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Annex A
The Articles of the OECD Model Convention
A Community perspective

Workshop of Experts

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INTRODUCTION

Some rules in bilateral conventions are inconsistent with Community law - cross-border situations are regulated by tax conventions on a bilateral basis without necessarily taking account of Community principles. This is because tax conventions have, until now, simply facilitated the apportionment of tax sovereignty between Member States without actually creating a supranational legal order. Convention law currently consists of a series of arbitration rules designed to put into effect the national tax legislation of the Contracting States. But simply referring to national laws which are incompatible with the Community legislation (primary or secondary) in cross-border situations will inevitably have repercussions on the application of the convention itself.

The Commission's 2001 study provides an overview, in Box 56,¹ of the provisions (based on the OECD Model) in Member State bilateral conventions which need to be adjusted in the light of the obligations of the Member States under the EC Treaty and European Court of Justice case law. The following discussion expands on that original analysis. It deals mainly with the tax treaties between Member States, but several suggestions could also concern the tax treaties concluded between Member States and third countries.

Preamble to the Convention

There is no standard formula for the preamble to conventions in the OECD Model, which refers to the constitutional procedures of the Contracting States.

It would be advisable for Member States to make explicit reference in the preamble to the objective set out in Article 293 of the EC Treaty of securing "the abolition of double taxation within the Community" for Community nationals.

Article 1 (persons covered)

Article 1 of bilateral conventions restricts the scope of the agreement to residents of the two contracting states (A and/or B). In a few rare cases, the scope *ratione personae* is even restricted to nationals of the Contracting States only.

The current wording of Article 1 of the OECD Model does not allow permanent establishments of enterprises of other Member States (C, D, etc.) operating in State A (or B) which are in a comparable situation to resident enterprises of State A (or B) to enjoy the provisions of the A-B treaty Article 43 ECT, however, prohibits restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State, while Article 48 ECT equates companies with their place of business in the Community to Member State nationals.

¹ SEC(2001) 1681 final, 23 October 2001, p. 377.

Article 2 (taxes covered)

Most bilateral conventions only cover income and wealth taxes. Only a few are extended to cover inheritance and gift taxes.

The EC Treaty applies to all taxes. Article 293 ECT requires Member States, so far as such action is necessary and cannot be derived from the Treaty's internal market provisions, to enter into negotiations with a view to eliminating double taxation within the Community². The almost complete absence of conventions on inheritance and gift taxes is a major impediment to the free movement of persons within the Community. Bilateral conventions should - or even must - also take account of the risk of double taxation arising because of a lack of coordination between Member States on tax and social security contributions.

Article 3 (definitions)

This Article contains the general provisions needed to interpret the terms used in the bilateral agreement. One of the definitions in the Article concerns the term "national", which means "any individual possessing the nationality or citizenship of that Contracting State".

Article 24 (non-discrimination) of the conventions between Member States following the OECD Model uses the term "national" as defined in Article 3. It states that persons possessing the nationality of one of the contracting parties may not be treated by the other contracting party any less favourably than its own nationals in respect of taxation.

Independently of the Court's eventual interpretation in cases which it is currently examining,³ it would be useful for tax conventions at any rate to spell out a Member State's obligation not to discriminate against Community nationals of other Member States who are in the same situation as its own nationals.

To establish more clearly that the conventions must uphold the prohibition of any discrimination on grounds of nationality, as stated in Article 12 ECT, Article 3 should specify that the word "national" means any natural (or legal) person who possesses the nationality (or is created in accordance with the law) of a Member State of the European Union.

The second paragraph of Article 3 states that any term not expressly defined in the convention shall be interpreted according to the meaning it has in the tax law of the Contracting States. A reference to Community tax law as the primary interpretative source could be included in this paragraph.

² However, the EC Court of Justice, in its judgment of 12 May 1998, Case. C-336-96 (*Gilly*), items 15-17, specified that Article 293 does not have *any direct effect*.

³ Possible application of the most-favoured-nation clause referred to in Cases C-376/03 (*D. v. Rijksbelastingdienst*) and (*E. Bujara v. Inspecteur van de Belastingdienst Limburg*).

Article 4 (resident)

The concept of “resident” defined in Article 4 determines the scope of conventions and helps solve cases of dual residence by specifying which of the Contracting States is fully entitled to tax that person under the convention, taking account of the taxable person’s personal circumstances. The Article stipulates that any (natural or legal) person who is liable to tax in that State “in respect only of income from sources in that State” cannot be regarded as a “resident of a Contracting State”.

The distinction between residents and non-residents made by this Article is fundamental, as international tax principle, to the sharing of tax competences. It is not necessarily incompatible with Community law.⁴ However, where Member States’ tax legislation makes no distinction between the treatment reserved for resident companies (including resident subsidiaries of non-resident companies), on the one hand, and permanent establishments of non-resident Community companies on the other, as regards, for example, liability to tax on dividend receipts from shares in foreign subsidiaries and sub-subsidiaries,⁵ the resident and non-resident subjects are in objectively comparable situations and should be able to enjoy the same benefits as national subjects, in particular those benefits which derive from the enforcement of tax conventions.⁶ Given that (a) the permanent establishment in one Member State of an enterprise situated in another Member State may not be less favourably taxed than the enterprises of the first State, (b) foreign source income in the form of assets and rights effectively connected with the activities of the permanent establishment is normally taxable in the country where the establishment is situated, and (c) the scope of the parent-subsidiary directive has been extended to permanent establishments,⁷ the expression “resident in a Contracting State” should also encompass permanent establishments whose actual head office is situated in the European Union.

Article 5 (permanent establishment)

Permanent establishment is a fundamental concept of international tax law. It helps determine a State’s right to tax the profits of an enterprise engaging in cross-border activity. There is no definition of permanent establishment in some Member States’ tax

⁴ “Even if the possibility cannot altogether be excluded that a distinction based on the location of the registered office of a company or the place of residence of a natural person may, under certain conditions, be justified in an area such as tax law ...” Case C-270/83 (*Commission v. France “Tax credits”*), point 19.

⁵ See Case C-307/97 (*Compagnie de Saint-Gobain*), point 47.

⁶ In the case of workers, the Court of Justice has ruled that, where there is no objective difference between the situations of a non-resident and a resident engaged in comparable employment such as to justify different treatment, Article 39 of the Treaty must be interpreted as precluding the application of rules of a Member State under which a worker who is a national of, and resides in, another Member State and is employed in the first State is taxed more heavily than a worker who resides in the first State and performs the same work there when the national of the second State obtains his income entirely or almost exclusively from the work performed in the first State and does not receive in the second State sufficient income to be subject to taxation there in a manner enabling his personal and family circumstances to be taken into account.

⁷ Directive 2003/123/EC, Article 1, which amended Article 1 in Directive 90/435/EEC.

legislation. Bilateral conventions often therefore serve as the sole legal point of reference. Yet the interpretation of this article in the OECD Model is far from consistent.⁸ Many States have actually departed from the Model. Consequently the right to tax a permanent establishment may vary considerably according to the nationality of the company to which the permanent establishment belongs.

Within the Community, determining whether a person should be regarded as "established" in a Member State other than the one where they engage in their principal activity not only helps in the division of taxation powers between the Member States concerned, but also allows the fundamental rights accorded to citizens and enterprises by Community law to be correctly applied. The internal market gives a Community enterprise the opportunity, without restriction, either to set up a branch in a Member State other than the one where it has its head office (Article 43 ECT) or to carry out its activities in one Member State from headquarters established in another Member State (Article 49 ECT). However, the exercise of either fundamental right will have inevitable consequences.⁹

Article 7 (business profits)

As the corollary to Article 5, Article 7 of the OECD Model deals with determining which profits of the permanent establishment are taxable in the host country. In principle, the right of the country of source to apply its own rules to the non-resident subjects is legitimate. Some States impose rules specific to permanent establishments relating to bookkeeping, the deduction of general expenses and/or losses which are in several respects more restrictive than the rules imposed on resident companies.

Articles 43 and 48 ECT prohibit all restrictions, whether direct or indirect, on the right of establishment. The Court has commented on the subject several times.¹⁰

In accordance with the Community law principle that permanent establishments be treated in the same way as resident companies, their income should be determined in the same way as for resident companies.¹¹

⁸ Several EU Member States (Spain, Greece, Italy, Portugal, Poland, Czech Republic and Slovakia) have entered reservations.

⁹ The way in which a Member State defines the expression "permanent establishment" - and which enables it to consider that a company of another Member State has such an establishment on its territory - exerts an influence on the delimitation of the extent of the fundamental right to the freedom to provide services. In other words, by defining the concept of permanent establishment freely, a Member State could have "the result of depriving Article 59 of the Treaty of all effectiveness, a provision whose very purpose is to abolish restrictions on the freedom to provide services of persons who are not established in the State in which the service is to be provided" (Case C-205/84, *Commission v. Germany*, point 52).

In the area of indirect taxation, the Court of Justice has already expressed its own views on the concept of "permanent establishment" in a number of judgments; see the Court's judgments of 17 July 1997 in Case C-190/95 (*ARO Lease*) and of 4 July 1985 in case C-168/84 (*Berkholz*) in relation to VAT, in which the Court states that the existence of a permanent establishment "entails the permanent presence of both the human and technical resources".

¹⁰ Judgments of the Court of 14 December 2000 in Case C-141/99 (*AMID*), 21 September 1977 in Case C-307/97 (*Saint-Gobain*) and 15 May 1997 in Case C-250/95 (*Futura*).

Article 9 (associated enterprises)

When a transaction takes place between associated enterprises under circumstances other than full competition, the tax authorities of State A are allowed to make certain adjustments when determining the profits of associated enterprise (a) established on its territory. At the same time, State B should make a corresponding adjustment to the profits of associated enterprise (b) in order to avoid economic double taxation.

Adapting taxation in one Member State to an adjustment made by another Member State is inherent in the principle of the internal market. The EU Member States confirmed this principle in a multilateral Arbitration Convention.¹² It would be advisable to include mention of or explicit reference to this Convention.

Article 10 (dividends)

When profits are distributed by company (a) to non-resident shareholders (b), they are taxed in the shareholders' country of residence (B) in the form of capital yields tax. However, under international law, the right to tax is not exclusive and State A, where company (a) is resident, may also deduct at source. The rate of tax and arrangements for its deduction are laid down by the convention.

Directive 90/435/EEC¹³ prohibits the State of the subsidiary to apply withholding tax on these dividends distributed to the parent company as defined in Article 3, para 1. The taxation of dividend distributions in the EU, even in cases which fall outside the scope of the Directive, must comply with the Community principles of non-discrimination, free movement of capital and freedom of establishment.

Since the rules in the convention cannot be contrary to or limit the scope of the Community Directive in question, the wording of Article 10 of the bilateral conventions should be brought into line with the Directive.

The Court has found that the failure to grant tax credits for dividends distributed to certain non-residents would constitute a discrimination prohibited by the Treaty.¹⁴

¹¹ The Commission's 2001 study suggests pro rata apportionment of the costs (and/or losses) between the entities concerned. In its *Futura* judgment, the Court of Justice confessed its perplexity regarding the effectiveness of this method for determining profits: "Given that the apportionment method involves inaccuracies, a Member State is not under any obligation to determine the taxable base for a taxpayer by means of that method alone" (C-250/95, point 42).

¹² Convention 90/436/EEC on the elimination of double taxation in connection with the adjustment of profits of associated enterprises: OJ L 225, 20.8.1990, pp. 10-24.

¹³ Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, OJ L 225, 20.8.1990, pp. 6-9.

¹⁴ Infringement of Article 43 ECT; see the Court's judgment of 28 January 1986, Case C-270/83 (*Tax credits*).

The Directive does not affect the application of the provisions of the convention aimed at eliminating economic double taxation (payment of tax credits to recipients of dividends). Some Member States do

A number of bilateral conventions contain provisions for bilaterally granting tax credits to recipients of dividends resident in other Member States.¹⁵ With no harmonisation of taxation of dividends in the internal market,¹⁶ the extension of a provision to this effect to the whole of the Community tax convention network would allow individuals in particular, who cannot apply the parent-subsidiary Directive, also to enjoy the internal market freedoms.

Article 11 (interest)

Article 11 in the OECD Model Convention stipulates that interest may be taxed by deduction on payment. The Article includes a definition of “interest” which has been adopted in the Community legislation too.

Directive 2003/49/EC¹⁷ provides for an exclusive right to tax interest in the beneficiary’s State of residence if the beneficiary is an associated company of another Member State. Article 11 in the conventions should be brought into line with the Directive.

Article 12 (royalties)

The OECD Model lays down the principle of exclusive taxation of royalties in the State where the beneficiary is actually resident. However, some EU Member States have not accepted this principle and consequently entered a reservation.¹⁸

The abovementioned Directive 2003/49/EC exempts royalties, as well as interest, from taxation in the State of source where the beneficiary is an associated company of another Member State.

Article 12 in the conventions should be brought into line with the Directive.

away with economic double taxation by granting a tax credit (corresponding in full or in part to the tax paid by the company on the distributed profits) to the recipients resident in those States of the dividends paid by a company domiciled there. However, this method of eliminating double taxation may not be applied in a discriminatory way. The Court has ruled that Article 56 and 58 ECT preclude legislation which limits the right of residents to obtain such tax credits where the dividends are distributed by Community companies which are not established in that State; judgment of the Court of 7 September 2004, Case C-319/02 (*Manninen*).

¹⁵ See Article 8(3) of the France-Luxembourg convention mentioned in the judgment in Case C-270/83 (*Tax credits*) or the Finland-Ireland convention referred to in the Advocate-General’s conclusions in case C-319/02 (*Manninen*).

¹⁶ See COM(2003) 810 final, 19.12.2003.

¹⁷ Council Directive of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, OJ L 157, 26.6.2003, p. 49.

¹⁸ Spain, Greece, Italy, Portugal, Czech Republic, Slovakia.

Article 13 (capital gains)

Arrangements for taxing capital gains vary considerably between OECD Member States. With that in mind, Article 13 of the Model restricts the right to tax to the State authorised to tax the ordinary income from the property from which the gain derives. The relevant provision gives no detailed definition of “capital gains” and refers to national legislation for determination of the time when tax actually becomes due in connection with the realisation of a gain.

The EC Treaty allows the Community’s citizens and enterprises the freedom to circulate within the EU and settle in another Member State without being penalised in consequence. On this point the Court of Justice has commented that taxing (unrealised) capital gains simply because the holder of securities in another Member State has transferred his/her tax residence¹⁹ – when transfers within the State of origin are exempt from such taxation – has a dissuasive effect on taxpayers wishing or having to establish themselves in another Member State and therefore represents discrimination by comparison with the treatment of taxpayers who maintain their residence in the State of origin.²⁰

Nevertheless, one cannot ignore the fact that the "exit taxes" that certain Member States apply at the moment of the transfer by the taxpayer of his residence abroad, respond to the real need to combat tax avoidance and tax treaty abuse. Bilateral conventions between Member States could identify a solution in keeping with the principles of the EC Treaty²¹ which would allow the State of departure to maintain the right to tax capital gains realised during the taxpayer’s period of residence in that State. The EC provisions on exchange of information could contribute to achieving this kind of solution.

Article 15 (income from employment)

Article 15 of the Model (income from employment) lays down the rule that employment is taxable in the State where it is actually exercised. This is not generally an exclusive tax

¹⁹ The legal meaning of Article 13 of the OECD Model Tax Convention is subject to debate. In particular, the view that this provision covers all forms of "exit tax" is far from unanimously accepted. Some authors consider that exit taxation constitutes a form of purely domestic taxation, outside the scope of the tax treaties. Other commentators, take the opposite view that this form of taxation is covered by tax treaties. Nevertheless, some of the latter invoke, as a relevant provision, not Article 13 of the OECD Model, but Article 21 (other incomes), owing to the fact that the capital gain subject to the exit tax is not yet realized. Consequently, under Article 21, the exclusive right to tax is given to the State of residence of the taxpayer. In this respect therefore, a common definition of the expression "capital gain" could improve, in the future, the free movement of capital in the Internal Market.

²⁰ Judgment of the Court of 11 March 2004, Case C-9/2002 (*de Lasteyrie du Saillant*).

²¹ For example, Member States could in principle agree rules for sharing taxation powers according to the length of the respective periods of residence in both States before the chargeable event giving rise to the gain, but include anti-abuse clauses to deal with specific situations. In the conclusions to *Lasteyrie* (point 64), Advocate-General Micho suggests, for example, that the tax authorities of the State of origin provide for tax on capital gains realised by a taxpayer who, after a relatively short stay in another Member State [which does not exercise – or exercises on a limited basis – its right to tax capital gains], returns to the original State of residence after having sold his/her shares.

right. The State of residence can also take employment income into account but must avoid double taxation by means of the methods described in Articles 23A and 23B of the Model. It may therefore simply exempt the income or allow the employee a deduction of an amount equal to the tax paid in the other State. However, this amount must not exceed the tax payable on the income in the country of residence.²²

Where a convention gives the country of employment exclusive right to tax – e.g. border workers in certain cases²³ – or the country of residence uses the exemption method to avoid double taxation, employees may find that they no longer receive a significant taxable income in their State of residence which is consequently not in a position to grant them personal and family allowances and the like. The Court of Justice has ruled that, in such cases, it is the country of employment which should grant the benefit of such allowances to avoid discriminating against non-resident workers whose situation is not objectively different to that of resident taxpayers engaged in comparable employment. Nevertheless the question arises of whether these jurisprudence principles should be explicitly incorporated in a Tax Treaty Model or, on the contrary, whether they should be considered as implicitly included (without the need for any specific or explicit formalisation).

Article 17 (artistes and sportsmen)

According to the OECD Model, artistes and sportsmen resident in a Contracting State are taxable in the Contracting State where they exercise their activity. This is an exception to the rules laid down in Articles 7 (business activities) and 15 (employment).

As in the case of cross-border workers, if such persons do not have a sufficient taxable base in their country of residence (because the convention gives the country where the activity is carried out exclusive taxation rights, or the country of residence uses the exemption method to avoid double taxation), they risk not enjoying the benefits which would result from their personal and family circumstances being taken into account. Taxation in the country of residence only could avoid this risk.

Moreover the Model makes no mention of how the income in question should be calculated. The Commentary to the Model (paragraph 10), however, explicitly mentions the possibility of taxation at source at a low rate based on the gross amount paid to artistes and sportsmen. The Court²⁴ noted that the Treaty precludes a national provision which “excludes the possibility for partially taxable persons to deduct business expenses

²² In *Gilly*, the Court of Justice ruled that this restriction was compatible with Community law.

²³ A number of tax conventions between Member States lay down exceptions to the rule of taxation in the country of employment for certain types of border worker, e.g. those resident in border districts or close to the border. See for example Article 13(5)(b) and (c) of the Germany-France Convention (20/30 km from the border). However, the problem might also be solved if Article 15 were worded differently, e.g. introduction of a general exception giving the country of resident the right to tax all cross-border workers would avoid problems within the Community.

²⁴ Judgment of the Court of 12 June 2003, Case C-234/01 (*Gerritse*), point 29. Mr Gerritse was wholly taxable in Germany on his income from German sources despite having no fixed base, pursuant to the provisions on artistes in the Germany-Netherlands convention (Article 9(2)).

from their taxable income, whereas such a possibility is granted to wholly taxable persons". A reference in conventions between Member States to national treatment of deductions of business expenses of non-resident artistes and sportsmen might clarify the rights of Community taxpayers who take advantage of free movement.

Article 18 (pensions)

According to the OECD Model, pensions paid in respect of private employment are taxable only in the State of residence of the recipient. In practice, however, alternative methods for allocating taxation rights exist.

There is no uniform approach to the taxation of retirement benefits within the Community. If a person earns their pension in a Member State which taxes contributions but exempts benefits (TEE system) and receives it in a State where, conversely, contributions are exempt and benefits taxed (EET or ETT systems), application of the OECD Model without any adjustments may lead to their pension being subject to double taxation in contravention of the Treaty.²⁵

As the Commission has already suggested,²⁶ double taxation arising from divergent tax rules on pensions can be avoided through the inclusion of provisions in double taxation conventions. The two countries might, for example, include a provision to the effect that pensions arising in Member State A and paid to a resident of Member State B may be taxed in State B, but that the amount of the pension not included in the income taxable in State A, if the recipient were resident in State A, would be exempt in State B. Such a provision would allow workers from a TEE country to retire to an EET country but not have their pension taxed there, but in their country of origin. Moreover, the inclusion of provisions intended to avoid abuses and situations of double "non-taxation" could be envisaged.

Article 19 (government service)

This Article applies to salaries, wages and other similar remuneration, and pensions in respect of government service. The provision is based on the principle of the paying State's exclusive right to tax such remuneration. The principle is also in conformity with the concept of international courtesy in the Vienna Conventions. There is one exception to the rule that the State paying the remuneration possesses the exclusive right to tax: the host State is normally authorised to tax remuneration paid by the other State to its nationals.

²⁵ According to the Court of Justice (Judgment of 11 August 1995, Case C-80/94, *Wielockx*), legislation in a Member State which allows its residents to deduct contributions to a pension reserve from their taxable income but denies that benefit to non-resident Community nationals (who receive almost all of their income in the first State), cannot be justified by the fact that the payments drawn out of the pension reserve by the non-resident are not taxed in the first State pursuant to the bilateral convention. On the contrary, since "fiscal cohesion" is secured by the bilateral convention, that principle may not be invoked to justify the refusal of such a deduction.

²⁶ Commission communication on the "Elimination of tax obstacles to the cross-border provision of occupational pensions", COM(2001) 214, 19.4.2001, points 20-21.

According to the Court of Justice, the differentiation between public-service remuneration and private sector salaries embodied by the provisions of the convention for the purpose of allocating powers of taxation cannot be regarded as constituting discrimination prohibited under Article 39 ECT.²⁷ The same applies to distinctions and exceptions based on nationality.²⁸

Article 20 (students)

According to Article 20, payments received by a student (or trainee) to cover education or training expenses in the other Contracting State may not be taxed in the State where the student is following his/her course unless they arise from sources inside that State. In practice, a grant paid to a student resident in country A for following a course in country B will be taxed in country B only if paid by a body in country B. However, if the grant in question is paid by a body based in country A (or in country C²⁹), it may not be taxed in country B. It could however be taxed in country A (or, where applicable, country C).

Most students, by definition, have limited economic resources and grants are often their only means. If the course followed abroad is a short course, they do not acquire the status of a tax resident of that country. Taxing the grant paid by a body in the host State, in accordance with the principle set out in the OECD Model, may therefore penalise students wishing to take advantage of the free movement guaranteed by the EC Treaty by comparison not only with students resident in the host Member State, but also with students of the State of origin who have chosen not to study (or train) in another EU Member State.³⁰

Taxation of these amounts, on the basis of the convention, in the country of residence rather than the host country might present a simple solution to the problem.³¹

²⁷ Judgment of the Court of 12 May 1998, Case C-336/96 (*Gilly*).

²⁸ *Gilly*, *op. cit.*, point 30: Although the criterion of nationality appears as such ... for the purpose of allocation of fiscal jurisdiction, such differentiation cannot be regarded as constituting discrimination prohibited under Article [39] of the Treaty. It flows, in the absence of any unifying or harmonising measures adopted in the Community context under, in particular, Article [293] of the Treaty, from the contracting parties' competence to define the criteria for allocating their powers of taxation as between themselves, with a view to eliminating double taxation.

²⁹ E.g. grants from Community institutions.

³⁰ Several Member States charge a flat-rate, proportional tax on non-residents' income of this type but do not allow any personal deduction of the taxable income.

³¹ In a recent decision (Judgment of 1 July 2004, Case C-169/03, *Wallentin v. Riksskatteverket*), the Court of Justice ruled, in line with established case law, that in a situation where the State of residence cannot take account of the student worker's personal and family circumstances because there is no liability for tax there, the Community principle of equal treatment requires that, in the State of employment, the personal and family circumstances of a foreign non-resident be taken into account in the same way as those of resident nationals and that the same tax benefits be granted to him.

Article 22 (capital)

Only some Member States charge taxes on capital, and only some of the bilateral conventions cover this type of tax. The OECD Model states that, in principle, the State which is entitled to tax the income from a given element of capital may charge this tax additionally on that same element. Consequently, the State whose resident owns the elements of capital is, in principle, entitled to levy tax on them exclusively. However, a number of major exceptions are allowed: immovable property, for example, is taxable in the State where it is situated. In this case, the State of residence (if it charges a tax on capital) is responsible for eliminating the double taxation.

The Court of Justice has not been called upon to rule as frequently on taxation of capital as it has on income tax,³² but the principles and observations on each category of income concerning compatibility with Community law also appear to apply to taxation of capital.

Article 23 (methods for elimination of double taxation)

Articles 23A and 23B of the Model Convention deal with ways of eliminating so-called juridical double taxation where neither of the Contracting States is given the exclusive right to tax by the treaty. It is up to the State where the taxpayer is resident to eliminate double taxation in this case. In conventions between Member States two different leading principles are followed: exemption and credit. Each method has its advantages and its drawbacks.³³ Note, however, that the Court has often challenged certain tax treaty provisions which specifically allow the source country to tax workers, without taking appropriate counter-measures, at the national or conventional level, to avoid any form of discrimination,³⁴ However, the Court has not raised objections in cases where the State of residence, using the credit method, has not allowed a full tax credit on income from abroad.³⁵

³² But see CJEC, Judgment of 13 April 2000, Case C-251/98 (*Baars*) and the case currently before the Court, C-376/03 (*D v. Rijksbelastingdienst*).

³³ Within the Community, the exemption method often seems preferable because it puts non-resident enterprises on an equal footing - for taxation purposes - with local enterprises. Since competition among multinationals is an important element of Community policy aimed at achieving greater economic efficiency, it follows that tax policy should not distort competition by discouraging the most efficient multinationals from establishing their production facilities in what would otherwise be the least-cost location (*Ruding Report*, point 36).

³⁴ See *Schumacker and Gerritse, op. cit.* In *de Groot* (C-385/00) judgment of 12 December 2002, the Court confirmed that *the Member States are at liberty, in the framework of bilateral agreements, to determine the connecting factors for the purposes of allocating powers of taxation.* However, the Court specifies that this exercise of the power of taxation must comply with the Community rules *and, more particularly, respect the principle of national treatment of nationals of other Member States and of their own nationals who exercise the freedoms guaranteed by the Treaty.* The State of residence must grant its own nationals who exercise EC Treaty freedoms all the allowances and other tax benefits (connected with the personal and family situation of the taxpayer) envisaged by national legislation. This, independently of the other advantages than these taxpayers could obtain (for example, the mechanism known as "salary split") by applying the principle of exemption laid down in the bilateral tax treaties.

³⁵ See *Gilly, op. cit.*

Some conventions between Member States³⁶ which adopt the credit method in order to eliminate double taxation allow the Member State of residence to grant its enterprises a notional tax credit (“tax sparing credit”) when the source State allows exemptions or temporarily reduces its taxes to encourage foreign investment.

At first view, a provision of this nature seems to constitute a state aid within the meaning of Article 87 ECT and its compatibility should be checked. It would be preferable not to include such provisions in tax agreements between Member States and to remove existing ones.

Article 24 (non-discrimination)

The provision on non-discrimination is generally included in all tax treaties in accordance with the OECD Model. It establishes the principle that discrimination on grounds of nationality is forbidden. The nationals of one Contracting State may not be less favourably treated in the other State. To qualify for this clause, both nationals and non-nationals must be placed in the same circumstances, “*in particular with respect to residence*”. Consequently tax benefits (personal deductions, tax reductions according to number of dependants) granted to residents by national legislation, cannot be claimed by non-residents on that basis even if their situation is otherwise comparable to that of a resident.

The Treaty (Article 12 and the other special provisions in the ECT) prohibits any discrimination on grounds of nationality. The Court of Justice has considerably broadened the scope of the prohibition, thus criticising any *indirect* discrimination on grounds of residence.

Article 24 in the conventions should reflect the fundamental non-discrimination principles of the Treaty. This implies that nationality and residence confer the same rights;³⁷ that, in special cases,³⁸ persons not residing in the Community may enjoy the same benefits as residents; that permanent establishments must be treated in the same way as resident subsidiaries;³⁹ that public institutions and non-profit foundations or bodies set up in one Member State qualify in Contracting Member States for the provisions of national legislation, i.e. exemptions or other benefits relating to inheritance or gift tax granted to similar national entities;⁴⁰ that provisions available to groups of companies within a Member State must also be applicable where one of the members of the group is resident in another Member State.⁴¹ In the context of free movement of

³⁶ E.g. Germany/Greece, France/Portugal and United Kingdom/Spain.

³⁷ See *inter alia* the Judgment of 14 February 1995, Case C-279/93 (*Schumacker*), points 28-29.

³⁸ Where the non-resident receives no significant income in the State of his residence and obtains the major part of his taxable income from an activity performed in the State of employment; Judgment of 14 February 1995, C-279/93 (*Schumacker*), points 36-37.

³⁹ See *inter alia* the Judgment of 28 January 1986, Case C-270/83 (*Tax credits*), points 19-20.

⁴⁰ See Case C-386/04 (*Centro di musicologia*), under examination.

⁴¹ See *inter alia* the Judgment of 16 July 1998, Case C-264/96 (*Imperial Chemical Industries*), point 30.

capital, this also implies that dividends distributed by companies resident in the Community must enjoy the same tax benefits as dividends distributed by national companies.⁴²

Article 25 (mutual agreement procedure)

For disputes involving the interpretation or application of a bilateral convention, the OECD Model proposes a mutual agreement procedure between Contracting States' tax administrations. Unfortunately, the procedure is not binding. States are therefore under no obligation to achieve a satisfactory outcome. Transfer pricing is the most frequent subject of disputes about the application of a bilateral convention (although other conflict scenarios can arise from the application of conventions).

The multilateral Arbitration Convention,⁴³ signed by all the Member States and based on Article 293 ECT, deals with the scenario of associated enterprises located in two different Member States who agree to offer each other greater commercial or financial advantages than would normally exist between independent enterprises. Its aim is to eliminate cases of double taxation which arise when an enterprise in one Member State has its profits adjusted on account of commercial and financial advantages which it receives from an enterprise in another Member State which it controls or belongs to.

It is inconceivable from the Community perspective that only a non-binding procedure is available to resolve differences in interpretation of the provisions of tax conventions governing the taxation of cross-border profits. This leads to an increased risk of double taxation or, at the very least, uncertainty, which is likely to affect the proper operation of the internal market. This Article must be amended to reflect the provisions of the Arbitration Convention and to allow Community nationals access to a binding procedure for settling disputes which are not related to transfer pricing. In line with the example set by the Austria-Germany tax convention, the Court of Justice should be enabled to arbitrate in all disputes arising in connection with the implementation of a bilateral convention (or conventions, in a triangular dispute) between Member States. The question arises, however, whether Article 239 constitutes a relevant and appropriate legal basis to grant this kind of power of arbitration to the Court of Justice.

Article 26 (exchange of information)

The Article in the OECD Model contains rules for the exchange of information with a view to ensuring the most appropriate implementation possible of the domestic laws concerning taxes covered by the tax treaty.

⁴² See the Judgments of 6 June 2000 in Case C-35/98 (*Verkooijen*) and of 15 July 2004, Case C-315/02 (*Lenz*).

⁴³ Convention 90/436/EEC on the elimination of double taxation in connection with the adjustment of profits of associated enterprises: OJ L 225, 20.8.1990, pp. 10-24.

The Community has a directive which provides for mutual assistance between Member States in the field of direct taxation.⁴⁴ This legal instrument incorporates and reinforces the provisions of the existing conventions between Member States.

The directive explicitly states that it will not impede the fulfilment of any wider obligations. On the other hand, more limited obligations in relation to the exchange of information are automatically replaced by the relevant provision of the directive.

Explicit reference should at least be made to the mutual assistance directive which takes precedence over the provisions of the convention.

Another possibility would consist of the removal of this article.

Article 27 (assistance in the collection of taxes)

This Article sets out the rules by which Contracting States may agree to provide each other assistance in the collection of taxes.

Most conventions between Member States do not yet include this Article which was only recently introduced in the OECD Model. However, there are provisions of Community law which already oblige Member States to provide each other assistance in the collection of taxes,⁴⁵ and these should be mentioned and – where possible – extended on a bilateral basis in tax conventions between Member States.

Another possibility would consist of the removal of this article.

⁴⁴ Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation (OJ L 336, 27.12.1977, pp. 15-20).

⁴⁵ See Council Directive 76/308/EEC of 15 March 1976 on mutual assistance for the recovery of claims relating to certain levies, duties, taxes and other measures, and Commission Directive 2002/94/EC of 9 December 2002 laying down detailed rules for implementing certain provisions of Council Directive 76/308/EEC.