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Advocate General's Opinion in Austria v. Germany on the interpretation of 'income from debt-claims with participation in profits' (C-648/15)

Double Tax Convention — Taxation of interest income from registered certificates — Profit-participating loans — Profit-sharing bonds — Arbitration Procedure in Article 273 TFEU — Dispute between Member States

On April 27, 2017, Advocate General (AG) Mengozzi of the Court of Justice of the European Union (CJEU) issued his Opinion in the Republic of Austria v Federal Republic of Germany case (C-648/15), concerning a dispute between two Member States brought before the CJEU pursuant to Article 273 of the Treaty on the Functioning of the European Union (TFEU). The dispute concerns the interpretation of the phrase 'income from (...) debt-claims with participation in profits' within the meaning of Article 11(2) of the Convention for the avoidance of double taxation with respect to income and capital ('Convention') between Austria and Germany.

The AG is of the opinion that the CJEU does have jurisdiction to rule in this dispute and that the disputed phrase must be interpreted as covering income which provides a creditor with a part or a share in the debtor's profits, to the exclusion of income which varies only in the event of losses incurred by that debtor.

Background
The case concerns the taxation of interest from registered certificates ('Genussscheine') purchased by an Austrian company – UniCredit Bank Austria AG ('UniCredit') – from a German bank. The certificates in question confer on the holder an entitlement to the payment of annual interest at a fixed rate of the nominal value of the certificates. However, the payment of
interest may be suspended if the issuer incurs an accounting loss or reduced where it is itself likely to generate a loss, thus giving rise to an entitlement to payment of arrears in subsequent years, when the debtor realizes sufficient profit.

Both Member States agree on the legal classification of income from the certificates at issue, i.e. as interest within the meaning of Article 11 of the Convention, and not as dividends within the meaning of Article 10. Under Article 11(1) of the Convention, taxing rights over interest income are allocated to the state of residence of the beneficial owner – in this case, Austria. However, Article 11(2) introduces an exception whereby ‘income from rights or debt-claims with participation in profits’ may also be taxed in the state in which the income arises. Although the parties agree that only remuneration from debt-claims that depend on profits fall within the scope of the exception, they disagree on the required level of dependency.

According to Germany, the criterion of dependency is satisfied where the payment is dependent on the realization of a certain level of profit by the debtor; Germany considers this to be the case for the instrument at issue. It therefore claims that it has the exclusive right to tax the income from these certificates.

Austria, on the other hand, argues that the exclusion should be interpreted narrowly, i.e., as referring to remuneration, in addition to the fixed interest component, determined based on the issuer’s profits, and therefore claims exclusive taxing rights over the income from the certificates acquired by UniCredit.

The AG's opinion

The AG first examined whether the CJEU has jurisdiction in this dispute, noting that it is the first time that a dispute between two Member States (in this case: Austria and Germany) has been brought before the CJEU pursuant to Article 273 TFEU. Under this Article, the CJEU is given jurisdiction in disputes (i) between Member States, (ii) which relate to the subject matter of the treaties, and (iii) that are submitted to it under a special agreement between the parties. According to the AG, a dispute arising from the interpretation of a bilateral convention for the avoidance of double taxation has a direct link to the objective of the realization of the EU internal market, as provided for under the EU Treaties. The AG also noted that Article 25(5) of the Convention contains an arbitration clause that requires the two parties to submit unresolved disputes to the CJEU for arbitration under Article 273 TFEU. The AG therefore concluded that the proceedings have been legitimately brought before the CJEU.

Upon examining the case, the AG concluded that 'interest' and the phrase 'income from (...) debt-claims with participation in profits' used in the Convention must be interpreted autonomously in the context of international treaties and not by reference to the national law of the source State.

In his assessment of the meaning of the disputed terms, the AG drew on two of the examples of financial instruments mentioned in Article 11(2) of
the Convention: profit-sharing bonds, which are generally defined as obligations that give the holder the right to a portion of the debtor’s profit (in addition to a fixed income component), and profit-participating loans, which are characterized by a basic interest rate, supplemented by interest linked to the amount of the issuer’s profit. The AG believes that the disputed phrase must be interpreted strictly and be restricted to income which provides the creditor with a part or a share in the debtor’s profit. The certificates at issue confer an entitlement to remuneration calculated on the basis of a fixed percentage of the nominal value of the certificates and is independent of the amount of profit made by the issuer. The AG therefore concluded that this is not a case of ‘income from (...) debt-claims with participation in profits’ within the meaning of Article 11(2) of the Convention.

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This is the first time the arbitration procedure contained in Article 273 of the TFEU has been used to resolve a dispute between two Member States and it will be interesting to see if the CJEU follows the AG’s conclusion that the conditions for triggering its jurisdiction have been met but that the CJEU does not have the authority to issue injunctions to the two Member States. Should this be the case, the two parties will have to decide and agree on the measures needed to implement the CJEU’s judgement.

Should you have any questions, please do not hesitate to contact KPMG’s EU Tax Centre, or, as appropriate, your local KPMG tax advisor.

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