the structure of shareholders it is also pacific that at least 50% of Closed Skies is not owned by five or fewer companies entitled to benefits under clause i) of this subparagraph. Therefore it cannot be a '*qualified person'* under the clause ii) provision.

## 5.2 - Subparagraph d)

33. To demonstrate that Closed Skies does not fulfill the requirements set for by the provision of subparagraph d), we need to bring a more wider argument. In particular, we want to demonstrate that Closed Skies does not have that direct link to the Contracting State due to its structure of shareholders. In fact this clause provides that at least 50% of Closed Skies' shares must be, directly or indirectly owned, by an individual or a company or other person. Even if the 40% of the Company is directly owned by Mr. Mark Schweps, none of the remaining shareholders is eligible under the provision set for in paragraph 2), clause i) of subparagraph c), as they are all companies.

34. The point is that the clause under exam provides for a different treatment for direct ownership (in our case company Vest&Gards and Emsland-Sharp) and indirect ownership (company Fin Caps Glow through its holding Daily Nail Company). None of the direct owner is resident in one of the Contracting States. In this case it is clear that Closed Skies is not eligible to be a 'qualified person' as the 50% rule is not fulfilled.

35. We can reach to the same conclusion as for as the indirect owner. In fact in this case the intermediate is not in one of the Contracting States as stated in the provision. Secondly, Daily Nail Company's shares are not listed in stock exchange as the same provision requires.

36. In particular we also assume that this kind of provision is not against with the ECJ view on the free movement of capital (Article 63 TFEU). In order to demonstrate this, we need to examine the notion of '*discrimination*'. Discriminations consists of dissimilar treatment in comparable

situations, i.e. differentiation in comparable situation[66]. Differentiation based on objective criteria is permissible, but any unjustified difference of treatment constitutes discrimination. Both direct and indirect discrimination are prohibited. Tax treaties are designed primarily to eliminate, or at least restrict, international juridical double taxation. And moreover, the elimination of juridical and economic double taxation within the Community is, as already pointed out, a Community objective. Tax treaties concluded for this purpose must, under EU law comply with internal market requirements on non-discrimination and the four basic freedoms laid down in the Treaty establishing the EU[67].

37. We aim to demonstrate that this provision under this Protocol is not in breach of free movement of capital set in Article 63 TFEU by an exam of some ECJ cases.

Firstly in Schumacher[68] case, the ECJ held that, regarding direct taxes, the situation of residents and non residents is not, as a rule, comparable. As a matter of fact, non-residents are subject to limited tax liability. This results from the fact that the State where the capital is invested has only a limited sovereignty in the field of taxes compared to the taxpayer's residence State[69].

38. In the D case[70], a German national resident in Germany owned a real estate in Netherlands. That ownership made D liable for Dutch wealth tax with respect to his Dutch real estate. However , he was not allowed to benefit from a general exemption accorded to residents of the Netherlands. That, in itself, was not so serious given the fact that a non-resident, having only a portion of his assets in the Netherlands, was not in the same tax position as a full resident of the Netherlands. However, there was a tax treaty between the Netherlands and Belgium pursuant to which a Belgium resident owning a real estate in the Netherlands would be granted the general exemption. The ECJ ruled that the Belgian resident and the German resident were not in the same situation. The reasoning was based on the fact that the Netherlands did not negotiate a tax treaty with Germany covering the wealth tax issue, whereas the Netherlands and Belgium had specifically covered the issue in a tax treaty.

[66] ECJ, 19 October 1977, Case C-117/76, Albert Ruckdeschel & Co. and Hansa-Lagerhaus Ströh & Co. v. Hauptzollamt Hamburg-St. Annen (1977) ECR 1753, at 1778 (Advocate General).

[67] Ec Law and Tax Treaties, Workshop of Experts, July, 5, 2005.

[68] ECJ, 27 June 1996, C-107/94.

[69] Dr Dennis Weber, Drs Etienne Spierts, *The 'D Case': Most-Favoured-Nation Treatment and Compensation of Legal Costs before the European Court of Justice*, European Taxation, February, March 2004.

[70] ECJ, Case C-376/03, C-298/13, 13 November 2003.

39. The Court took the view that the benefits of DTCs are inherently intended only to be applied to residents in the two M.S. For the ECJ there is no reason to extend that credit to persons resident in a third M.S. who are not protected by a favourable provision in a DTC. Thus, according to the ECJ, it is not discriminatory for the Contracting M.S. to limit the benefit of a DTC to its own residents. Granting residents of third countries the benefit of a DTC would be tantamount to granting Most Favoured Nation (hereinafter also 'MFN') treatment or a 'free ride' to third country residents.

40. In the D case the ECJ acknowledged that national tax regulations, concerning the free movement of capital in which distinctions are made on the basis of taxpayer's state of residence, may be consistent with Community law as long as they are justified on the grounds of overriding reasons of general interest, such as the need to preserve the coherence of the tax system. However, under Article 65 (3) TFEU, this may not constitute an arbitrary discrimination or a disguised restriction of movement of capital and payments. Therefore, whether the restriction of the movement of capital, tax payer, as a result of not allocating a basic allowance to a non-resident taxpayer can be objectively justified by an overriding reason of general interest is something that needs to be examined[71].

41. Therefore, the next step is to examine the Most Favoured Nation clause (hereinafter also 'MFN'). This is in general associated with non-discrimination of non-residents and with liberalization of international trade, but does not usually concern direct taxes, unless the treaty expressly states so.[72] Within the GATT, the MFN clause (Art. 1 (1)) means that any advantage, favour, privilege or immunity granted by any Member of the WTO to any product originating in or destined to any other Country, shall be accorded immediately to the like product originating in or destined to the territories of all the other WTO Members, without any conditional reciprocal benefits. As mentioned before, the D judgment makes it clear that no MFN clause applies between EU[73] M.S.

42. Another starting point is the Gilly case in which the ECJ was requested to determine the compatibility with EC law of certain provisions of DTCs between France and Germany dated. The

[71] ECJ, 6 June 2000, C-35/98, Verkooijen.

[72] Borges and Infant Mota, 'National Report Portugal', WTO and direct taxation, hrsg. M. Lang, Herdin, Hofbauer and Wien (2005), p. 570; P. Infante Mota, O Sistema GATT/OMC (Coimbra, 2005), p. 114.

[73] K. Vogel, D. Gutmann, A. P. Dourado, *Tax treaties between M. S. and Third States: 'reciprocity' in bilateral tax treaties and non-discrimination in EC law*.

Gilly case may be referred to for two propositions: firstly, EC M. S. may conclude DTCs based on the OECD Model conventions on income and wealth (paragraph 24). Secondly, differentiation based on nationality is not necessarily tantamount to discrimination under the EC Treaty.

43. As indicated by the ECJ in Columbus Container[74] in the absence of any unifying or harmonization measures, M.S. retain the power to define, by treaty or unilaterally, the criteria for allocating their powers of taxation, particularly with a view to eliminating double taxation by means of international agreements.

44. We must also recall the position held by the Court in ACT Class IV[75]. In particular, the UK Advance Corporation Tax[76] presented a number of issues involving a possible violation of Article 49 and 63 TFEU. The ACT , was a system whereby a UK corporation was paying a tax with respect to dividends distributed to its shareholders, who then benefited from a tax credit. That tax, deemed to have been paid by the corporation on behalf of its shareholders, was available as tax credit to the shareholders. Unless specifically authorized under a DTC, the ACT system also enabled corporations subject to UK income tax to waive the payment of ACT on dividends paid to recipient corporations resident in the UK. Such a dispensation was not, however, permitted where the corporate shareholder was not a resident of the UK. In ACT Class IV the Court concluded that there was no discrimination mainly because there was no comparability between UK shareholders, on the one hand, and foreign non-resident shareholders, on the other hand ( paragraph 58 and 59)[77]. The UK has no control over the ultimate treatment of foreign shareholders. It follows that the UK, as a source state, has no obligation to grant a tax credit to a foreign resident with respect to outbound dividends[78].

45. Therefore, the decision of State A tax authority to deny the tax refund is not in breach of EU law because Closed Skies does not fulfill the requirements under paragraph 2 of the Protocol.

[74] Case C-298/05, Columbus Container Services BVBA v. Finanzamt-Biele/eld Innestadt, (2007) ECR I-10451, paragraph 28.

[75] Case C-373/04, Test Claimants in Class IV of the ACT Group Litigation.

[76] From now on ACT.

[77] E. Osterweil, '*Are LOB Provision in Double Tax Conventions Contrary to EC treaty Freedoms?*', EC Tax Review 2009/05.

[78] T. O'Shea, '*Limitation on Benefit (LoB) clauses and the EU part I', International Tax Report* (2008), 1.

## *6. Paragraph 3 of the Protocol*

46. We want to examine now the existing relation between the companies Closed Skies and Fogglia to demonstrate that there is no relation between their activities and also between the part of dividend distributed from Fogglia and Closed Skies' activities.

47. In particular, paragraph 3 states that a resident, even if not a 'q*ualified person'*, can be entitled to the benefits of the Conventions with respect to an item of income derived from the other State, if the resident is engaged in the active conduct of a trade or business in its resident State and the part of income originated from the other Contracting State is derived in connection with that business.

48. We strongly deny that the dividends distributed by Fogglia to Closed Skies are connected with Closed Skies' activity. In order to demonstrate that, we suggest the exam of the activities of the two companies under the arm's length principle. It put associated and independent enterprises on a more equal footing for tax purposes, it avoids the creation of tax advantages or disadvantages that would otherwise distort the relative competitive positions of either type of entity[79].

49. The two companies are manufacturers of a similar kind of product, however there is no connection in the production of the two goods. Both companies did not modified the production process: in particular, it is important to note that the sales of Closed Skies's products in State A through Fogglia were charged at a price higher than to independent customers, because there is no direct Connection between the two companies.

### 6.1 Profit split method

50. As Closed Skies sold products to Fogglia, we assume that they used the profit split method. The profit split method first identifies the profit to be split for associated enterprises from the controlled transactions in which the associated enterprises are engaged. It splits those profits

[79] See paragraph 1.7 of the 1995 OECD Guidelines.

between the associated enterprises on an economically valid basis that approximates the division of profits that would have been anticipated. The contribution of each enterprises is based upon a functional analysis and valued to extent possible by any available external market data[80]. In this way Closed Skies already received the price of the sales in a first moment allowing us to exclude that the profit distributed by Fogglia in the form of dividends can be considered connected to Closed Skies' activities in its State of residence. According to the OECD Guidelines[81], the profit split method is one of the profit method that respect the arm's length principle[82]. This demonstrates the will of the two Companies to keep the two activities independent.

51. Therefore we argue that the dividends received by Closed Skies from Fogglia are not connected to Closed Skies business, thus excluding the applicability of paragraph 3 in order to obtain tax benefits under the Convention.

## 7. Legitimacy of the tax representative rule

52. Domestic rule of State A requiring appointment of a tax representative could be pled as being restrictive, unjustified under European law, and also potentially unenforceable in case of conflict with special and non waivable rules provided by a bilateral tax treaty, the latter being unsuitable to determine and justify a denial of a tax refund due under the relevant clauses thereof. However, we hereby argue that a rule as that of State A is clear as to its application to non residents *whenever* they want to claim *any* tax benefit.

53. In particular, pursuant to the above broad wording we could not ignore non compliance of the Applicant's request with the rule, that being not presented by a resident fiscal representative, but directly by the taxpayer represented by a lawyer of State A, not formally designated as tax representative.

54. Thereby, it follows that our denial was the result of a mere application of the domestic rule, as being applicable for refunds against *any claim*, that covering also the Applicant's claim and

[80] R. Franzè, *Transfer Pricing and Distribution Arrangments: From Arm's Lenght to Formulary Apportionments of Income*, Intertax, Volume 33, Issue 6/7 2005.

[81] 1995 OECD Guidelines.

[82] R. Franzè, *Transfer Pricing and Distribution Arrangements: From Arm's length to Formulary Apportionments of Income*, Intertax, Volume 33, Issue 6/7.

needed for purposes of reaching effectiveness of fiscal supervision and or preventing tax avoidance in either granting or not the claimed refund.

55. The fundamental obligation of the tax representative under State A's law, is to liaise between the non-resident taxpayer and the national tax administration.

56. However, within such procedural requirement, State A encloses a manifold series of functions that are always needed for purposes of letting the whole national tax system work properly.

57. The requirement of a tax representative for non resident taxpayers of State A effectively refers to further functions such as that of ensuring guarantee or collection of taxes due under the State of source, that not making up a comparable situation with resident taxpayers of State A.

58. In this regard, in *Truck Centre* (C-282/07), the ECJ held that national rules processing through a series of different modalities as to collection of taxes between residents and non residents may be deemed as admissible under EU law, that being due to non comparability of circumstances existing in respect thereof.

59. In particular, with reference to the claim of discriminatory treatment between resident and non resident recipients of interest, the ECJ noted that discrimination arises only when identical situations are treated differently and different situations are treated in the same way. As a rule, the situations of residents and non residents are not comparable, so a difference in treatment cannot, in itself, be deemed discriminatory. The ECJ considered this to be the case for the difference in the treatment with respect to Belgium's imposition of withholding tax on non resident companies but not on resident companies.

60. Further, in a recent holding (Haribo C-436/08) the ECJ held that "*in order for national tax legislation [...] to be compatible with the provisions on the free movement of capitals, the difference in treatment must concern situations which are not objectively comparable or be justified by an overriding reason in the public interest*"[83].

[83] See, *inter alia,* C-319/02 Manninen at § 29; C-512/03 Blankaert at § 42; and C-487/08 Commission v. Spain at § 47.

61. In light of the above reasoning it is clear how further functions and modalities for collection of taxes through appointment of a tax representative, as provided for by national rule of State A, may be justified under EU law, being it non comparable with residents hanging in the same context, and yet deemed proportional to the aims pursued (*i.e.* effectiveness of fiscal supervision and prevention of tax avoidance).

62. In case of comparability, the statutory rule at issue could effectively be deemed as discriminatory for non resident taxpayers of State A. However, adoption thereof is justified for ensuring both effectiveness of fiscal supervision by State A and prevention of tax avoidance[84] with respect to non resident taxpayers.

63. It is Article 63 of the TFEU that while guaranteeing abidance by the freedom of movement of capitals, being it to be understood as generally forbidding any restriction to the internal market of the European Union, saves certain specific exceptions that may effectively be justified on the above grounds.

64. In support thereof, the ECJ case law has established that the free movement of capitals may be restricted only by national rules which are *justified* by reasons referred to in Art. 63 TFEU or by overriding requirements of general interest[85].

65. Therefore, we were not in the position to entrust a mere legal representative of X with the essential role, our national law attributes to tax representatives. In this respect, it is the ECJ itself

[84] C-196/04 *Cadbury Schweppes*, §75.

[85] C-463/00 Commission v. Spain, , §68, and C-174/04 Commission v. Italy, §35, where the Court stated that *"in order to be so justified, the national legislation must be suitable for securing the objective which it pursues and must not go beyond what is necessary in order to attain it, so as to accord with the principle of proportionality*". Part of the general interest circumstances, not explicitly stated in the TFEU, have been established by the ECJ case law (see http://ec.europa.eu/internal_market/capital/framework/treaty_en.htm): '*Some examples: on services of general interest the Court acknowledged with regard to safeguarding the solvency and continuity of the provider of the universal postal service, 'that the guarantee of a service of general interest, such as universal postal service, may constitute an overriding reason in the general interest capable of justifying an obstacle to the free movement of capital' (see joined cases C-282/04 and C-283/04, Commission v. the Netherlands, §38, §39). Regarding the petroleum, telecommunications and electricity sectors, the ECJ has ruled, that 'it is undeniable that the objective of safeguarding supplies of such products or the provision of such services within the M. S. concerned in the event of a crisis may constitute a public-security reason…and therefore may justify an obstacle to the free movement of capital.' (case C-463/00, Commission v. Spain, §71). In joined Cases C-388/00 and C-429/00, Radiosistemi, §44 (for the free movement of goods), the Court found that 'It is true that the national type-approval for radio equipment is of such a nature as to be justified by considerations of public security and imperative requirements relating to the proper functioning of the public telecommunications network…*'.

that in its ruling Commission v. Portugal[86] included prevention of tax evasion and effectiveness of fiscal supervision, within the aforesaid general interest justifications/grounds that may be applied as rationales supporting national rules of M.S. in restricting the freedoms guaranteed by the European treaties[87].

66. We hereby wish to stress that though potentially discriminatory in dealing, *inter alia*, with the necessary collection of information from taxpayers, national rule of State A is justified on basis of the above grounds, which are suitable and proportional to the aims pursued. Such conditions reflect the jurisprudence of ECJ which, as to the assessing of validity of the above justifications that a M.S. should provide, while constraining the fundamental freedoms, has generally accepted those measures, if designed to guarantee achievement of a general interest and not exceeding the bounds of what is absolutely necessary.

67. The measure taken by State A is proportional to the aims pursued even if adopted by a M. S. of the EU. In this respect, State A could not pursue the said aims and satisfy the needs relating to exchange of information for non resident taxpayers of State A by application of tools and means provided for by the directives on mutual assistance. In fact such tools may not qualify and be sufficient in pursuing the said aims as to the effectiveness of fiscal supervision and prevention of tax avoidance.

68. Potential insufficiency of tools provided by the mutual assistance directives (77/799/EEC, which shall be repealed by directive 2011/16/EU effective as of January 1, 2013) has been upheld by the ECJ in case A[88] wherein the Court’s rationale was that if a national rule is provided and makes grant of a tax advantage dependent on satisfying the said aims, such rule may be legitimate to the extent that verification of achievement of the said aims *proves impossible otherwise* (i.e. the other tools are insufficient in respect thereof).

69. In light of the above, rule of State A does not overcome the said bounds, being it impossible otherwise, *inter alia*, to pursue clarity and collect basic information which we deem as crucial in evaluating claims of refunds presented by non resident taxpayers.

[86] C-267/09 Commission v. Portugal.
[87] C-267/09 Commission v. Portugal at § 41.
[88] C-101/05, Skatteverket v A;

70. A further argument is that the Applicant has not effectively proved that national rule of State A is detrimental. In general, a taxpayer who believes that a “normative” treatment by a M. S. in a cross border situation is less favorable that the treatment received by a similar taxpayer in a similar domestic situation should provide proof thereof[89]. A lack of proof by a taxpayer who does not provide in its request for refund any supporting argumentation whatsoever, as to an existing less favourable treatment due to the obligation to appoint a tax representative for refunds’ requests, fails to satisfy the above burden of proof. In respect thereof, domestic law of State A imposes the obligation to claim for tax benefits through a tax representative, but does not impose any sanction on this requirement, that showing clearly the absence of a detrimental treatment for nonresident taxpayers.

71. Lastly, we wish to submit to the Court’s attention that the DTC entered into between State A and State B in 2000, was structured, *inter alia*, as to reflect the normative framework existing in State A. Such framework already provided for the tax representative requirement as part of the national tax code, which was introduced a long time ago, and considered as an essential rule in collecting information from nonresident taxpayers. Pursuant to the above and because of the DTC exclusion of any reference to a specific clause on the exchange of information (such as that of Art. 26 of the OECD Model), compliance with the national rule at issue is essential to collect basic information and ensure effectiveness of fiscal supervision in State A.

72. Therefore, in light of the absence of a similar mechanism within the DTC, pursuant to the above non comparability between residents and non residents, and to the proportionality of the measure adopted as in connection with the aims pursued, we could not proceed otherwise than rejecting the Applicant’s request of refund.

[89] C-386/04 Walter Stauffer at § 47-50. In §95 of his opinion of January 13 2011, in Melicke II, Advocate General Trstenjak provides a summary on the issue of proofs:
*‘the question of which evidence (…) is admissible requires more than an abstract answer. Generally one may assume that the furnishing of proof (…) will become extremely difficult when (…) issued statements or certificates would never be accepted as evidence. That tax authorities may experience administrative inconveniences when verifying foreign evidence is not in this respect sufficient reason to, in general, refuse to accept such evidence. However, M S. are entitled to continue to insist that conclusive documentation be provided which would make it possible for the tax authorities to accurately assess whether the legal requirements (…) have been met’.*

### 8. *Conclusion*

73. Therefore, we strongly claim that the tax refund request presented by Closed Skies cannot be accepted; this is because Closed Skies neither fulfilled the ownership test provided for by the LOB clause contained in the Protocol, nor the tax refund request was presented by a resident tax representative as the Protocol required.

## V. TABLE OF ABBREVIATIONS

| | |
|---|---|
| DTC | Double tax convention between State A and State B |
| EU | European Union |
| ECJ | European Court of Justice |
| LOB | Limitation of benefits |
| M.S | Member State |
| OECD | Organization for Economic Co-Operation and development |
| TEC | Treaty of the European Community |
| TEU | Treaty on European Union |
| TFEU | Treaty on the functioning of the European Union |