What is the content of each substance requirement?

Is there a rational-systematic relationship between the four substance requirements?

Case Study

1. A high-taxed parent enters into a Cost Contribution Agreement (CCA) with its low-taxed subsidiary
2. The subsidiary is the economic owner of the developed intangible (IP)
3. The subsidiary licenses the IP to other high-taxed subsidiaries of the group like Sub1
4. Tax-related results:
   a) “milking” of the profits of Sub1
   b) “parking” of the profits in the low-taxed jurisdiction

Responses

- Article 4(3) OECD MTC provides that the subsidiary is resident for treaty purposes where its place of effective management is located (POEM), i.e. "where key management and commercial decisions that are necessary for the conduct of the entity’s business as a whole are in substance made.”

- The profits from the IP will be attributable to the subsidiary only if it “in substance: performs and controls all of the functions (...) provides all assets (...) assumes all of the risks”.

- Article 29 OECD MTC refers to the entitlement to treaty benefits. It includes the Limitation on Benefits Clause (LoB) and the Principal Purpose Test (PPT). Both the LoB and the PPT are substance-oriented according to literature.

- In Europe, after the Cadbury Schweppes judgement and according to the new Anti Tax Avoidance Directive, Controlled Foreign Corporation rules (CFC rules) do not apply where “the controlled foreign company carries on a substantive economic activity”.

Notice something? All rules in question require from the subsidiary to have substance!

Research questions