Subsidiarity of tax treaties in relation to domestic law

Philippe MARTIN
Conseil d'Etat (France)

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Subsidiarity: origin of concept

- Art. 55 French Constitution: international treaties are superior to domestic legislation. No treaty override.
- Subsidiarity of tax treaties: case law concept meaning that domestic law should be considered first, before applying tax treaties.
- Consequence of the primary object of tax treaties, *i.e.* the avoidance of double taxation.
- First *Conseil d'Etat* case law in 1975, current wording in CE 28 June 2002 Schneider Electric

Subsidiarity: legal consequences (Schneider)

- Tax administration cannot rely on treaty provisions alone to tax income. Domestic legislation is needed.
- Courts should look first at domestic tax law, to check if income is taxable, and under which qualification.
- Then courts should, if income is taxable under domestic law, compare domestic qualification with treaty provisions and check if treaty blocks application of domestic tax law.

Issue: double non-taxation?

- Logically, subsidiarity can lead to double non-taxation if treaty grants taxing rights but domestic law does not tax.
- Domestic stopgap legislation: law of 28 December 1959 (Art. 4 bis, 165 bis, 209 French tax code).
- With regard to personal and corporate income tax, all income attributed to France by a tax treaty is taxable in France.

Issue: double non-taxation?

- Methodology (CE 31 July 2009, Overseas Thoroughbred Racing Stud Farms Ltd)
  - Apply « ordinary » domestic tax law
  - Check tax treaty
  - If domestic law does not tax but tax treaty gives France the right to tax, look for consequences of 1959 law
- Interpretation of stopgap legislation
  - Extends domestic territoriality rules?
  - Blocks domestic economic or social exemptions?
  - Widens domestic taxing mechanisms?

Issue: does domestic qualification of income influence treaty qualification?

- Schneider decision does not mean that categories of income should be the same
- Major issue: domestic tax fictions (deeming provisions)
- How to confront domestic tax fictions with tax treaties?
  - Disregard treaties (notional income)?
  - Look at treaties from the legal design of domestic fiction?
  - Look at treaties from the real qualification and attribution of income?

Issue: does domestic qualification of income influence treaty qualification?

- French case law: apply treaties following legal logic of domestic tax fiction
  - Branch tax: CE 31 January 2001, Bank Polska
  - CFC: CE 28 June 2002, Schneider Electric
  - Artistes: CE 28 March 2008, Aznavour
- Risk of fine-tuning by domestic legislation: after Schneider, 2005 law shifts French CFC from « look-through » to « deemed distribution » in order to avoid Art. 7 OECD Model.

Issue: can taxpayers stick to domestic law?

- Argument by taxpayers: tax treaties should never increase tax burden.
- Conflict between domestic tax domicile and treaty residence: CE 8 July 2002, Lecat
  - Domestic law: tax benefits on overall income if French domicile
  - Mr Lecat: tax domicile in France under domestic law, but residence in Belgium under France-Belgium tax treaty
  - *Conseil d'Etat*: domestic law intended tax benefits to apply if worldwide income can be taxed in France

Issue: can taxpayers stick to domestic law?

- Domestic deduction of losses in State R if treaty assigns gain to State S: CE 12 June 2013, BNP Paribas
- French bank BNP Paribas deducted in France provisions for depreciation of shares of full Canadian subsidiary
- France-Canada tax treaty 2 May 1975
  - Art. 13 (3): capital gains from alienation of substantial participations are taxable in the state of residence of subsidiary
  - Art. 23 (3): exemption in France if income taxable in Canada under Art. 13(3)

Issue: can taxpayers stick to domestic law?

- Taxpayer: apply subsidiarity and allow deduction justified in domestic law
- *Conseil d'Etat:*
  - In domestic law, provision is deductible only if future loss or expense is deductible
  - If tax treaty denies French jurisdiction over capital gains on sale of substantial participations, then capital losses on such substantial participations are not deductible in France