



Euro Tax Flash from KPMG's EU Tax Centre



[Background](#)

[The CJEU's decision](#)

[EU Tax Centre comment](#)

CJEU decision in *Austria v. Germany* case 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 September 12, 2017, the Court of Justice of the European Union (CJEU) rendered its decision in the *Republic of Austria v Federal Republic of Germany* case ([C-648/15](#)), concerning a dispute between two Member States brought before the Court pursuant to Article 273 of the Treaty on the Functioning of the European Union (TFEU). The case 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 Court ruled that it does have jurisdiction to rule in this dispute and that the disputed phrase must be interpreted as excluding income from certificates such as those at issue in this case, i.e. income which varies only in the event of losses incurred by the 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 when 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 on the basis of the issuer's profits, and therefore claims exclusive taxing rights over the income from the certificates acquired by UniCredit.

The CJEU's decision

The Court first examined whether it has jurisdiction in this dispute 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 – i.e. the TFEU and the Treaty on the European Union (TEU), and (iii) that are submitted to it under a special agreement between the parties. The Court noted that the existence of a dispute between Member States is without doubt in this case since the mutual agreement procedure provided for under the Convention was unsuccessful.

According to the Court, in order for the second condition to be met, the dispute should have an identifiable link to the subject matter of the Treaty. The Court confirmed the existence of such a link in this case by reference to the beneficial effect on the EU internal market (established through the Treaties) of the mitigation of double taxation. If not addressed through, for example, conventions between Member States, double taxation resulting from the exercise in parallel by Member States of their powers to tax may have the effect of rendering less attractive the exercise of the freedoms of movement provided for in the TFEU.

As regards the third condition, the Court observed that the application made before it was not based on an arbitration clause addressing this dispute specifically, but rather under the general terms of Article 25(5) of the Convention, which contains a clause that requires the two parties to

submit unresolved disputes to the CJEU for arbitration under Article 273 TFEU. However, the Court noted that, in light of the objective of Article 273 TFEU, giving Member States a means to resolve their disputes related to the subject matter of the Treaties, there is no reason for the Member States concerned not to agree in advance on the referral of a potential dispute to the CJEU. The Court therefore concluded that it has jurisdiction to rule in the dispute brought before it by the two Member States.

Regarding the substance of the case, the Court concluded that the phrase '*income from debt-claims with participation in profits*' used in the Convention must be interpreted autonomously in the context of international law and not by reference to the national law of the source State.

In its assessment of the meaning of the disputed term, the Court noted that 'debt-claims with participation in profits' normally confer entitlement to remuneration that varies with the debtor's profits, as is the case for the three types of financial instruments listed as examples 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), profit-participating loans, which are characterized by a basic interest rate, supplemented by interest linked to the amount of the issuer's profit and income of a 'silent partner', by definition entitled to a share in profits.

The Court further noted that Article 11(2) is a derogation from the general principle expressed in Article 11(1) of the Convention and therefore that the disputed phrase must be interpreted strictly. The CJEU observed that the instruments 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 fact that the annual payment of interest is subject to the existence of profits does not imply that the lender is entitled to a share in the debtor's profits. The Court therefore concluded that the concept of '*income from debt-claims with participation in profits*' within the meaning of Article 11(2) of the Convention must be interpreted as excluding certificates such as those at issue in the dispute brought before it.



EU Tax Centre comment

The CJEU decision is in line with the AG's Opinion summarized in [ETF 322](#). As mentioned there, this is the first time the arbitration procedure contained in Article 273 TFEU has been used to resolve a dispute between two Member States and the Court's clarifications regarding the conditions for triggering its jurisdiction are welcome. However, the Court noted that the

information available to it does not allow for a decision on the reciprocal claims by the two parties regarding reimbursement of taxes wrongfully levied. The two Member States will have to agree on the outcome of the Court's decision by cooperating in good faith.

Should you have any questions, please do not hesitate to contact [KPMG's EU Tax Centre](#), or, as appropriate, your local KPMG tax advisor.



Robert van der Jagt
Chairman, KPMG's EU Tax Centre and
Partner, Meijburg & Co

kpmg.com/socialmedia



kpmg.com/app




[Privacy](#) | [Legal](#)

You have received this message from KPMG's EU Tax Centre. If you wish to unsubscribe, please send an Email to eutax@kpmg.com.

If you have any questions, please send an email to eutax@kpmg.com

You have received this message from KPMG International Cooperative in collaboration with the EU Tax Centre. Its content should be viewed only as a general guide and should not be relied on without consulting your local KPMG tax adviser for the specific application of a country's tax rules to your own situation. The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

To unsubscribe from the Euro Tax Flash mailing list, please e-mail KPMG's EU Tax Centre mailbox (eutax@kpmg.com) with "Unsubscribe Euro Tax Flash" as the subject line. For non-



KPMG parties – please indicate in the message field your name, company and country, as well as the name of your local KPMG contact.

KPMG's EU Tax Centre, Laan van Langerhuize 9, 1186 DS Amstelveen, Netherlands

© 2017 KPMG International Cooperative ("KPMG International"), a Swiss entity. Member firms of the KPMG network of independent firms are affiliated with KPMG International. KPMG International provides no client services. No member firm has any authority to obligate or bind KPMG International or any other member firm vis-à-vis third parties, nor does KPMG International have any such authority to obligate or bind any member firm. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International.