

Austria: CJEU Recent Case from Austria – Austria / Germany (C-648/15)

Claus Staringer

- 1. Overview**
- 2. The Dispute and the CJEU's Decision**
- 3. The Reasoning of the CJEU**
 - 3.1. The Irrelevance of Domestic Law
 - 3.2. The “Ordinary Meaning”
 - 3.3. The Contextual Analysis
 - 3.4. Rule versus Exception?
 - 3.5. Exemption over Credit Method?
- 4. The CJEU's Jurisdiction under Article 273 TFEU**
- 5. The Effects of the CJEU Decision**
- 6. Conclusion and Outlook**

1. Overview

On 12 September 2017, the CJEU handed down its judgment in *Republic of Austria v Federal Republic of Germany* (C-648/15). This case is rather special: it concerns a dispute over the interpretation of a particular rule in the Austria-Germany tax treaty. This dispute is now resolved by the CJEU's judgment, the Court having acted, in effect, as an arbitration tribunal. The CJEU was given the competence to do this by the two contracting states in their bilateral tax treaty: when the Austria-Germany tax treaty established arbitration as the ultimate resolution mechanism over tax treaty disputes (in its Article 25 para. 5), the CJEU was explicitly chosen as the (exclusive) court of arbitration.

In this respect, the present case is absolutely unique: since the Austria-Germany tax treaty (which was negotiated around the year 2000), no other bilateral (or multilateral) tax treaty has given the CJEU such a role. For many years, there was no practical experience of any kind of arbitration under the Austria-Germany tax treaty itself. The present case is actually the first case ever for a dispute between the two states to have escalated to the CJEU for arbitration, after an unsuccessful mutual agreement procedure (MAP).

It is not surprising therefore, that several of the issues in case C-648/15, as discussed below, are (at least so far) uncharted territory. In this regard, the CJEU's judgment has given some answers to what have thus far been open questions.¹ The author has already speculated on some of these answers when discussing the case while it was still pending before the CJEU.² Hence, the analysis below provides an opportunity to verify whether the author's earlier speculations were correct.

2. The Dispute and the CJEU's Decision

A brief summary of the underlying dispute:³

The issue in dispute was whether Germany is allowed to levy a withholding tax on certain cross-border interest payments under Article 11 of the Austria-Germany tax treaty. Under the treaty the general rule for allocating taxing rights over cross-border interest payments is that the residence state of the recipient of the interest has the exclusive right to tax such interest. There is in general no right for the source state to levy tax (e.g. by withholding) on the interest payments (Article 11

1 See also J. Luts & C. Kempeneers, *Case C-648/15 Austria v. Germany: Jurisdiction and Powers of the CJ to Settle Tax Treaty Disputes Under Article 273 TFEU*, EC Tax Review 2018, p. 5; I. Kerschner, *Deutsche Genusscheinträge: Debut des EuGH als DBA-Schiedsrichter*, ecolex 2017, p. 1102; H. Jirousek, *EuGH entscheidet im Schiedsverfahren zugunsten Österreichs*, SWK 2017 p. 1186.

2 See C. Staringer, *Austria*, in: M. Lang et al. (eds.), *CJEU Recent Developments in Direct Taxation 2016* (Vienna: Linde Verlag, 2017) p. 1.

3 See also C. Staringer, in *CJEU Recent Developments in Direct Taxation 2016*, p. 2 et seq.

para. 1 of the treaty). By way of exception, the source state is however allowed to levy a tax (with no percentage cap) on interest payments on debt instruments which have a profit participation (in the authentic German language: *Gewinnbeteiligung*).

The disputed issue was now whether a particular kind of interest payment is covered by Article 11 para. 2 of the treaty so that the source state (here Germany) may levy a source tax. The relevant facts of the case are as follows: A German issuer has issued profit participation rights (PPR) (in German: *Genussscheine*) to Austrian investors. The PPR had a fixed coupon, i.e. payments to investors under the PPR were calculated as a fixed percentage of invested capital. However, interest payments were only due where the issuer had sufficient profits to satisfy the coupon. If not, unpaid coupons were cumulated (i.e. carried forward) until the issuer became profitable enough to pay the accumulated coupons out of his profits.

The core question was therefore whether the PPR described above generated interest payments that could be classified as stemming “*from debt instruments with a profit participation*”. If this was the case, Germany would be entitled to levy a source tax under Article 11 para. 2 of the treaty, leading to a credit obligation for Austria in respect of such German source tax. Otherwise (i.e. if no “*debt instrument with a profit participation*” was found to exist), Germany would not be entitled to levy any source tax and Austria consequently would not face any credit obligation under the treaty.

The CJEU has given a clear answer to this question in its judgment: it has interpreted Article 11 para. 2 of the Austria-Germany treaty in such way that there is no right for Germany to levy a source tax on a PPR structured in the manner that it was in the present case. In other words, Austria has “won” the case.

Indeed, the outcome of the case is exactly consistent with the argument submitted by Austria in the proceedings: for the Austrian government, it was always very clear that a PPR such as in the case at hand cannot be a “*profit participating*” instrument because it has a fixed coupon (i.e. there is no percentage entitlement in the issuer’s profit). The only “profit related” element in the PPR concerned is that the issuer is not required to make any interest payments in loss years (or less than the full payment in years where profit is not sufficient to meet the full coupon), but is allowed to carry forward the payment obligation into future profitable years. However, this mechanism is not a “*profit participation*”, but at best a “condition of profitability” which is not covered by Article 11 para. 2 of the treaty.⁴ The CJEU followed the substance of this argument, i.e. that instruments cannot fall under Article 11 para. 2 of the treaty if they are only *profit dependent*, but not *profit related*.

⁴ See I. Kerschner/ F. Koppensteiner/ C. Seydl, *Österreich erhebt aufgrund einer DBA-Streitigkeit erstmals Klage beim EuGH*, SWI 2016, p. 134 (134 et seq).

3. The Reasoning of the CJEU

While the CJEU's ultimate result is, in the author's view, convincing, the underlying reasoning it has employed to arrive at such result is more difficult to follow.

3.1. The Irrelevance of Domestic Law

The CJEU starts its analysis of the case with a reference to Article 3 para. 2 of the Austria-Germany tax treaty (which corresponds to Article 3 para. 2 of the OECD Model Convention), where it is stated that items not defined in the treaty should be given the meaning they have under the contracting states' domestic law.⁵ This reference to Article 3 para. 2 is unfortunate as it could be seen as an indication that the CJEU indeed has looked, at least as a starting point, into domestic law to get an understanding of the term "*profit participation*" in Art 11 para. 2 of the Austria-Germany tax treaty. However, this creates the wrong impression. The CJEU's further reasoning clearly shows that in reality it rejects domestic law as the guiding source of interpretation in the present dispute.⁶

The CJEU arrives at this result through an elaborated interpretation of Article 25 para. 5 of the Austria-Germany tax treaty, i.e. of the treaty's arbitration clause. This clause would be ineffective if undefined terms (like "*profit participation*") were governed by the contracting states' domestic laws, as different domestic law backgrounds would then necessarily lead to a dispute that it could not resolve. There would simply be two "correct" interpretations of "*profit participation*", each following a different domestic law concept. This would deprive the arbitration clause of all practical effect. Therefore, the CJEU concludes that Article 11 para. 2 must be interpreted according to the methods of International Law (i.e. the Vienna Convention on the Law of Treaties) by its ordinary meaning, object and purpose.⁷

The whole analysis of the CJEU on the "interpretation by domestic or international law issue" is long and indeed is not even necessary. A quick answer to this issue could have been found in Article 3 para. 2 of the Austria-Germany tax treaty itself, where it is stated that domestic law can only be used for interpretation "*unless the context otherwise requires*". Actually, it seems that the CJEU has overlooked (or underestimated) this important part of Article 3 para. 2. Giving proper relevance to "*unless the context otherwise requires*" would have avoided the CJEU having to reinvent the wheel on tax treaty interpretation in this judgment.

5 CJEU 12 September 2017, C-648/15, *Republic of Austria v Federal Republic of Germany*, EU:C:2017:664, m.no. 35.

6 M. Lang, *DBA-Interpretation durch den EuGH*, SWI 2017, p. 507 (510 et seq.).

7 CJEU 12 September 2017, C-648/15, *Republic of Austria v Federal Republic of Germany*, EU:C:2017:664, para. 39.

3.2. The “Ordinary Meaning”

In the next step, the CJEU looks for the “*ordinary meaning*” of “*profit participation*” in Article 11 para. 2 of the Austria-Germany tax treaty. For such purposes, the court refers to “*everyday language*” which would understand a profit participation as meaning “*receiving a share in the positive income of the annual operations of an undertaking*”. From this starting point, the CJEU concludes that it is the “*inherent variability and unpredictability of the annual income of any high-risk economic activity*” that is in the nature of a “*profit participation*”, which is “*uncertain at the beginning of the financial year, liable to vary from one year to another, indeed capable of being zero*”.⁸

By creating such definitions, the Court indeed gives a very precise verbal explanation of what an entitlement to a share in profits is. However, the CJEU should have been honest in disclosing that all this is more its *own* understanding of “*profit participation*” rather than the meaning of the term in “*everyday language*”. In reality, it is rather unlikely that “*everyday language*” will contain a precise understanding of a technical term such as “profit participation”.

3.3. The Contextual Analysis

Further, the CJEU wants to have its result on the “*ordinary meaning*” confirmed by a contextual analysis of Article 11 para. 2 of the Austria-Germany tax treaty. This treaty rule mentions “*profit participation*” next to “*profit sharing bonds*”, “*profit participating loans*” and “*silent partner*”. The CJEU’s argument, which, as such, certainly makes good sense, is that this list of instruments must have a common element as to the required nature of profit entitlement in order for it to qualify under Article 11 para. 2 of the Austria-Germany tax treaty. In the CJEU’s view, this common element is the varying remuneration of all these instruments, which, it considers to confirm the “*ordinary meaning*” found earlier.⁹

The CJEU has certainly good reasons for its view. However, it is interesting to see that the German *Bundesfinanzhof* (BFH) has also made this contextual argument (i.e. what is the common element in the listed instruments?) in its earlier jurisprudence, but arrived at the opposite result (i.e. that for a “*profit participation*” it is enough that a profit merely exists, even if the coupon itself is fixed, as this was seen by the BFH as the common element in Art 11 para. 2 of the treaty).¹⁰ In fact, this BFH case law was actually the reason why Germany insisted on its position in the now decided case for so many years (notably, the case was brought to the

8 CJEU 12 September 2017, C-648/15, *Republic of Austria v Federal Republic of Germany*, EU:C:2017:664, para. 40 et seq.

9 CJEU 12 September 2017, C-648/15, *Republic of Austria v Federal Republic of Germany*, EU:C:2017:664, para. 44.

10 See BFH 26 August 2010, I R 53/09.

CJEU only after years of the unsuccessful MAP between the Competent Authorities of Austria and Germany). Obviously, Germany (i.e. the German Competent Authority) felt that it had to follow the longstanding view of the jurisprudence of the BFH as to the interpretation of the term “*profit participation*”.¹¹

The lesson to be learned from this “contextual analysis” exercise is that one has to be careful with a contextual (or systematic) interpretation.¹² Such interpretation necessarily has to presuppose what the “context” (in the present case: the common element of the instruments mentioned in Art 11 para. 2 of the treaty) really is. Depending on the presupposed “context”, one may easily arrive at different outcomes which all claim to be based in the “context” of the term in question.

3.4. Rule versus Exception?

The most difficult part of the CJEU’s reasoning is where the Court is going deeper into core concepts of tax treaty law.

According to the CJEU, Art 11 para. 2, providing for taxation in the source state, is to be seen as a derogation from the general principle of the tax treaty expressed in Art 11 para. 1 of the treaty, whereby interest is generally taxed in the residence state.¹³ From this structure of Article 11 of the treaty, the CJEU concludes that that a “*criterion allowing for derogation from the agreed principle of taxation must be given a strict interpretation*”.¹⁴ Therefore, the term “*profit participation*” must be given a narrow meaning as such “*profit participation*” would create source taxation, which goes against residence taxation as the “*agreed principle of taxation*”.

This approach of the CJEU is dangerous. It is nothing other than a “rule versus exception” logic, which is, from a methodological point of view, unacceptable.¹⁵ A “rule versus exception” argument pre-empts what the “rule” and what the “exception” is, with the CJEU thinking that source taxation is exceptional (and therefore secondary) in nature. However, there is no such primary or secondary taxation right under a tax treaty. Rather, residence or source states are on an equal footing when it comes to the allocation of taxing rights by a tax treaty. It is true that the wording of many tax treaty allocation rules (like Art 11 para. 2 of the Austria-Germany tax treaty) mention residence taxation first, and then carve out cases of

11 See in detail H. Jirousek, *Schiedsverfahren nach Art 25 Abs 5 DBA Deutschland vor dem EuGH*, SWI 2017, p. 36 (40).

12 M. Lang, *DBA-Interpretation durch den EuGH*, SWI 2017, p. 507 (511 et seq.).

13 CJEU 12 September 2017, C-648/15, *Republic of Austria v Federal Republic of Germany*, EU:C:2017:664, para. 48.

14 CJEU 12 September 2017, C-648/15, *Republic of Austria v Federal Republic of Germany*, EU:C:2017:664, para. 49.

15 M. Lang, *DBA-Interpretation durch den EuGH*, SWI 2017, p. 507 (513.); Kerschner, *Deutsche Genussscheinerrträge: Debut des EuGH als DBA-Schiedsrichter*, *ecolex* 2017, p. 1102 (1005).