European and International Tax Moot Court Competition - 2008/2009

Memorandum for the applicant
Memorandum for the defendant

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Marzo 2009
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.


I paragrafi A e C (escluso il punto 3) del *Memorandum for the applicant* sono stati redatti dalla dott.ssa Federica Pitrone.

I paragrafi B, C.3 e D del *Memorandum for the applicant* sono stati redatti dalla dott.ssa Livia Ventura.

I paragrafi da 1 a 5 del *Memorandum for the defendant* sono stati redatti dal dott. Luca Giancola.

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MEMORANDUM FOR THE APPLICANT

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ECJ, case C-446/03, Marks & Spencer;
ECJ, case C-374/04, Test Claimants in Class IV of the ACT Group Litigation;
ECJ, case C-513/04, Kerckhaert-Morres.
III STATEMENT OF FACTS

Mr. A is a resident of an EU Member State X. Mr. A is holder of a savings account held in the branch office of bank M in third (non-EU) country Z. Bank M is established with HQ in Member State Y. The interest is paid out to Mr. A through bank M’s branch office in third country Z, because Mr. A has a trading office in country Z through which he performs his trading activities in Z and the trading office keeps an account on A’s name with the office of bank M in Z. The same account is used for all business activities of Mr. A in Z, but the interest received in this account from savings is in no way connected to Mr. A’s business activities in country Z. The interest on the savings account is paid by the branch office of bank M to the savings account in the name of Mr. A and this payment is recorded in the accounts of the branch office.

At the occasion of a routine tax audit in December 2008 of the HQ of bank M the tax administration of Member State Y, finds out that there are several such arrangements in place in bank M, whereby interest payments due in Member State Y are made payable to resident beneficiaries of other EU Member States through the bank’s branch office in third country Z. The tax administration of Member State Y takes the position that bank M should have withheld the special withholding tax of 20% under the directive on the interest paid out to Mr. A on its savings account through its branch office in third country Z. In addition the tax administration of Y also claims the ordinary withholding tax of 10% (as reduced under the tax treaty between Member State Y and Member State X) on the interest payments, because it takes the position that the interest payment represents interest income paid by a person resident in Member State Y to a beneficiary in Member State X. Therefore the tax administration imposes an assessment for both withholding taxes on bank M in Member State Y. Bank M pays both withholding taxes on behalf of Mr. A as debtor of the interest payment, but at the same time files a protest against the assessment and claims reimbursement of the two withholding taxes from Mr. A in Y. The litigation between bank M and the tax administration of Member State Y is still pending before the tax tribunal of first instance, without any decision.

In filing his tax return for 2008 in April 2009 Mr. A claims credit for the withholding tax applied in Z and the ordinary and the special withholding taxes assessed in Member State Y. The tax administration of Member State X refuses the tax credit for the ordinary withholding tax and the special withholding tax in Y on the grounds that the payment of interest was made
through the office of bank M in third country Z and therefore withholding tax was only due in Z and not in Y.
IV ISSUES

The present case involves many juridical questions and topics that can be summarised as follows:

1. PRELIMINARY RULING TO THE EUROPEAN COURT OF JUSTICE

   1.1. The necessity of the ruling
   1.1.1. Question raising in a case pending before a court against whose decisions there is no judicial remedy.
   1.1.2. Question has not already been answered in an earlier judgment of the Court of Justice.
   1.1.3. Question proposed has not yet been answered in the case law of the Court of Justice.
   1.1.5. Necessity for giving judgment in that pending case.

   1.2. The correct interpretation of Art. 4 of the ESD
   1.2.1. The real paying agent is situated in State Y and not in State Z.
   1.2.2. The ESD is applicable and the withholding taxes in State Y are fair
   1.2.3. State X must grant the tax credit.

   1.3. The wrong interpretation of the ESD breaches Art. 56 ECT on free movement of capital
   1.3.1. Unresolved problems of double taxation.
   1.3.2. Two different states of source.
   1.3.3. Restriction to the free movement of capital.

   1.4. Free movement of capital and its exceptions
   1.4.1. Contents and application.
   1.4.2. The unjustified breaches.

   1.5. The absence of any unifying or harmonising Community measures
   1.5.1. The power of Member States to define criteria for allocating their powers
of taxation eliminating the double taxation phenomena.

1.5.2. The harmonization in direct taxation and the elimination of double taxation

1.5.3. European directives for the elimination of double taxation.

2. THE OBBLIGATION OF STATE X TO GRANT THE TAX CREDIT FOR THE ORDINARY WITHHOLDING (10%) AND THE SPECIAL WITHHOLDING (20%) TAXES ASSESSED IN MEMBER STATE Y

2.1. The applicability of the European Savings Directive in the case at hand

2.1.1. The territorial scope of the ESD

2.1.2. The concept of “Paying Agent”

2.1.2.1. Art. 4(1) of the ESD

2.1.2.2. Concept of “payment of interest”

2.1.2.3. The “passive role”

2.1.2.4. Luxembourg tax administration approach

2.1.2.5. The UK guidelines

2.1.3. Branch is not a separate entity.

2.1.4. Interests are in no way connected to the business activities in country Z.

2.1.5. Yet again the paying agent

2.1.5.1. Interpretative problems

2.1.5.2. Report from the Commission to the Council

2.1.6. The application of art. 14 ESD and the duty for State X to grant the tax credit

2.2. The Good Faith of the taxpayer and the undeserved enrichment of State X

2.3. The necessity of the tax credit for the ordinary withholding tax

2.3.1. The general criteria of OECD-MC

2.3.1.1. OECD-MC as a soft law instrument

2.3.1.2. Criteria of Art. 11 OECD-MC

2.3.2. Two different States of source

2.3.2.1. No solutions in Art. 11

2.3.2.2. The application of two different treaties by State X
2.3.2.3. The tax credit for both the withholding taxes levied by state Y and Z.

3. THE NECESSITY OF THE ELIMINATION OF DOUBLE TAXATION EVEN WITHOUT THE APPLICATION OF THE ESD

3.1. Double Taxation Principle
   3.1.1. Art. 293 of the ECT
   3.1.2. Limit of states’ tax jurisdiction
V ARGUMENTS

A) General remarks on method

1. The purpose of the present work is to demonstrate, at first, that the interpretation of the *European Savings Tax Directive*\(^1\) as provided for by Member State X breaches Art. 56 of the European community Treaty\(^2\). Secondly, that the Tax Administration of Member State X breaches Art. 14 of the ESD and the X-Y Treaty for the elimination of double taxation, that follows the latest OECD Model Convention\(^3\), in refusing the tax credit for the ordinary withholding tax and the special withholding tax (pursuant to art. 11 of ESD) in Member State Y, on the grounds that the payment of interest was made through the office of bank M in third country Z and therefore withholding tax was only due in Z and not in Y.

2. The main purpose of this paper is to demonstrate that the request of Mr. A claiming credit for the ordinary (10%) and the special (20%) withholding taxes assessed in Member State Y is legitimate.

3. This demonstration is possible analyzing two different fields. At first, Community law and, in particular, the ESD. In fact, what this work wants to demonstrate is that Member State X is obliged to grant Mr. A the tax credit for the special withholding tax on the grounds of the application of the ESD in Member State Y, and, in particular, according to Art. 14 of the ESD.

4. Secondly, we will analyze International tax law and, in particular, article 11, par. 5, of the OECD Model and its Commentary. Through this article, we are going to demonstrate that State X is obliged to grant Mr. A also the ordinary withholding tax assessed in Member State Y.

5. It is necessary to stress, from the outset, that denying the right of Mr. A to the tax credit at issue subjected the taxpayer to an heavier tax burden than the one imposed on interest originated in State X.

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\(^1\) Hereinafter: ESD.
\(^2\) Hereinafter: EC Treaty, or ECT.
\(^3\) Hereinafter: OECD-MC.
6. At first Mr. A sought annulment, before the highest court of Member State X, of the decision of the State X tax administration rejecting his request of tax credit for the ordinary and the special withholding tax in Member State Y, alleging the infringement of Article 56(1) of the ECT.

7. The behavior of State X in rejecting the request of Mr. A for the tax credit related to the withholding taxes of State Y is contrary to the free movement of capital, because in this way we have a multiple taxation on the same income. This is the reason why the claimant ask to this highest Court of State X a preliminary ruling to the European Court of Justice\textsuperscript{4} in accordance with Art. 234 ECT.

8. After the demonstration that the application of the ESD as provided for by State X breaches the free movement of capital, the applicant will also demonstrate that the special withholding tax in State Y is due because the ESD is applicable in the case at hand, so the tax credit connected with the special withholding tax at the rate of 20%, must be granted by State X to Mr. A.

9. The credit for the special withholding tax is due because of art. 14 of ESD according to which “The Member State of residence for tax purposes of the beneficial owner shall ensure the elimination of any double taxation which might result from the imposition of the withholding tax referred to in article 11...”.

10. Having shown that the tax credit connected to the special withholding tax is due, we are going to demonstrate that State X must however grant the tax credit for the ordinary withholding tax levied by State Y because of the X-Y Treaty against double taxation. In fact, applying it, State Y has to be considered as the Source State and according to the double taxation convention, State of residence (X) must grant the tax credit. The fact that in our situation there are two source States is not a problem. In fact, State X is obliged to grant the credit for both the withholding taxes by his treaties with State Y and State Z.

11. At the end of this paper we are going to underline that even if the Directive were to be considered not applicable in the case at hand, State X should however grant the tax credit

\textsuperscript{4} Hereinafter: ECJ.
because of the general principle and the general commitment of States to the avoidance of international double taxation besides the application of the general criteria of the OECD-MC for the attribution of taxation power between States.

**B) Preliminary ruling to European Court of Justice**

1) The necessity of the ruling

12. The claimant asks to this highest Court of State X a preliminary ruling to the ECJ, in accordance with Art. 234 ECT, on the interpretation of the ESD.

13. We believe that this preliminary ruling must be permitted by this Court as we are in front of the highest Court of this Country and according to article 234(3) EC Treaty, a court is under the obligation to refer a preliminary ruling where a question relating to the interpretation or validity of Community law is raised in a case pending before a court or tribunal of a Member State against whose decisions there is no judicial remedy.

14. Moreover, according to the “Acte éclairé” doctrine, the highest Court is under an obligation to refer the ruling if the question that has arisen has not already been answered in an earlier judgment of the Court of Justice. In fact the authority of an interpretation already given by the court may deprive the obligation of the purpose of the ruling and thus empty it of its substance. Such is the case especially when the question raised is materially identical with a question which has already been the subject of a preliminary ruling in a similar case. In respect to the ruling we are proposing there is not any answer from the ECJ.

15. So according to the “Acte clair” doctrine this highest Court is obliged to refer the ruling to the ECJ because the question proposed has not yet been answered in the case law of the Court of Justice.

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5 See ECJ, Case C- 6/64, Costa/ENEL.
16. Finally another problem is that the contents of the ESD is not really easy and clear for the interpreter so there can be reasonable doubts on its interpretation. The preliminary ruling must also be granted because it is necessary for giving judgment in the case at hand.

2) The ruling

17. For all the reasons we have already explained we require the following preliminary ruling to the ECJ.

18. First of all, in order to prove that the withholding tax in State Y was due, we ask to the Court a preliminary ruling to clarify that the correct interpretation of Art. 4 of the ESD is the one we propose (as we shall see later), the one in which the real paying agent is situated in State Y and not in State Z. Consequently the ESD is applicable, the withholding taxes in State Y are fair, and State X must grant the tax credit “for any foreign withholding taxes paid on foreign sources interest”, as its internal legislation requires. Only in this way there would be no restrictions to the free movement of capital.

19. In fact, Art. 4 contains a definition of paying agent according to which paying agent is any economic operator who pays interest, whether is the debtor of the debt or the operator charged by the debtor. But, in the case at hand there is a particular situation caused by the subjects involved. We must analyze, in fact, the relations between a bank and its branch, underlining that the branch has no legal personality. Consequently, all the legal relationships shall be analyzed looking at the relations between the Head Quarter of the bank and each single customer. So the definition laid down in Art. 4 must be interpreted as referring to the paying agent as the debtor, that in the case at hand is the bank M Head Quarter, and not the branch in State Z.

20. If the Directive is not interpreted in this way, we believe it is incompatible with Art. 56 EC Treaty because it creates unresolved problems of double taxation. In fact the special withholding tax system, as described in art. 11 and the following of the ESD, modifies the international general criteria for the attribution of taxation powers between Member States in relation to the
elimination of double taxation within the Community. These criteria are provided in the double taxation conventions, generally based on the OECD-MC, where the legal right to tax is attributed to the Resident State. Consequently, the Source State can apply a withholding tax on the same income only within certain limits (better specified in each treaty).

21. According to the ESD provisions, there are different criteria to determine the source of the income. In fact enforcing the Directive’s criteria laid down in Art. 4 (where the paying agent could be any economic operator who pays interest, whether the operator is the debtor of the debt or the operator charged by the debtor with paying interest) there can be two different States of Source: the State of Residence of the Debtor and the State of Residence of the Paying Agent. In addition to these States of Source we must also consider the State of Residence of the taxpayer. Each of these three States - State of Residence of the Debtor, State of Residence of the Paying Agent and State of Residence of the Taxpayer - can impose a tax on income. In this way the same foreign income can be subjected to a multiple taxation without any Directive’s provision for its elimination.

22. This creates an evident restriction to the free movement of capital between EU and Third States. We are dealing about the only European freedom also applicable towards no Member States. In this way, with the restriction to the movement of capital, for European citizens it is not convenient to transfer their capital abroad.

23. The ESD, as it is, has a restrictive effect on the movement of capital, in that it constitutes an obstacle to the transfer of capital out of the Residence State. Interests arising abroad of state X receives less favourable tax treatment than interests deriving from savings account in a bank established in State X, so banks established in other Member States are less attractive to investors residing in X than banks which have their seat in that Member State.

24. Now we are going to analyze the free movement of capital and its exceptions.

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7 For similar situation in which there is a restriction see ECJ, Case C-35/98 *Verkooijen*, paragraph 35; ECJ, Case C-334/02, *Commission v. France*, paragraph 24.
3) The free movement of capital and its exceptions

25. Free movement of capital is at the core of the Single Market and is one of its 'four freedoms'. It enables integrated, open, competitive and efficient European financial markets and services.

26. The full liberalization of capital movements in the EU was agreed in 1988 with the Directive 88/361/EEC and came into effect in 1990 for most Member States, while for the rest specific transitional periods were agreed. The liberalization of capital movements accompanied the development of Economic and Monetary Union and was eventually enshrined in Maastricht Treaty, which came into force in November 1993.

27. The EC Treaty provides that all restrictions on capital movements and payments, both between Member States and between Member States and third countries, are prohibited. This principle is directly effective and it requires no further legislation at either EU or national level.

28. Art. 58(1) EC Treaty provides for some exceptions to the free movement of capital both within the European Union and with third Countries. These are primarily linked to taxation, prudential supervision, public policy considerations, money laundering, and financial sanctions agreed under the Common Foreign and Security Policy.

29. In case C-446/03, Marks & Spencer, the ECJ underlined that “a restriction is permissible only if it pursues a legitimate objective compatible with the Treaty and is 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 pursued and not go beyond what is necessary to attain it”.8

30. The application of these exceptions is connected and it is subject to the proportionality principle, so every time we need to verify if the measures adopted by states are necessary to reach the scopes pursued and if the same scopes could be pursued with less restrictive provisions for the movement of capital. However, the last paragraph of art. 58 ECT provides that “the measures and procedures referred to in paragraphs 1 and 2 shall not constitute a

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8 To that effect see Case C-250/95 Futura Participations and Singer, paragraph 26, and Case C-9/02 De Lasteyrie du Saillant, paragraph 49.
means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 56."

31. For example in case C-319/02 Manninen⁹, we can draw from the ECJ decision that whilst, for State X, granting a tax credit in relation to withholding tax on interest due in another Member State would entail a reduction in its tax receipts in relation to interests arising in other Member States, it has been consistently held in the case-law¹⁰ that reduction in tax revenue cannot be regarded as an overriding reason in the public interest which may be relied on to justify a measure which is in principle contrary to a fundamental freedom.

32. We believe that, in the case at hand, the breach of the free movement of capital is not justified having regard to Art. 58 of the EC Treaty. In that respect, it should be noted, as ECJ underlines in case Manninen¹¹ that Article 58(1)(a) of the EC Treaty, which, as a derogation from the fundamental principle of the free movement of capital, must be interpreted strictly, cannot be interpreted as meaning that any tax legislation making a distinction between taxpayers by reference to the place where they invest their capital is automatically compatible with the Treaty.

33. The derogation in Article 58(1)(a) EC Treaty is itself limited by Article 58(3) EC Treaty, which provides that the national provisions referred to in Article 58(1) shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 56 EC Treaty.

34. As the ECJ has pointed out in case Test Claimants in Class IV of the ACT Group Litigation¹² in the absence of any unifying or harmonising Community measures, Member States retain the power to define, by treaty or unilaterally, the criteria for allocating their powers of taxation, particularly with a view to eliminate double taxation¹³.

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⁹ ECJ, Case C-319/02.
¹⁰ See for example ECJ, case C-35/98, Verkooijen, paragraph 59; ECJ, case C-136/00 Danner, paragraph 56.
¹¹ ECJ, Case C-319/02, Manninen, paragraph 28.
¹² ECJ, C-374/04, Test Claimants in Class IV of the ACT Group Litigation, paragraph 52 and 54.
¹³ Similary : ECJ, C-336/96, Gilly, paragraphs 24 and 30; ECJ, 307/97, Saint-Gobain, paragraph 57.
35. The mere fact that it is for the Member States to determine whether, and to what extent, a series of charges to tax and economic double taxation are to be avoided and, for that purpose, to establish, either unilaterally or through Double Taxation Conventions concluded with other Member States, procedures intended to prevent or mitigate such a series of charges to tax and that economic double taxation, does not of itself mean that the Member States are entitled to impose measures that contravene the freedoms of movement guaranteed by the EC-Treaty.

36. In the European Union system the different States should try to approximate their fiscal policies in order to respect and promote the European Common Market. This approximation is conducted by States even if there are no specific provisions in EC Treaty for the harmonization in the field of direct taxation.


38. The goal of this directives was also, in connection with the harmonization of direct taxation, the elimination of the double taxation phenomena. This purpose is obtained by avoiding the taxation of the same income in two different countries in order to promote the Common Market and the European freedom within the EU.

39. In the case at hand we are dealing about taxation of saving income, a field falling in the application of the Council Directive 2003/48/CE. Consequently we can at least underline that there is an incentive to the harmonization and so also to the elimination of the double taxation phenomena.

40. At the outset it must be also pointed out that, although direct taxation falls within the competence of the Member States, the latter, according to settled case-law, must none the less exercise that competence in a manner consistent with Community law\(^\text{15}\).

41. In conclusion we assert that the preliminary ruling is necessary because from the right interpretation of the ESD depends the right solution of the case at hand.

42. In the next paragraphs we are going to explain how the ESD can be correctly interpreted for avoiding the violation of Art. 56 EC Treaty.

**C) The obligation of State X to grant the tax credit for the ordinary withholding (10%) and the special withholding (20%) taxes assessed in Member State Y**

43. As we have already said, the purpose of this paper is to demonstrate that the request of Mr. A claiming credit for the ordinary (10%) and the special (20%) withholding taxes assessed in Member State Y is legitimate, according, broadly speaking, to the ESD and article 11, par. 5, of the OECD Model.

44. For reaching these goals, our work is going to demonstrate, at first, the application of the ESD in the case at hand.

**1) The applicability of the European Savings Directive in the case at hand**

**1.1. The territorial scope of the ESD**

45. At first, it is worth noting that the territorial scope of the Directive is described by art. 1(2) and art. 7 of the ESD.

\(^{15}\) In this sense see ECJ, case C-264/96 ICI, paragraph 19; ECJ, case C-311/97 Royal Bank of Scotland, paragraph 19; ECJ, case C-35/98 Verkooijen, paragraph 32; ECJ, case C-315/02 Lenz, paragraph 19; ECJ, case C-319/02 Manninen, paragraph 19; ECJ, case C-513/04 Kerckhaert- Morres.
46. According to art. 1(2) of the ESD: «Member States shall take the necessary measures to ensure that the tasks necessary for the implementation of this Directive are carried out by, paying agents established within their territory, irrespective of the place of the establishment of the debtor of the debt claim producing the interest».

47. Moreover, Art. 7 of the ESD, describing the territorial scope of the ESD, states that: «the Directive shall apply to interest paid by a paying agent established within the territory to which the Treaty applies by virtue of Article 299 thereof».

48. The crucial point of these two articles is the concept of “paying agent established within their territory”, which means nothing more than the territory of the EU Member States.

49. Broadly speaking, the territorial scope of the ESD is limited to paying agents established within the territory of the EU Member States\textsuperscript{16}. So, in the case at hand, interests paid by paying agents established in the non EU country Z are not covered by the ESD.

50. Since the duty to exchange information or to levy a withholding tax depends on the definition of paying agent, having clarified the territorial scope of the ESD, for reaching our aim is necessary to demonstrate that, in the case at hand, the paying agent is established in Member State Y.

51. Let us start with the definition of 	extit{paying agent} as laid down in the ESD.

1.2. The concept of “Paying Agent”: a difficult but crucial term

52. The definition of 	extit{paying agent} is provided in Art. 4(1) of the ESD. In particular, according to the latest draft of the ESD the “paying agent” is any economic operator who pays interest to or secures the payment of interest for the immediate benefit of the beneficial owner, whether the operator is the debtor of the debt claim by the debtor or the beneficial owner paying the interest or securing the payment of interest. The explanatory Memorandum on the 2001 ESD proposal\textsuperscript{17} explains that a “paying agent” can be the debtor of the interest, any agent acting on behalf of


\textsuperscript{17} Explanatory Memorandum on the 2001 ESD proposal, \textit{OJ} 270 E, 25 September 2001, Comments on Art. 4 (1).
the debtor, or any agent collecting the interest on behalf of the beneficial owner. In particular, “paying agent” means the last intermediary which pays interest directly to, or secures the payment of interest for the immediate benefit of, the beneficial owner18.

53. In our understanding Art. 4(2) of the ESD is useless in the case at hand, because, as indicated in the statement of facts, we are not in the situation of an entity established in a Member State to which interests is paid or for which interest is secured for the benefit of the beneficial owner.

54. When there is a plurality of intermediate operators, as in the case at hand, it is difficult to determine the last operator established within the Community charged with the payment. In this situation, the meaning of payment in art. 4(1) of the ESD is decisive19.

55. It is worth noting that, the ESD does not define the concept of “payment of interest” but it is commonly understood that this concept demands an “active role”. So, paying agents who have only a “passive role”, such as acting on instruction of others, or whose intervention is of an auxiliary nature, are not paying agents within the meaning of Art. 4(1) of the ESD20.

56. According to the statement of facts, the subjects involved in the case at hand are a bank and its branch, which is a permanent establishment21 located in a non EU country.

57. It is important to underline that, the concept of PE and its role in international taxation are rapidly gaining importance, especially in the growing globalized commercial environment. PE plays a pivotal role in international taxation in that it provides the basis for countries to extend their taxing jurisdiction over multinational enterprises operating outside their countries of residence.

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21 Hereinafter: PE.
58. The definition of PE is provided for by Art. 5 of the OECD Model. Art. 5 of the OECD Model considers two different types of permanent establishments. The first type, the “fixed place of business permanent establishment”, arises from the basic definition of permanent establishment in Art. 5(1), which refers to “a fixed place of business through which the business of an enterprise is wholly or partly carried on”. In requiring the existence of a “fixed place of business”, the first part of the definition incorporates both a geographical requirement (i.e. that a fixed physical location be identified as a permanent establishment) and a time requirement (i.e. that the presence of the enterprise at that location be more than merely temporary, having regard to the type of business carried on). The second part of the definition simply requires that at least part of the business activities of the enterprise be carried on at the relevant location.

59. The basic definition of PE is supplemented by the rule of Art. 5(5) that deems a non-resident to have a permanent establishment in a country if another person acts in that country as an agent of the non-resident and habitually exercises an authority to conclude contracts in the name of the non-resident (the “agency permanent establishment”). That rule, however, does not apply to independent agents acting in the ordinary course of their business.

60. Having clarified the definition of PE, it is worth noting that PE has no legal personality. For this reason, financial flows between a branch and its Head office do not represent payment from a juridical perspective.

61. This in mind, it is important to analyze the behaviour of some Member States as regards these statements.

62. For example, Luxembourg, which is known as one of the biggest European financial State and which has implemented the special withholding tax on interest payments due under the EU interest-savings directive, stated in its guidelines on the ESD, that “lorsqu’une banque n’intervient que de façon purement passive, elle n’est pas considérée comme agent payeur. Ceci peut etre le cas si la banque ne remplit que la function de banquet dépositaire ou si elle ne transfère que des intérêts”.

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63. In other words, according to Luxembourg tax administration, banks which have no active role, or which have the function of depositary banks or which only transfer interests, cannot be considered as paying agents.

64. Moreover, UK guidelines on ESD state that “a bank or similar institution does not therefore make a payment merely by issuing or sending a cheque, or arranging for the electronic transfer of funds on behalf of one of his customers. Equally, a bank or similar institution does not secure a payment merely by clearing a cheque, arranging for the clearing of a cheque, or receiving an electronic transfer of funds on behalf of one of its customers”

65. In conclusion, for determining a paying agent it is necessary to look at the final recipient and go back in the chain to last person to pay him his money, except that if this is a mere bank account, with no other active involvement, then it would be the person in the chain just before that.

66. In the case at hand, the office of bank M in third (non EU) country Z from savings is a branch that we cannot consider as a separate entity. In fact, treating branches of international banks as separate entities ignores economic reality. In particular, the developments in information and communications technologies have enabled international banks operating globally through branches to function as highly integrated businesses. Thus, it is inappropriate and a serious theoretical weakness to treat a branch of an international bank as a notional separate entity when it is really one part of a unitary bank operating for a common profit purpose.

67. The branch in Z, which is not a separate entity, acts on the instructions of the legal payer, which is generally considered as the debtor who owes the interest under private law, in other words the HQ in Y. In conclusion, the payment is made by bank M’s non EC branch office in Z to Mr. A only economically and for corporation tax purposes, but legally it is made by the EC-established bank M.

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24 Saving Income reporting guidance Notes V 5, 30 June 2006, cit., par. 23.
68. Moreover, it is worth noting that there is no economic link between the interest paid to Mr. A and Mr A’s business activities in country Z.

69. In fact, even if Mr. A has a permanent establishment in country Z through which he performs his activities in Z and the interest received from savings is paid through bank M’s branch office in Z, that interest is in no way connected to Mr. A’s business activities in country Z. In conclusion, there is no connection at all between the interest paid to Mr. A and country Z.

70. These are incontrovertible evidences of the passive role of the branch office in Z in the payment of the interest to Mr. A. So, the branch office in Z is only a depositary bank and not a paying agent within the meaning of Art. 4(1) of the ESD.

71. In conclusion, the paying agent is the HQ of bank M established in Member State Y and, being an EU Member State, the ESD is applicable. So, Member State Y could withhold the special withholding tax of 20% on the interest paid out to Mr. A on its savings account through its branch office in third country Z.

1.3 Another visual angle of the concept of paying agent

72. If the Court considers insufficient what has been said since now, it is worth noting that, the concept of paying agent in the ESD causes lots of interpretative problems\(^\text{28}\), because the interpretation that the reading of the text suggests at first sight, as written above, gives the opportunity to taxpayers to circumvent the Directive.

73. Generally speaking, it is well known that since 1988 efforts have been made in the European Union to coordinate the taxation of savings income between the Member States, introducing a package aimed at tackling harmful tax competition. In fact, fighting tax evasion on income arising on cross-border investments has been an EU objective ever since capital movements were liberalized by Council Directive 88/361/EEC of June 24, 1988. Considering tackling tax evasion the most important aim of the Directive, it is weird or even unreasonable that it is the Directive itself to give the opportunity of tax avoidance.

74. Moreover, it is worth noting that, the ECJ has repeatedly held that «Community law cannot be relied on for abusive or fraudulent ends» 29. The Court has also made it clear that Member States are entitled to take measures designed to prevent such abuses of Community law. The ECJ refers to abuses of Community law, in other words all sources of Community law, i.e. the EC Treaty, Directives and Regulations and international agreements entered into by the Community. The burden of proving that there is abuse of Community law is incumbent on the party invoking it. Proving an abuse of law is to a large extent factual. So it is for the national Court to determine, on a case-by-case basis, whether there is a fraudulent or abusive conduct on the part of the economic operator who seeks to take advantage of provisions of Community law 30.

75. Over the years the ECJ has developed a concept of abuse of Community law in matters of direct taxation and of illegitimate tax avoidance 31.

76. The ECJ case law is the key that can be used for saying that the general principle of abuse of Community law can enlarge the concept of paying agents as laid down in art. 4(1) of the ESD.

77. In fact, according to a literal interpretation, the provision of the ESD could easily be avoided by routing interest payments through paying agents that are not residents of the EU. This is an evident problem that can be easily solved through the recognized 32 broad concept of “paying agent”.

78. In particular, we have to consider, as some Member States tax administrations have stated 33, that when an EU paying agent routes a payment through a third country for the benefit of an EU resident, the payment is within the scope of the ESD.

79. In fact, if the ESD wants to have any force within the European Union it shall be on the basis of the application of the principle of “substance over form”. Otherwise, operators could escape the

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29 ECJ, Halifax plc et alia, C- 255/02, par. 68; ECJ, Fini, C-32/03, par. 32; ECJ, Kefalas, C-367/96, par. 28.
30 ECJ, Centros Ltd, C-212/97, par. 25; ECJ, Brenett v. Paletta, C-206/94, par. 25.
Directive migrating out of the European Union in legal form only whilst continuing to perform the core paying agency activities within the European Union. This would clearly frustrate the intention behind the ESD\textsuperscript{34}.

80. Even a recent report from the Commission to the Council in accordance with Article 18 of Council Directive 2003/48/EC on taxation of savings income in the form of interest payments stated that “it would be worth clarifying the responsibility of the EU economic operators when they are aware that an interest payment made to an operator established outside the territorial scope of the Directive is made for the benefit of an individual, known by them to be a resident of another EU Member States and who can be considered their customer”.

81. So, according to the “substance over form” principle, on which, in our perspective, the ESD has to be based upon, in the triangular structure of the case at hand the branch in Z is not the real paying agent and the payment is within the scope of the ESD.

82. It is necessary to underline that our aim is not to demonstrate that the trading activities of Mr. A in Z are not effective, but that, broadly speaking, for reaching the aims of the ESD, is necessary to consider a triangular situation, as the one laid down in the case at hand, within the scope of the ESD.

83. Consequently, in the case at hand, the paying agent is the HQ of Bank M established in Y. For this reason, the Member State Y could apply the ESD and withheld the special withholding tax of 20\% on the interest paid out to Mr. A on its savings account through its branch office in third country Z.

2) The application of art. 14 of the European Savings Directive and the duty for State X to grant the tax credit for the withholding tax paid in State Y

84. As we have seen so far, the ESD is applicable and consequently the bank M fairly withheld the special withholding tax of 20\% under the Directive on the interest paid out to Mr. A on its savings account through its branch office in third country Z.

\textsuperscript{34} D. NEWTON and A. KAZIMI, The savings directive, cit.
85. Obviously, the ESD is applicable *in toto*, and, in particular, for reaching our aims, we want to underline the applicability of art. 14 of the ESD.

86. In fact, this article requires that the Residence State of the beneficial owner shall ensure the elimination of any double taxation which might result from the imposition of the special withholding tax. In particular, the Residence State of the beneficial owner has to prevent double taxation by crediting the withholding tax against his individual income. If the source State withholding tax exceeds the beneficial owner’s income tax exposure in respect of the interest, his home State must refund the excess.

87. It is clear that, according to art. 14 of the ESD, there is an obligation of State X to grant the tax credit for the special withholding tax paid by Mr. A in State Y. Otherwise the tax administration of State X would violate art. 14 of the ESD.

3) The Good Faith of the taxpayer and the undeserved enrichment of State X

88. Another important element that we want to analyze is a general principle. In particular, on the grounds of what has been said since now, there is an important consideration to do: the legitimacy of the application of the ESD can never be a problem of the taxpayer. In fact, it is evident that the directive had been applied and the taxpayer have had an heavy taxation.

89. The taxpayer has just exercised the European freedoms guaranteed by the European Community Treaty, he is in good faith, and he is wrongly subjected to a multiple taxation without any kind of relief.

90. The applicant promotes his action against the Residence State X because, as ECJ asserts, it is generally a matter for the home state to relieve the juridical double taxation. So an unlawful withholding tax has not to be reimbursed only by the state that levy such tax, but this is a matter for the State of Residence of the taxpayer and in the case at hand is State X that must grant the credit.

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35 See ECJ, C-513/04, Kerckhaert-Morres.
91. Moreover, art 12 of the ESD provides that “Member States levying withholding tax in accordance with Article 11(1) shall retain 25 per cent of their revenue and transfer 75 per cent of the revenue to the Member State of residence of the beneficial owner of the interest”. So State X has the 75 per cent of a withholding tax considered wrongful and at the same time refuse to grant the credit.

92. Moreover, the applicant believes that State X has got an undeserved enrichment from the transfer of the 75% of the euro-withholding tax paid in State Y and for this reason has to give a reimbursement for the revenue received from a tax that the same State X maintains unlawfully levied.

93. The problem of the unlawful application of the Directive is a problem between states, that does not affect the taxpayer. States can, and maybe has to, resolve it through a mutual agreement procedure in accordance with art. 25 of OECD-MC.

4) The necessity to grant the tax credit for the ordinary withholding tax by Member State Y and the 5% withholding tax applied by the non EU country Z.

94. As we have already said, we are going to demonstrate that State X must recognize to Mr. A the tax credit also for the ordinary withholding tax of 10% levied by State Y according to the general provisions of the OECD-MC, and, in particular, art. 11(5) of the OECD-MC.

95. In order to achieve this goal we will refer to the OECD-MC as the main example of double taxation convention containing the general criteria for the attribution of tax jurisdiction between States in relation to the elimination of double taxation.

96. Taxation cannot be unfair and unjustified. The OECD-MC try to give a solution to this problem. There is not an international principle of double taxation avoidance but we must consider the OEDC-MC as a soft law instrument.
97. Also at the European level, ECJ pointed out that\(^{36}\), in the allocation of fiscal jurisdiction, it is not unreasonable for Member States to base their agreements on international practice and the model convention drawn up by the OECD.

98. Considering the OECD-MC as a soft law principle means that\(^{37}\) “at least some form of a “soft” obligation must, therefore, be derived from the recommendation of the Council: the OECD Model Convention must be applied.”.

99. In the OECD-MC, there are generally accepted international tax law rules of taxation priority. Usually the taxation right is given to the Residence State but the Source State has the right to tax the same income into certain limits. The consequent juridical double taxation is to be relieved by the residence state, that can choose whether and how it wishes to provide such relief by using the exemption or the credit method as described for example in art. 23a and 23b of the OECD-MC.

100. Art. 11 of OECD-MC provides that interest arising in a contracting state and paid to a resident of the other contracting state may be taxed in that other state, but however “may also be taxed in that contracting state in which it arises, but if the beneficial owner of the interest is a resident of the other contracting state, the tax so charged shall not exceed 10 per cent of the gross amount of the interest”. So interests are taxed in the state of residence of the beneficial owner and in the state in which they arise.

101. In the case at the hand, the right to tax is not exclusive, so interests arising in a Contracting State and paid to a resident of the other Contracting State may be taxed by both State of Residence, State X in the case at hand, and State of Source, Y. Consequently the State of Residence, (X), must give relief to avoid the double taxation.

102. The applicant considers as the “state in which they arise” the state of Residence of the debtor, so Member State Y, because generally in the relationship between the head quarter of a bank and its branch every kind of juridical relation is related to the head quarter and not to the

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\(^{36}\) ECJ, C-336/96, Gilly, paragraph 30-31; ECJ, C-307/97 Saint-Gobain, paragraph 57; ECJ, C-513/04, Kerckhaert-Morres, paragraph 32; ECJ, C-376/03, D paragraph 50-53.

\(^{37}\) K. Vogel, 45.
branch. So in the case at hand the relationship of Mr. A is not with the M’s branch in Z but it is directly with the M’s head quarter in Y.

103. For this reason state X should consider fair the taxation of Mr. A’s income in state Y and should grant the tax credit to avoid the double taxation according to art. 23b of OECD-MC.

104. Art 23b of the OECD-MC provided that where a resident of a Contracting State derives income or owns capital which may be taxed in the other Contracting State, the first-mentioned State shall allow as a deduction from the tax on the income or tax on the capital of that resident, an amount equal to the tax paid in that other State.

105. Consequently State X should grant a credit for every tax paid abroad. It is not important the fact that in this way no possibility would remain for state X to defend its fiscal sovereignty from taxation levied by foreign states.

106. The problem in the case at hand, is that there are two different States of source, the Member State Y where the payer, bank M, is resident and the non EU country Z where the payer has a PE through which it made the payment of the interests to Mr. A, who is resident in another member State X.

107. The OECD Model Commentary to art. 11 paragraph 5 does not give any solution to this kind of problem.

108. Interests are considered as arising in state Y where the debtor is resident as the general rule in the first sentence of art. 11(5) of the OECD Model provides. Consequently, interests are taxable in state X, the state of Residence of Mr. A, and in state Y the state of Residence of the debtor, following the provision of the X-Y treaty.

109. As we have already said before, the branch office in Z has only a passive role, and it can be considered only a transition place for the interests. According to this interpretation, the debtor is bank M which is resident in Member State Y.
110. So, according to our perspective, the X-Y treaty is applicable and Member State Y could apply the ordinary withholding tax of 10%.

111. The problem is that, having two States of source, also the treaty between Member State X and third country Z, the State in which the debtor has a branch, is applicable. In this way also the Country of the PE, state Z, can apply a withholding tax on the interests.

112. Member State X has two different treaties and, according to their provision, the source of the interest is in two different states\(^\text{38}\). The State of Residence of the recipient must apply both treaties at the same time (X-Z and X-Y) and must grant a tax credit ex art. 23 OECD for both the withholding levied by state Y and Z.

113. So, it is obvious that State X will be obliged to give the relief for both the withholding taxes charged by state Z (5%) and Y (10%) because both are levied in accordance with the provision of art. 11 OECD\(^\text{39}\).

**D) The necessity of the elimination of double taxation even without the application of the Interest Savings Directive**

114. If the Court believes that the ESD directive is not applicable in the case at hand, here the applicant wants to demonstrate that the taxpayer who has paid multiple taxes on the same income, on the interest originated from a foreign savings account in State Z with the branch office of Bank M in Y, has however the right to the tax credit in State X.

115. This multiple taxation on the same income is wrongful not only because breaches the European free movement of capital but it is also wrongful because it infringes the general principles of double taxation.

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116. In the next paragraph we are going to briefly analyse this topic.

1) The Double Taxation Principle

117. The problem we are dealing with is about the attribution of the power of taxation between Member States in relation to the elimination of double taxation. Normally, at the international level, this kind of problem is solved with the conclusion of double taxation conventions between Member States.

118. Also the EC Treaty provides for avoidance of double taxation within the Community, this is one of the objectives of the Treaty. In fact, art. 293 of the European Community Treaty provides that Member States shall, so far as is necessary, enter into negotiations with each other with a view to securing, for the benefit of their nationals, the abolition of double taxation within the Community. Even if the ECJ underlines that this provision is not directly effective, however is an objective of the ECT, and states must try to follow it.

119. As we have already said, we know that the avoidance of double taxation can not be considered as one of the international recognized general principles, that no rules of international law exist to limit the extent of any country’s jurisdiction and that similarly no rules exist to require a country to grant relief from international double taxation, but the solution to the problem of the elimination of double taxation however is an important purpose for every country especially in this period in which the progress of the globalization affects every aspect of the life, it affects every kind of market, from the financial to the property market. In this situation, it is easy for people to reach every country with their activities and their investments. The fiscal system must take into consideration this situation and has to try to do not put obstacles to the use and the evolution of instruments of modern life by the citizens of the world.

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40 K. VOGEL, Der raumliche Anwendungsbereich, 197.
41 M. NORR, Jurisdiction to tax and international income, in Tax law review, 1962, 431.
120. As Norr said\textsuperscript{43} the fact that no principles of international or even constitutional law require relief to be given does not mean that relief is generally denied. The necessities of commercial and fiscal co-existence and a decent self-restraint, often grounded in considerations of administrative convenience, have led the nations of the world voluntarily to limit the scope of their tax jurisdiction.

121. For this reason it is necessary for States to conclude and fulfil agreement against double taxation following the OECD-MC even if there is not a customary international law principle of double taxation avoidance and the OECD-MC is just a soft law instrument (as we have already said).

122. Even if we are not dealing about a customary international law principle, we are however dealing about a principle which is at the base of all the international tax law. Every kind of treaty that States conclude is oriented to the elimination of double taxation.

123. The elimination of double taxation is an important goal for States because it represents the element that leads people, the taxpayers, to the execution of activities, business, job and financial transactions abroad.

124. In fact, over the last decades economies have increasingly become globalized and business models have changed as a consequence of, inter alia, the intense growth of the service sector and international capital markets and the development of electronic business\textsuperscript{44}. The increased mobility of capital facilitates investments in foreign capital markets and the movement of income from such investments across national borders\textsuperscript{45}.

125. So, the double taxation avoidance is not recognize as a general international principle but is a fundamental principle in a modern and globalized world where the national borders represent

\textsuperscript{43} M. NORR, Jurisdiction to tax and international income, cit.
\textsuperscript{44} E.C.C.M. KEMMEREN, Source of Income in Globalizing Economies: Overview of the Issues and a Plea for an Origin-Based Approach, Bulletin, November 2006, 430.
just territorial limits but certainly they do not have to represent limits to the possibility of operating abroad.

126. The importance of this principle is demonstrated by the fact that all States have concluded and continue to conclude, between them, double taxation conventions following the OECD-MC provisions.

127. Based on these considerations we believe that State X can not act in a manner contrary to the international tax law tendency. Consequently the tax credits for the withholding taxes levied by State Y must be granted to Mr. A, the taxpayer can not suffer three different taxes on the same income just because he decided to go abroad for working or for investing his money.

128. In conclusion we assert that the taxpayer, Mr. A in the case at hand, who has paid multiple taxes on the same save income originated from abroad has however the right to the tax credits in State X, even if the ESD directive is not considered applicable in the case at hand because the avoidance of double taxation is a fundamental principle of the international tax law.
VI  TABLE OF ABBREVIATIONS:

Art(s)……………….Article(s)
ECT……………….European Community Treaty
OECD …………...Organization for Economic Co-Operation and development
OECD-MC………OECD Model Convention
MEMORANDUM FOR THE DEFENDANT

Registration number: B/002
II LIST OF SOURCES

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III. STATEMENT OF FACTS

Mr. A is a resident of an EU Member State X. Mr. A is holder of a savings account held in the branch office of bank M in third (non-EU) country Z. Bank M is established with HQ in Member State Y. The interest is paid out to Mr. A through bank M’s branch office in third country Z, because Mr. A has a trading office in country Z through which he performs his trading activities in Z and the trading office keeps an account on A’s name with the office of bank M in Z. The same account is used for all business activities of Mr. A in Z, but the interest received in this account from savings is in no way connected to Mr. A’s business activities in country Z. The interest on the savings account is paid by the branch office of bank M to the savings account in the name of Mr. A and this payment is recorded in the accounts of the branch office.

At the occasion of a routine tax audit in December 2008 of the HQ of bank M the tax administration of Member State Y, finds out that there are several such arrangements in place in bank M, whereby interest payments due in Member State Y are made payable to resident beneficiaries of other EU Member States through the bank’s branch office in third country Z. The tax administration of Member State Y takes the position that bank M should have withheld the special withholding tax of 20% under the directive on the interest paid out to Mr. A on its savings account through its branch office in third country Z. In addition the tax administration of Y also claims the ordinary withholding tax of 10% (as reduced under the tax treaty between Member State Y and Member State X) on the interest payments, because it takes the position that the interest payment represents interest income paid by a person resident in Member State Y to a beneficiary in Member State X.

Therefore the tax administration imposes an assessment for both withholding taxes on bank M in Member State Y. Bank M pays both withholding taxes on behalf of Mr. A as debtor of the interest payment, but at the same time files a protest against the assessment and claims reimbursement of the two withholding taxes from Mr. A in Y. The litigation between bank M and the tax administration of Member State Y is still pending before the tax tribunal of first instance, without any decision.

In filing his tax return for 2008 in April 2009 Mr. A claims credit for the withholding tax applied in Z and the ordinary and the special withholding taxes assessed in Member State Y. The tax
administration of Member State X refuses the tax credit for the ordinary withholding tax and the special withholding tax in Y on the grounds that the payment of interest was made through the office of bank M in third country Z and therefore withholding tax was only due in Z and not in Y.
IV. ISSUES

1 - PRELIMINARY RULING TO THE EUROPEAN COURT OF JUSTICE

1.1 The ESD does not appear applicable in the case at hand. As a result, the present case does not involve any question of EU law’s interpretation.

1.2 If the Court will decide to submit questions for a preliminary ruling to the ECJ we ask to the Court a preliminary ruling to the ECJ in order to clarify that the correct interpretation of Art. 4 of the ESD is the one we propose.

2 - POSSIBILITY TO APPLY THE ESD IN THE CASE AT HAND

2.1 The Territorial scope of the ESD – Art. 7

2.2 The interpretation of the term “paying agent” and the differences between the notions of “paying agent upon payment” and “paying agent upon receipt” contained in the Art. 4 ESD

2.3 The interpretation of the term “paying agent” – Art. 4: the definition of “paying agent upon payment” according to the “theory of last intermediary in the payments chain”

2.3.1 If interest is paid through a chain of intermediaries, only the last economic operator, individual or legal person, making the payment to the beneficial owner is considered to be a paying agent under the ESD.

2.3.2 The status of “paying agent” must be recognized in both circumstances: where the branch office would be the debtor or simply the economic operator that made the payment of the interest in charge of the Bank M.

2.4 The interpretation of the term “established”, contained in Art. 7 ESD, according to Community law and the concept of Permanent establishment under Art. 5 OECD-MC.
2.4.1 The branch office must be considered a Bank M’s PE because it runs the actual operations and therefore has an operating link with the interest payment made out in Country Z.

2.4.2 The connection between a European individual member and its territory is regulated by Art. 43 and 48 EC Treaty, which require a substantial criteria of economic connection between the person and the territory.

2.4.3 The concept of PE according to the Community law presume the presence of a genuine and actual pursuit of an economic activity.

2.4.4 Since Community law does not give a different notion of PE in respect to the one given by the International rules, seems possible referring to the conditions that need to be fulfilled in order to give rise to a permanent establishment, set out in Article 5 of OECD – MC.

2.4.5 As a result, even thought the HQ of Bank M is in the Member State Y, the effective activities concerning the interest paid out to Mr. A are made by its branch established in a third State Z where, therefore, the effective center of business is fixed. As a result, in the case at hand, the paying agent should be identified with the branch and not with the HQ of M in Y.

2.5 The interpretation of the term “paying agent” – Art. 4 and the proposal for a council Directive amending Art. 4 ESD.

2.5.1 The amending proposal, until it will be transposed in law, has no binding force, neither as a rule of interpretation.

2.5.2 Should the Court find the possibility to use the amending proposal as a rule of interpretation, have to be said that, however, by reading the amending proposal, the above mentioned theory of last intermediary in the payments chain results confirmed.
3 - THE ABSENCE OF AN UNDESERVED ENRICHMENT OF STATE X - ART. 12 ESD

3.1 The Applicant may argue that X has got an undeserved enrichment from the transfer of the 75% of the special withholding tax paid in Y and, consequently, X has to give a reimbursement to A for that withholding tax.

3.2 The revenue-sharing system involves a relation that is only between the two states. No connection can be found between the amount of the revenues transferred from State Y to State X and the withholding tax levied in Y. Consequently, every reimbursement must be claimed only to the state which levied the withholding tax that is, in the present case, Y.

4 - THE RESPECT OF THE EUROPEAN COMMUNITY LAW BY STATE X

4.1 The respect of the free movement of capital and the freedom of establishment by State X

4.1.1 It is the behavior of State Y that, forcing the meaning of the ESD, appears converse with the above mentioned freedoms.

4.1.2 State X had to choose if the interest paid in Z have to be taxed in this Country or in Y but – according with the provisions against double taxation - it cannot assume that the saving income could be taxed in both States.

4.1.3 There are no evidence of proof about the effective abuse of freedom by X.

4.2 The respect of the Directive’s aim by State X

5 - THE GENERAL CONDITIONS TO REQUEST A TAX CREDIT

5.1 State X applies unilaterally in its domestic tax law the credit method for foreign source private investment income.
5.2 A tax credit can be given only for a lawfully levied foreign withholding tax for an implicit condition of the tax system.

5.2.1 State X has to defend his right to tax from the unlawful impositions levied by foreign States.

5.2.2 Source rules will be meaningless if a credit would be given also for a unlawful foreign tax.

5.2.3 The OECD-MC can be used as an authoritative rule of interpretation of the credit method application: Art. 23 OECD-MC gives to the State of residence the possibility to deny a credit claimed for an unlawful imposition paid in a foreign State.

5.3 In order to grant a tax credit, taxes must be definitely paid abroad.

5.3.1 In the present case is still possible a reimbursement of the tax paid and the imposition is not still definitively paid.

6 - LOCALIZATION OF THE SAVING INCOME IN STATE Z AND THE CONSEQUENT IMPOSSIBILITY TO TAX IT IN STATE Y

6.1 In the case at the hand the attribution of taxation rights is ruled by Art. 11 OECD-MC.

6.2 May be argued that the effect of Art. 11(5) is that both the X–Y Treaty and the X–Z Treaty can be applied, nevertheless the Y-Z Treaty, should prevent this result.

6.3 There is a self-evident connection between the Mr A’s savings account and the PE of the bank M, so the interest shall be deemed to arise in State Z.

6.4 The bank M’s branch has not any abusive purpose and shall be considered a PE.

7 - THE RELATIONSHIP BETWEEN INTERNATIONAL TAX TREATIES AND THE ESD
7.1 The ESD does not provide for any guidance on the relationship between international tax treaties and the directive itself.

7.2 The differences between the ESD and the OECD-MC could lead to an autonomous application of the ordinary withholding tax or of the special withholding tax, so the court must consider independent the application of the two different regimens.
V. ARGUMENTS

1. Generally remarks

1. The purpose of the present paper is to demonstrate, firstly, that the ESD is not applicable in the case at hand and, secondly, that State X does not break any provision, neither in the Community law nor in the International field. In fact, as it will be demonstrated further, the behaviour of State X in rejecting the request of Mr. A for the tax credit related to the withholding taxes paid in State Y, does not conflict with the so called Community’s “four freedoms” and, furthermore, against the X-Z Treaty for the elimination of double taxation.

2. Specifically regarding the International field, this paper is going to focus on the inconsistency of the applicant’s request concerning a credit for the ordinary withholding tax levied by state Y. In fact we are going to prove that, according to both the internal and the international criteria, the state of residence of the taxpayer has to grant a tax credit only if the foreign taxation is lawfully levied and definitely paid in the state of source.

3. Once assessed the conditions for granting the ordinary credit, we will demonstrate that the income earned by Mr. A shall be deemed to arise in state Z according to the double tax conventions that countries X, Y and Z have concluded following the latest OECD model convention46. Especially, we will demonstrate that in the case at the hand there is not a problem of double source of income according to art 11 OECD-MC.

4. Finally we will demonstrate that the PE of the bank M has not an abusive purpose and carries on an effective business activity in state Z.

5. So, once proved that the income earned by Mr A shall be deemed to arise in state Z and that a credit must be given only for a lawfully levied foreign imposition, it will be proved that the behaviour of state X is completely correct and Mr A has no right to claim a tax credit neither for the Special nor Ordinary withholding tax, both paid in Y.

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46 Hereinafter OECD-MC.
2. Preliminary ruling to the European Court of Justice

6. Regarding the EC law, except for what we will say more specifically below\(^{47}\), it must be stated beforehand that the ESD is not appear applicable in the case at hand. As a result, since the present case does not involve any question of EU law’s interpretation, we believe that the request of a preliminary ruling seems not necessary.

7. However, if the Court will decide to submit questions for a preliminary ruling to the ECJ; in order to prove that the paying agent (as defined in Article 4 ESD) is not established inside the EU territory and, consequently, according to the articles 4 and 7 ESD the Directive result not applicable at the case at hand, we ask to the Court a preliminary ruling to the ECJ in order to clarify that the correct interpretation of Art. 4 of the ESD is the one we propose, according to which, in the present case the paying agent has to be identified in the Bank M’s branch office in Z and not in the Bank M’s HQ in Y. Thus, the Directive could not be applied and the tax credit claimed by the applicant, referring to the special withholding tax paid in State Y, cannot be recognized because the payment of interest was made by a paying agent situated outside the EU territory.

3. Possibility to apply the ESD in the case at hand

8. The two preliminary conditions that need to be fulfilled in order to consider applicable the ESD in the present case and, consequently, to allow State Y to withhold the so called “special withholding tax” of 20% on the interest paid out to Mr.A, are set out, respectively, in Art. 7 and Art. 4 ESD.

3.1 - The Territorial scope of the ESD – Art. 7

9. As for the first of the above mentioned conditions, Article 7 ESD, concerning the territorial scope of the Directive, provide that: “This directive shall apply to interest paid by a paying agent established within the territory to which the Treaty applies by virtue of Article 299”.

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\(^{47}\) Cfr. under paragraph 3 of this paper.
10. Thus, it is clear that any payment of interest “made” outside the EU territory is not covered by the Directive\textsuperscript{48}.

11. As a result, according to the “territorial scope” of the Directive, a payment would seem to be made inside the EU only if it is made by a paying agent established in a Member State. So, in order to determinate whether or not the case falls within the territorial limit of the ESD, “paying agent” is the pivotal notion in the Savings Directive and it is on its grounds that we can define the limits of the law.

12. In particular, for the purpose of the Directive we need to verify two conditions: a) which one of the two financial entities involved in the case (Bank M or its branch) have to be considered paying agent and, consequently; b) if this identified entity is established inside or outside the EU territory.

3.2 - The interpretation of the term “paying agent” and the differences between the notions of “paying agent upon payment” and “paying agent upon receipt” contained under Art.4 ESD

13. The ESD distinguishes between two types of paying agents: “paying agent upon payment” and “paying agent upon receipt”. Regarding the first of the above mentioned models, pursuant to Art. 4 (1) of the Directive: “paying agent means any economic operator who pays interest to or secures the payment of interest for the immediate benefit of the beneficial owner, whether the operator is the debtor of the debt claim which produces the interest or the operator charged by the debtor or the beneficial owner with paying interest or securing the payment of interest”.

14. A separate provision has been taken up in Art. 4 (2) which provides: “Any entity established in a Member State to which interest is paid or for which interest is secured for the benefit of the beneficial owner shall also be considered a paying agent upon such payment or securing of such payment. This provision shall not apply if the economic operator has reason to believe, on the basis of official evidence produced by that entity, that: (a) it is a legal person, with the exception of those legal persons referred to in paragraph 5; or (b) its profits are taxed under the general arrangements for business taxation; or (c) it is an UCITS recognised in accordance with Directive 85/611/EEC”.

15. This article, introducing a residual entity, extends the definition of paying agent to any recipient of interest payments, that is not a legal person, which interpose itself between the entity who make the payment and the beneficial owner.

16. As it is clear, the latter provision could not be applied in the case at hand for two reasons: 1) because the branch office of Bank M is not an individual and, consequently, the above mentioned provision cannot be applied according to what it is stated down in the second section of the commented article; b) because, as an unequivocal result from the statement of facts\(^{49}\), the interest payment was made directly by Bank M’s branch in Z without third parties’ involvement. In fact, Mr. A received the interest payment from his saving account held in the branch office and not in Bank M. In other words, in the present case we do not have any transfer of capital from the Bank M towards its branch office.

3.3 - The interpretation of the term “paying agent” – Art. 4: the definition of “paying agent upon payment” according to the “theory of last intermediary in the payments chain”

17. Clarified that in the present case we have to refer to the definition of paying agent stated down by Art. 4 (1) ESD, now it must be clarified which is the right meaning of the expression: “any economic operator who pays interest”.

18. According to the letter of the above mentioned article, for the purposes of this paragraph, it is irrelevant whether the economic operator concerned is the debtor or issuer of the debt claim or security which produces the income, or the economic operator charged by the debtor or issuer or by the beneficial owner with paying the income or securing the payment of the income.

19. Thus, the paying agent under the ESD is any person who makes savings income payments (in the sense of Art. 6 ESD) to individuals in the framework of a professional activity, such as a financial institution, a bank or an independent asset manager. This means that the place of residence of the actual debtor under the debt claim is not decisive for the purposes of the ESD.

\(^{49}\) Cfr. Statement of facts, paragraph 1
20. It must be considered that question could arise when, like it happens at the case at hand, the payment was made through a branch office, established in a third (non-EU) Country, of a bank established with its HQ in a Member State. In such cases, the main problem concerns the individuation of the specific rule to localize, exactly, where the paying agent is established.

21. Regarding this matter, it is generally adopted in legal doctrine\(^{50}\) to recognize that, if interest is paid through a chain of intermediaries, only the last economic operator, individual or legal person, making the payment to the beneficial owner is considered to be a paying agent under the ESD.

22. In other words, the Directive uses the “standard payment” as a factual rule (merely economic more than juridical) without any connection with the subordinate juridical credit relation and without any economic correlation with the territory.

23. The so called “theory of the last link in the payments chain” is also adopted in the usual procedure by the greater number of tax administrations of Member States. Particularly referring to U.K. and its Saving Income Reporting Guidance Notes – updated on February 2008 -, according to what we said above and to complete it better, it also specifies that: “the person who is responsible for deducting tax at source from a payment, is likely to be a paying agent for the proposes of the regulations.

24. The “chain’s approach” is also adopted by Ireland which, introducing the dividend withholding tax of 24% by the Financial Act in 1999, instituted a system providing a fundamental position to the intermediary who pays dividends to their clients. Furthermore, the same approach can be found in the US legislation on the “qualified intermediary”\(^{51}\). The central element of both regulations is represented by the translation of the majority of fulfilments from the HQ banks (or custodian banks) to the intermediary (or qualified intermediary).

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25. As a consequence of all the above and referring to the specific case, the status of “paying agent” must be recognized in both circumstances: where the branch office would be the debtor, or simply the economic operator that made the payment of the interest in charge of the Bank M.

26. In conclusion, the payment of interest made by the Bank M’s branch office in Z is not covered by the Directive according to the articles 4 and 7 ESD, because that fee was paid by a paying agent established outside of EU territory and, furthermore, the only entity responsible of deducting tax is the branch office in Z and not the Bank in Y.

3.4 - The interpretation of the term “established” according to Community law and the concept of Permanent establishment under Art. 5 OECD-MC

27. The arguments set out in the previous paragraph make clear that the Directive, in order to be applied, requires that the payment should be made by a paying agent established within the EU territory and, according to the “theory of last intermediary in the payments chain”, the intepaid out to Mr. A is not covered by the Directive because is made by an entity established in a Third State (non-EU).

28. Should the Court find that the “theory of the last link” is not useful for the right identification of the paying agent, in subsidiary order, for the same purpose we could also refer to the meaning of the term “established” used in the ESD.

29. According to Art. 4 ESD, the main rule to localize the place of effective establishment of the paying agent is referred, both, to economic entities having its permanent business and activities centre in the EU as debtors of the debt claim, and financial operator which, as intermediary entities, made the payment of the interest.

30. As a result, we need to verify which entities, between the branch office and the Bank M’s HQ, runs the actual operations and therefore has an operating link with the interest payment made out in Country Z.

31. Referring to European law, the connection between an European individual member and its territory is regulated by Artt. 43 and 48 EC Treaty, which require a substantial criteria of
economic connection between the person and the territory: which is the effective and permanent link with the economic system of the referred Country, within the essential requirements of being permanent, effective and relevant (excluding, for example, offices merely representative that are not effectively operating).

32. Confirming what we stated above, the EU Supreme Court of justice, deciding on the case Uberseering BV v. Nordic Construction Company Baumanagement GmbH excluded the right of establishment to those subjects whose have only headquarters located in territories within the EU, but that are not effectively operating.

33. The same approach was also adopted in other decisions and, specifically, in the case Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd, in which the ECJ stated that: “… omissis… the concept of establishment within the meaning of the Treaty provisions on freedom of establishment involves the actual pursuit of an economic activity through a fixed establishment in that State for an indefinite period (see Case C-221/89 Factortame and Others [1991] ECR I-3905, paragraph 20, and Case C-246/89 Commission v United Kingdom [1991] ECR I-4585, paragraph 21). Consequently, it presupposes actual establishment of the company concerned in the host Member State and the pursuit of genuine economic activity there.

34. As stated by Advocate General Darmon in point 3 of his Opinion in the Daily Mail and General Trust case, ‘[e]stablishment “means integration into a national economy”’.

35. Substantially, the concept of PE according to the Community law presume the presence of a genuine and actual pursuit of an economic activity and, as suggested by the United Kingdom Government and the Commission, that finding must be based on objective factors which are ascertainable by third parties.

36. Moreover - except for what we will say more specifically below, since Community law does not give a different notion of PE in respect to the one given by the International rules, it seems

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54 ECJ 12 September 2006, Case C-196/2004, Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd
56 Cfr. under paragraphs 7 of the present memorandum.
possible to refer to the conditions that need to be fulfilled in order to give rise to a permanent establishment, set out in Article 5 of OECD – MC, according to which: <<*permanent establishment*" means a fixed place of business through which the business of an enterprise is wholly or partly carried on>>>, specifically includes also the branch in the concept of permanent establishment.

37. What we said above is confirmed by the circumstance that the concept of residence contained in the Directives n.90/435/CE and n.90/434/CE, correspond with that given by Art.4 OECD - MC. Furthermore, a large part of Scholars admit the possibility to perform European law according to the concepts and the principles laid out in the international field and, specifically, according to the OECD - MC provisions. In that contest it was recognized that some European concepts origin from the International law and, consequently, in specific case like the present, it is admitted the possibility to interpret European law according to International law.

38. As a result, referring to the case, even though the HQ of Bank M is in the Member State Y, the effective activities concerning the interest paid out to Mr. A are made by its branch established in a third State Z where, therefore, the effective centre of business is fixed. As a result, in the case at hand, the paying agent should be identified with the branch and not with the HQ of M in Y.

3.5 - The interpretation of the term “paying agent” – Art. 4 and the proposal for a council Directive amending Art. 4 ESD

39. Making some preliminary remarks on the nature of the amending proposal of Art. 4 ESD, it has to be pointed out that the proposal was laid out on September 15th 2008, that is to say after the entering into force of the Directive, which becomes applicable on July 1st 2005. As a result, until the amending proposal will be transposed in law, it has no binding force and, furthermore,
cannot constitute a standard to be used for the interpretation of the Directive’s letter in force since 2005.

40. Should the Court find the possibility to use the amending proposal as a rule of interpretation, have to be said that, however, by reading the amending proposal, the above mentioned theory of last intermediary in the payments chain results confirmed. In particular, that proposal conflicts against the opportunities to circumvent the Directive by using an interposed legal person or arrangement practice.

41. However, as we said above, the practice used by some resident individual (and not by the financial entity) to invest through an intermediate legal person or arrangement established in a non-EU jurisdiction falls within the provision of Art. 4 (2), and not in Art. 4 (1).

42. Strong arguments in favour of this approach can be found in the Report from the Commission to the Council which, concerning only about the definition of the intermediate structures (such us trusts, transparent entities…) and the opportunity to introduce an anti-avoidance measure, states that the <<concept of “paying agent upon receipt” seems to have generated uncertainty>>, and that: <<It has not produced all the results expected by Member States>>. As a consequence, the Report has no reference to the definition of paying agent contained in Art. 4 (1) ESD59.

43. As a result, the identification of the paying agent in the last financial intermediary who made the interest payment, or referring to the economic entity having its permanent business and activities centre is the Country where the interest payment is made, is not under discussion. Consequently, also under this point of view, indeed, in the specific case the paying agent is the branch office in Z.

44. The Applicant may argue that Bank M, instead of its branch office, could be considered the paying agent according to the opportunity, stated down in the proposal of amending, to consider an economic operator established in a Member State as the paying agent for the purposes of this Directive, where the following conditions are met: (a) it makes an interest payment as defined

in Article 6(1) to, or secures such a payment for, another economic operator established outside
the territory referred to in Article 7 and outside the territorial scope of application of the
agreements and arrangements referred to in Article 17(2), and (b) the first economic operator
has evidence that the second economic operator will pay the income to, or secure such a
payment for the immediate benefit of, a beneficial owner who is an individual known by the first
economic operator to be a resident of another Member State, having regard to Article 3. Where
the conditions referred to in points (a) and (b) are met, a payment made or secured by the first
economic operator for the immediate benefit of the second economic operator shall be deemed
to be made or secured by the first economic operator for the immediate benefit of the beneficial
owner referred to in point (b).

45. At this regard has to be remarked that, as unequivocally results from the textual meaning of the
draft’s letter, the proposal requests the contextual presence of the two above mentioned
conditions. In fact, the terms “the following conditions are met” and “an economic operator
established in a Member State ... makes an interest payment ... and ... the first economic
operator has evidence” show how those two conditions have to be met jointly.

46. As a consequence, if the statement of facts it is evident that, potentially, the second of those
conditions could been fulfilled in the present case, because Bank M admits that the branch
office in Z has been set up at the specific request from clients, could not be said the same
referring to the first condition. Actually, there are not any proofs submitted that the payment
was made by Bank M, neither about the circumstance that the taxpayer uses an intermediate
structure nor that the other several arrangements, through which it makes payable the interest in
Z instead in Y (which could be referred, maybe, only to Bank M). In fact Mr. A receives interest
payment directly from his saving account held in branch office of Bank M in Z.

47. Following this reasoning and as results from the statement of facts, can be concluded that, since
the paying agent does not result established in the EU territory, the case at hand does not fall
within the territorial scope of the ESD according to Art. 7 ESD. As a result, the special
withholding tax of 20% withheld by State Y was unlawfully withheld and, consequently, State
X has no duty to recognize a credit referring to that tax.
4. The absence of an undeserved enrichment of State X - Art. 12 ESD

48. According to Art. 12 ESD “Member States levying withholding tax in accordance with Article 11(1) shall retain 25 % of their revenue and transfer 75 % of the revenue to the Member State of residence of the beneficial owner of the interest”.

49. The applicant may argue that X has got an undeserved enrichment from the transfer of the 75% of the special withholding tax paid in Y and, consequently, X has to give a reimbursement to A for that withholding tax.

50. Actually the revenue-sharing system involves a relation that is only between the two states. No connection can be found between the amount of the revenues transferred from State Y to State X and the withholding tax levied in Y. The absolute autonomy between the inter-state relation and the single tax payments made by taxpayers is confirmed by the commentary of the proposal for the ESD presented by the European Commission, in which it is make evident that the state which operate the withholding do not has to give any information about the identity of the beneficial owner at the moment of transfer.

51. Consequently, every reimbursement must be claimed only to the state which levied the withholding tax that is, in the present case, Y.

5. The respect of the European Community Law by State X

5.1 - The respect of the free movement of capital and the freedom of establishment by State X

52. The Applicant may argue that the behavior of State X, in rejecting the request of Mr. A for the tax credit related to the ordinary and the special withholding taxes paid in Y, appears contrary to the free movement of capital or to the freedom of establishment.

60 European Commission, Proposal for a Council directive to ensure effective taxation of savings income in the form of interest payments within the Community, COM/2001/0400 final, Brussels, 18.7.2001.
53. On this matter it must be remarked that the opposite is true; actually, it is the behavior of State Y that, forcing the meaning of the ESD, appears converse with the above mentioned freedoms. In fact, recognizing tax credit for the withholding taxes withheld in Y (on the basis of the erroneous ESD interpretation given by State Y), in addiction to the other (recognized) tax credit for the withholding tax applied in Z, evidently, would imply problems of double taxation.

54. Substantially, State X must choose if the interest paid in Z is taxable in this Country or in Y, but it cannot assume that that interest could be taxed in both States, because this conclusion would contrast with the provisions against double taxation. Thus, on believing that the interest saving income results taxable only in Z, X allowed only the credit claim for the withholding tax paid in Z and refuses the other for the taxes paid in Y, which it considered wrong applied.

55. Even if the Court should find out that, as presumed by the tax administration of State Y, Bank M used several arrangements whereby the interest payments were made payable in Z, instead of Y, as by the statement of fact 61 results, unequivocally that this conduct has been done with the consciousness of Mr. A. In that case, the liability of the unlawful taxation in Y has to be ascribed only to the applicant.

56. However, at the moment when Mr. A claimed the tax credit for the withholding tax paid in Z there are no evidence of proof about the effective abuse of freedom; thus, there are no possibility to apply the ESD and, consequently to recognize the tax credit claimed by Mr. A.

57. Regarding this matter, the Court, in several cases 62 has held that the fact that the company was established in a Member State for the purpose of benefiting from more favourable legislation does not in itself suffice to constitute abuse of that freedom.

58. As a result, in order to consider the ESD applicable in the case at hand on the ground of the abuse of freedom, it seems necessary a previous judicial assessment concerning the effectiveness of the abuse and, therefore, in accordance with Article 58(3) of the Treaty and the ESD preamble (4), whether the provisions of State Y tax law, designed to counter abuse or

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61 Cfr. Statement of facts, paragraph 5
62 Cfr., to that effect, Centros, paragraph 27, and Case C-167/01 Inspire Art [2003] ECR I-10155, paragraphs 96 and 98.
fraud, should not constitute means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as established by Article 56 of the Treaty.

59. On the basis of the above mentioned arguments, it seems reasonable to conclude that, at the moment of the credit claim, State X has no possibility to recognize it on the ground of the abuse of Community law. Furthermore, even if should be find that the abuse were considered demonstrate, all its negative consequence must be ascribed to the effective author of the abuse who is, in the case at hand, Mr. A.

5.2 – The respect of the Directive’s aim by State X

60. On the basis of the above mentioned arguments, we can say that, the behaviour of State X does not breach any Community freedom and, moreover, it is respectful of the main goal of the Directive.

61. The ESD aims at enabling saving income in the form of interest payments made in one EU Member State to beneficial owners who are individuals residents for tax purposes in another EU Member State to be made subject to effective taxation in the latter EU Member State, that is the State of residence of the beneficial owner\(^{63}\).

62. Substantially, the ESD wants to guarantee that the State of residence of an individual gets information about interest payments the individual receives from paying agents in other EU Member States. Contrary to this so called information procedure, Austria, Belgium and Luxembourg and Y run the so called withholding tax procedure during a transitional period. In these countries the deduction of withholding tax on cross border interest payments shall guarantee a minimum of effective taxation by avoiding non-taxation if the interest income is not declared by the beneficial owner in her/his Member State of residence. Hence, the basic aim of the Directive is to minimise the opportunities to avoid taxes and therefore to decrease effective tax evasion while increasing public revenues.\(^{64}\)


63. In this respect it is important to point out that, the “legal or illegal” circumvention of the regulations of the Directive does not necessarily mean an effective evasion of taxes by the beneficial owner. A successful circumvention of these rules just enables the beneficial owner to conceal interest income from his State of residence, as if the Directive has never been introduced.

64. Regarding to what we said above and referring to the specific case it is clear that, the behaviour of State X does not conflict with the main goal of the Directive. In fact, according to its task, the saving income in the form of interest payment of Mr. A was effectively taxed by his State of residence X.

6. The general conditions to request a tax credit

65. Now we are going to prove that, according to both the internal and the international criteria, the State of residence of the taxpayer has to grant a tax credit only if the foreign imposition is lawfully levied and definitely paid in the State of source.

66. State X has agreed to the exemption method for foreign source business income in the tax treaties with Y and Z, but it applies unilaterally in its domestic tax law the credit method for foreign source private investment income. The general conditions provided for granting the ordinary credit are: (1) that tax has been effectively paid abroad and (2) that the credit does not exceed the amount of domestic tax due on the interest. Nonetheless some other conditions are implicit in the tax system itself. In particular a tax credit can be given only for a lawfully levied foreign withholding tax. In fact, it is not possible to grant a credit for every tax paid abroad regardless to the legitimacy of the imposition because in such a case no possibility would remain for the State to defend his right to tax from the unlawful imposition levied by foreign States that may also impose taxes on income no way connected with their tax system. A control on the legitimacy of the foreign tax is necessary in order to give significance to the rules provided for the allocation of the right to tax: if a state had to give a credit also for an unlawful
foreign tax, such rules would be meaningless. As a consequence, in the case at the hand, the internal tax system can not grant relief because, according to the OECD-MC rules, State Y has not the right to tax the income that has it Source in State Z, so, according to the internal tax system of State X, the payment made by Mr. A is not an effective payment of a tax but only an unfair withdrawal made by State Y in absence of the fundamental conditions. Consequently, State X can not grant a tax credit making a substantial renounce to the internal right to tax.

67. Furthermore, although the OECD-MC is not applicable to the foreign source private investment income, the convention can be used as an authoritative rule of interpretation of the credit method application conditions. In fact, such an institution derives from the international praxis and so also the internal law of State X is ruled in accordance with the OECD provisions.

68. Article 23b OECD-MC requires that relief be granted, through the credit method, where an item of income or capital may be taxed by the State of source in accordance with the provisions of the Convention. In order to understand if the OECD-MC consider the legitimacy of the foreign tax as a necessary condition for granting a tax credit, it is particularly important the interpretation of the phrase “in accordance with the provisions of this Convention”, which is used in both Articles 23a and 23b OECD-MC.

69. According to the OECD-MC commentary C(23)32.565 “Article 23 A and Article 23 B, however, do not require that the State of residence eliminate double taxation in all cases where the State of source has imposed its tax by applying to an item of income a provision of the Convention that is different from that which the State of residence considers to be applicable”.

70. So, the expression “in accordance with the provisions of this Convention” stated by Art. 23 OECD-MC gives to the State of residence the possibility to deny a credit claimed for an unlawful imposition paid in a foreign State. The international obligation to give a credit for the foreign taxes arises only if such taxes are levied according to the OECD-MC provisions: the commentary itself at C(23)5966 states that “The obligation imposed by Article 23 B on a State of residence to give credit for the tax levied in the other State on an item of income or capital

65 Par. 32.5 OECD -Commentary on art 23 OECD-MC.
66 Par. 59 OECD -Commentary on art 23 OECD-MC.
depends on whether this item may be taxed by the State of source in accordance with the Convention”.

71. Another condition which is implicitly contained in the tax system itself is that, in order to grant a tax credit, taxes must be definitely paid abroad. The concept of a definitively-paid tax coincides with that of non-recoverability of the tax itself, so those taxes for which there is the possibility of a partial or total refund cannot be considered definitively paid. In fact, granting a credit for a tax that can still be recovered by a successive reimbursement of the tax from the foreign State, a State will create a definitive situation of double non taxation. Such a situation of double non taxation seems to be in contrast with the international principle of tax systems as much as a situation of double taxation is.

72. In the case at the hand a claim for the reimbursement of both the ordinary and the special withholding taxes paid from Mr. A in Y is still pending before the tax tribunal of first instance, without any decision. So a reimbursement of such taxes is still possible and such impositions are not still definitively paid. The court must prevent the possible situation of double non taxation that the taxpayer could benefit if a tax credit would be given to Mr A in X and in Y would be either granted the reimbursement of the two withholding taxes claimed by Mr. A. So, even if the Court judges lawfully levied the imposition paid in Y, the claims of the applicant will still must be rejected in force of the absence of a definitive pronouncement of the State Y’s judicial authority. Only when the imposition will be definitely paid in State Y Mr A shall claim in State X a tax credit. Only when the imposition will be definitely paid in State Y Mr A shall claim in State X a tax credit.

7. Localization of the saving income in State Z and the consequent impossibility to tax it in State Y

73. Assumed that a credit can be granted only for a lawfully levied tax, concerning the credit claimed by Mr. A for the 10% ordinary withholding tax, we are going to prove the illegitimacy of the imposition assessed in State Y and the consequent impossibility to grant a tax credit for such an imposition in state X.
74. The withholding tax is lawful only if it can be in accord to the international criteria for the attribution of taxation rights, criteria which are fixed in the double tax conventions that countries X, Y and Z have concluded following the latest OECD-MC.

75. According to Art.11 OECD-MC, interests may be taxed in the State of residence of the taxpayer. This solution seems to be in accordance with the European law trends expressed by the ESD. Actually the ultimate aim of the ESD is to enable savings income in the form of interest payments made in one Member State to beneficial owners, who are individuals resident in another Member State, to be made subject to effective taxation in accordance with the laws of the latter Member State.

76. However the same article gives to the State of source the right to levy a tax if its laws provide so. The tax so charged shall not exceed 10% of the amount of the interest. So we have to make clear in which State the interest has its source in accordance with the OECD-MC.

77. According to Art.11(5) OECD-MC “Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a PE in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such PE, then such interest shall be deemed to arise in the State in which the PE is situated”.

78. It may be argued that the effect of Art. 11(5) is that both the X–Y Treaty and the X–Z Treaty can be applied. The former applies because the first sentence of Art. 11 subsection 5 provides that interest arises in the State where the HQ, bank M, is resident, which is Y. The latter applies because the second sentence provides that where the interest is connected with a PE in a contracting State, the interest arises in the State of the PE, Z. However the source rule in the Treaty X-Z (between the State of residence of the beneficial owner, X, and the State of the PE of bank M, Z), does not affect the source rule provided by the Treaty X-Y, which places the source in Y, because the second sentence of the above mentioned Art. has precedence over the first only where the PE is in a Contracting State for the purposes of the X-Y Treaty. So, according to this thesis, the bilateral nature of the double tax conventions involves that textual
formulation of Art.11(5) provides no solution for the case where both the beneficiary and the payer are indeed residents of the Contracting States, but the loan was borrowed for the requirements of a PE owned by the payer in a third State and the interest is borne by that establishment.

79. Nevertheless, it can be argued that the Treaty between State Y, the country of residence of HQ, and the State of the PE, Z, should prevent this result. First, it can be pointed out that the payer is a resident of State Y and so Art. 1 of the Y-Z Treaty is satisfied. Normally Art. 1 OECD-MC looks at the recipient’s residence State, but, in connection with a payment of interest, it applies to the payer’s State. Secondly, the definition of where interest arises in Art. 11(5) can be read as applying more widely than a source rule only for Art. 11(1), which relates to interest arising in a Contracting State and paid to a resident of the other Contracting State. Art. 11(4) contains a cross-reference to Art. 11(1) and (2), there is no such cross-reference in Art.11(5) and so it may be intended to apply more generally and constitute an agreement between the State of the HQ, Y, and the State of the PE, Z, that interest incurred by a PE in one State of a resident of the other shall be deemed to arise in the PE State for all purposes.

80. So Y can be considered the State of source only if it can be proved that the interest is not connected to the PE of bank M, or that the branch office of bank M in Z itself shall not be considered a PE according to art 5 OECD-MC. As we are going to demonstrate, it is not possible to provide such an evidence and so the income shall be deemed to arise in Z and a tax credit shall be given only for the tax levied by State Z, credit that State X has already granted.

According to the OECD-MC commentary the connection between the indebtedness on which the interest is paid and the PE laid down in the second sentence of paragraph 5 is fulfilled when “the management of the PE has contracted a loan which it uses for the specific requirements of the PE; it shows it among its liabilities and pays the interest thereon directly to the creditor”67.

81. In the case at the hand Mr. A is an holder of a savings account held in the branch office of bank M in country Z, the interest was paid out to Mr. A through bank M’s branch and any money transfer to the State Y is not proved. The capital on which the interest was paid was always

67 Par. 27 OECD -Commentary on art 11.
located in State Z and Mr. A had a business relation only with the bank M’s branch. The interest on the savings account is paid by the branch office of bank M to the savings account in the name of Mr. A and this payment is recorded in the accounts of the branch office. We have to suppose that the account was contracted with Mr A by the PE and was part of the business activity of the branch, if it is not proved otherwise. There is a self-evident connection between the Mr A’s savings account and the PE of the bank M, consequently the interest shall be deemed to arise in State Z. Consequently, in the present case, the income earned by Mr A is connected only with State Z and State Y can not levy a tax on it, so the imposition withheld by State Y is unlawful.

82. The applicant may argue that the office of bank M in Z has only an abusive purpose and shall not be considered a PE, so the second sentence of Art.11(5) can not be applied in the case at the hand. In order to reply to this argument we have to refer to the definition of PE as laid down by Art. 5 OECD-MC.

83. No doubt can arise that, in the case at the hand, the bank M’s branch is a “place of business”; that this place of business is “fixed”, that is established at a distinct place with a certain degree of permanence, and that the business of the enterprise is partially carried on through this fixed place of business. Furthermore a branch office is one of the examples pointed out by Art. 5(2) OECD-MC, each of which can be regarded, prima facie, as constituting a PE so it must be considered such until it is proved otherwise.

84. At the occasion of a routine tax audit in December 2008 of the HQ of bank M, the tax administration of State Y has argued that there are several arrangements in place in bank M, whereby interest payments due in Member State Y are made payable to beneficiaries resident of other EU Member States through the bank’s branch office in third country Z. The tax administration of State Y used this argument in order to maintain that the interest payment represents interest income paid by a person resident in Member State Y to a beneficiary in Member State X, claiming the ordinary withholding tax of 10%. In fact this argument is not sufficient in order to maintain that the branch office is not a real PE and no abuse can be assessed to Mr A. Actually Mr. A has a trading office in country Z through which he performs

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68 Cfr. statement of facts par. 1.
his trading activities in Z and the account is kept by this trading office. The same account is used for all business activities of Mr. A in Z and not only for Mr A’s personal expenses. The indebtedness on which the interest is paid, as well marked before, had no connection with State Y; the bank M’s branch has in Z an effective business activity with several other clients and its creation is not aimed at responding to Mr A’s needs\(^{69}\). Consequently, the branch must be considered a real PE and it is not possible to argue that the Mr A’s acts constitute an abuse of law. Furthermore the behaviour of bank M, even if considered elusive of State Y’s tax rights, can not create a disadvantage to Mr A’s position where it is not proved that Mr A himself had a full knowledge of the abusive purposes of such behaviour. State Y, in fact, cannot violate the free movement of capital, imposing an European citizen to know every behaviour of the bank in which he hold his savings accounts. The Mr A’s good faith must take him unharmed by every assessment take as a consequence of the arrangements created by a third part of which Mr A is not responsible.

85. Moreover, in order to validate all these thesis, we remember to the Court that the same arguments are maintained by the bank M, on behalf of the applicant, in a litigation with the tax administration of State Y for the reimbursement of the two withholding taxes, litigation which is still pending before the tax tribunal of first instance of State Y.

8. The relationship between international tax treaties and the ESD

86. According with the solutions proposed in this paper and, more generally, in every physiological situation, the lack of ability to tax of a State under the international criteria for the attribution of taxation rights goes together with impossibility to apply the special withholding tax provided by the ESD. Nevertheless the ESD uses some concepts not perfectly coincident with the OECD definitions and especially, as argued before, the definition of paying agent must be interpreted in the light of the OECD concept of PE, but some differences remains between the two definitions. Furthermore, the bilateral nature of the double tax conventions in cases which have a triangular nature could create, as already seen, some problems in the application of the ordinary criteria for sharing the ability to tax. Nonetheless even if the court will decide that in

\(^{69}\) Cfr. statement of facts par. 2.
the case at the hand the income has a double source for the purpose of the OECD-MC, such a lack of coordination between the different double tax conventions can not affect the interpretation of the ESD.

87. It must be underlined that the ESD does not provide for any guidance on the relationship between international tax treaties and the directive itself\textsuperscript{70}. In fact in the aims of the directive there is no reference to the allocation of taxing rights and it aims not at “tax harmonization”, but rather at “tax coordination”, in order to preserve national tax systems and avoid tax evasion on interest\textsuperscript{71}. So it seems that the aim of the ESD is just to make easier the effective taxation of interest payments in the taxpayer State of residence through an exchange of information system concerning interest payments between Member States.

88. These differences between the ESD and the OECD-MC could lead, in some situation, to an autonomous application of the ordinary withholding tax or of the special withholding tax, so the court must consider independent the application of the two different regimes and, even if the special withholding tax will be considered applicable in the case at the hand, cannot shirk to make a complete analysis of the presence of the ordinary withholding tax application conditions. In the same way, even if the court will find applicable the ordinary withholding tax, this fact cannot be considered as a sufficient condition for the assessment of the special withholding tax. In fact, in the case at the hand, the lack of the internal ability to tax the interest, is only a further indication of the impossibility to apply the special withholding tax.


\textsuperscript{71} F. VANISTENDAEL, \textit{General Report on the interest savings directive}, in \textit{European association of tax law professors Budapest June 1-3}, 2006
VI. TABLE OF ABBREVIATIONS

Art.: Article

ESD: European Saving Directive 48/2003/CE

HQ: Headquarter

OECD MC: OECD Model Tax Convention on Income and Capital

Par.: Paragraph

PE: Permanent Establishment