

Foreign Tax Credit – Is a Carry-Forward Obligatory?

The authors, in this article, explore what could be the legal basis for the granting of a tax credit carry-forward in respect of foreign taxes, with emphasis on the three legal bases for this, i.e. national law, EU law and treaty law.

1. What Is the Issue?

The elimination of double taxation is one of the main goals of the conclusion of tax treaties. It is either achieved by exempting income from the source state (the exemption method) or by crediting taxes paid in the source state (the credit method). It is the residence state that has to apply either of these two methods. When applying the credit method problems can arise if the taxes paid in the source state cannot be credited in the residence state due to a lack of taxes payable there. The following Example illustrates this problem.

Example

A Co. is resident in State X and receives dividend payments from State Y. The dividends' origin is B Co., in which A Co. holds a 3% participation. The State X-State Y Tax Treaty is modelled after the OECD Model (2010).¹ Accordingly, State Y (the source state) may levy a withholding tax on the dividend payments, which is limited to 15%. State X must credit the taxes withheld at source against the taxes levied on the dividends in State X. The tax rate in State X is 25%. Consequently, State X must grant a tax credit amounting to the full amount of source taxes. A Co. is not subject to a higher level of tax than it would have been if investing at home in State X. Double taxation is eliminated. What happens, though, if A Co. realizes an overall loss in the year in which it receives the dividends and is not subject to tax in the residence state? There are no taxes against which the withholding taxes could be credited. In addition, the dividends reduce the overall loss of A Co. and with it a potential loss carry-forward. As a result, the dividends are indirectly taxed twice, i.e. first at source in the year of distribution and second in the year in which A Co. becomes profitable again, as in calculating the profits only a reduced loss carry-forward is taken into account. In light of the objective of a tax treaty, it should, therefore, be asked: can A Co. claim a tax credit for the

withholding tax paid in previous years? Or is it simply a flaw of the credit method, the burden of which is borne by the taxpayer?

Similar issues arise in other circumstances and not only in respect of passive income. Many countries adopt the credit method for all types of income including business profits. In addition, when applying controlled foreign company rules, the taxpayer might face similar problems.

The Example reveals that the fact that the dividend income is indirectly taxed more onerously is closely linked to the loss situation in the residence state of the taxpayer and the reduction of the loss carry-forward. From this perspective, it can be argued that the source of these problems lies in the possibility of carrying forward losses in the first place. That is, assuming there was no loss carry-forward, foreign-source income could not reduce this and, therefore, the situation would not result in double taxation. Of course, overall, the taxpayer would be worse off without a loss carry-forward anyway. The fact is, though, that most countries do allow for a loss carry-forward.² Even though these rules are purely national, it cannot only be regarded as a domestic problem if the loss carry-forward is influenced by foreign-source income. In the authors' opinion, it can also not be argued that the taxpayer is given a benefit by the loss carry-forward and a reduction of this is just a diminution of a benefit that the taxpayer should be happy with.

Granting a carry-forward for foreign taxes could be a solution to the problem. The objective of this article is to explore what the legal basis could be for a tax credit carry-forward. There are three possible sources of law the authors analyse on a step-by-step basis: (1) national law; (2) EU law; and (3) treaty law. Emphasis is placed on the question whether or not, where national and EU law do not allow for a tax credit carry-forward, a tax treaty modelled on the OECD Model could be the legal basis.

2. Legal Basis in National Law: The Example of Sweden

The national law of several countries around the world provides for statutory rules that permit the carrying forward of tax credits, for example, those of Canada, Japan, the Netherlands, Sweden and the United States.³ If one of these countries had been the residence state in the Example, a tax credit carry-forward would be possible on the basis of national rules. For the purpose of this article, the authors have selected Sweden to describe the national legal basis for a tax credit carry-forward and to illustrate

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1. OECD Model Tax Convention on Income and on Capital (22 July 2010), Models IBFD.

2. See IBFD, *Global Individual Tax Handbook*, Global Tax Series (IBFD 2007).

3. See K. Vogel, in *Doppelbesteuerungsabkommen* 5th ed., art. 23 m.no. 154 (K. Vogel and M. Lehner eds., Beck 2008).

the reasons why a country might decide to introduce such a rule.

Sweden is a credit method country.⁴ The Swedish unilateral provisions for the avoidance of double taxation and most of the tax treaties concluded by Sweden provide for the credit method.⁵ The unilateral rules to avoid double taxation are set out in the Foreign Tax Credit Law (*avräkningsslag*, AvrL). The unilateral credit is only granted if no tax treaty applies.⁶ The provisions of a tax treaty, therefore, take precedence over the unilateral provision. However, the rules in the AvrL still apply where the credit is given by means of a tax treaty, as it is Swedish treaty policy to refer to the national rules in its treaty method articles.⁷ Consequently, Swedish method articles generally deviate from article 23B of the OECD Model.⁸

The AvrL provides for a maximum credit (*spärrbeloppet*).⁹ Accordingly, the creditable amount is subject to a limit, i.e. foreign taxes may only be credited up to the amount of taxes which would have been payable in Sweden. An overall principle applies,¹⁰ which means that there is no per-country or per-item limitation. The maximum credit is calculated by simply aggregating all of the Swedish taxes that have resulted from the income on which foreign taxes were levied. In a first step, all of the foreign income is aggregated and, second, the Swedish tax on the income is calculated. Only so much of the foreign tax can be credited as does not exceed this amount. As the AvrL provides for a maximum credit at the end of a tax year, a taxpayer may be in the situation that more tax was paid abroad than the amount of Swedish tax eligible for credit. Consequently, the Swedish legislator decided to introduce a credit carry-forward in respect of foreign taxes.¹¹ The taxpayer may,

on request, credit the excess amount until the fifth subsequent tax year, at the latest. In this regard, it does not matter why the taxes could previously not be credited, be it because of a loss (as in the Example)¹² or because the tax rate in the source state is higher than in Sweden.¹³

While the possibility to credit foreign taxes has existed since the 1960s,¹⁴ the possibility to carry forward excessive tax credits was first introduced in 1991. However, 10 years earlier, in 1982, a commission was established that had the task of reconsidering Sweden's practice in respect of the (unilateral) avoidance of double taxation in light of the activities of Swedish businesses abroad and the increased exports of Swedish enterprises.¹⁵ For this purpose, the Swedish methods were compared with the rules in other industrialized countries,¹⁶ which were more favourable to taxpayers and, therefore, put Swedish enterprises at a disadvantage in the world market.¹⁷ In the Commission's report, the possibility of tax credit carry-forwards was also discussed. In light of the fact that, when a business exports a significant amount it might encounter problems with not being able to credit higher source taxes and not offset source taxes in years of losses, it was considered to be necessary to take into account source taxes in later years, just as other competing industrialized countries do and the introduction of a carry-forward was proposed.¹⁸ However, the Public Representative (*allmänna ombudet*)¹⁹ noted that a carry-forward would result in increased administrative burden and control issues, as it would have to be ensured that a specific tax credit was not used more than once.²⁰ The main argument against a tax credit carry-forward was, therefore, that of the difficulties in its practical realization. Consequently, in 1982, a carry-forward provision was not introduced.

In 1991, a change in Sweden's tax system entailed the issue being reconsidered.²¹ The Swedish tax reform in 1991 included the widening of the tax base, so that companies, for example, can, to a lesser extent, place income in different reserves to postpone taxation. There was also a reduction in tax rates. These changes were expected to reduce the possibilities to receive credit for all of the foreign taxes paid in a given year.²² On the one hand, the reduced tax

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4. Up to the mid-1960s, Sweden used the exemption method in its tax treaties, but since then preference has been given to the credit method (with a short return to the exemption method in the 1980s). An explanation for this switch of method was never presented by the Swedish legislator. For a detailed analysis of Sweden's choices in method, see N. Mattsson, *Exemption or Credit of Tax: What's Sweden's Preference?*, in *Liber Amicorum Sven-Olof Lodin* p. 146 et seq. (K. Andersson ed., Norstedts Juridik 2001). See also M. Berglund, *Sweden*, in *The Impact of the OECD and UN Model Conventions on Bilateral Tax Treaties* p. 1075 et seq. (M. Lang et al. eds., Cambridge U. Press 2012); L. Mutén, *Credit-metod eller exempt-metod i dubbelbeskattningsavtal - en principfråga?*, *Svensk Skattetidning*, p. 302 (1993); and Ds B 1982:5 (Government Bill 1982/83: 14, annex 1, p. 41).
 5. SE: Income Tax Act (*Inkomst-skattelagen*), sec. 16:19; National Legislation IBFD states that foreign taxes may, on request, be deducted as expenses. This second method of relieving juridical double taxation may apply at the same time when the prerequisites for a tax credit are fulfilled. In such a case, it is ensured by the rules in the AvrL (*Lag 1986: 468 om avräkning av utländsk skatt*) ensure that no more relief from double taxation is granted than the foreign taxes that have been paid. See M. Berglund & F. Bexelius, *Sweden*, in *Key practical issues to eliminate double taxation of business income*, Cahier de Droit Fiscal International vol. 96b, sec. 1. (Sdu Uitgevers 2011), Online Books IBFD.
 6. See sec. 2:2 AvrL.
 7. See Berglund, *supra* n. 4, at p. 1076; Berglund & Bexelius, *supra* n. 5, at sec. 2.4.; and M. Dahlberg, *Sweden*, in *Source and residence: new configuration of their principles*, Cahier de Droit Fiscal International vol. 90a, sec. 4.7. (Sdu Fiscale & Financiële Uitgevers 2005), Online Books IBFD.
 8. See, especially, Sweden's more recent tax treaties, for example, those with Chile, India, Luxembourg, Mauritius and Poland.
 9. See sec. 2:9 AvrL.
 10. See M. Berglund, *Ändringar i systemet för avräkning av utländsk skatt - en kommentar*, *Skattenytt* 1-2, p. 8 (2009); Berglund & Bexelius, *supra* n. 5, at sec. 2.4.; and Mattsson, *supra* n. 4, at p. 155.
 11. See sec. 2:17 AvrL.

12. See Berglund & Bexelius, *supra* n. 5.
13. The grant of a carry-forward for higher source taxes is a rather liberal application of the credit method. This practice is only possible when a tax treaty does not provide for a maximum credit (as in the *OECD Model*), as it would limit the credit to the amount of taxes levied in the residence state. The Swedish tax credit carry-forward has the effect that, ultimately, the level of tax rate of the source state applies, which is usually only achieved by the exemption method.
14. See Mattsson, *supra* n. 4, at p. 148 and Ds B 1982: 5 (Government Bill 1982/83: 14, annex 1, pp. 21, 36).
15. The report of the commission (Ds B 1982:5) can be found in annex 1 of the Government Bill 1982/83: 14, at pp. 15 et seq.
16. These countries were Denmark, Finland, France, Germany, Japan, the Netherlands, Norway, the United Kingdom and the United States.
17. See Ds B 1982:5 (Government Bill 1982/83: 14, annex 1, p. 20).
18. See Ds B 1982:5 (Government Bill 1982/83: 14, annex 1, p. 88).
19. The Public Representative is one of the bodies of the *remissinstanserna*, which are the bodies and organizations that are asked to give their opinion on proposed new legislation. As the name suggests, the Public Representative must also represent citizens in general.
20. See Ds B 1982:5 (Government Bill 1982/83: 14, p. 96 et seq.).
21. See Government Bill 1990/91: 54, pp. 290-292.
22. See Government Bill 1990/91: 54, p. 291.

rates come with the risk that foreign tax rates would be higher and, therefore, could not be credited due to the maximum credit. On the other hand, the widened tax base could result in both more excess tax and more years with losses. Due to these changes, a tax credit carry-forward was thought to be necessary and this was introduced in 1991.²³

At first, the carry-forward period was three years. While the representatives from the business sector requested an unlimited carry-forward period, administrative problems mitigated against such an approach and it was decided to introduce the new provision with a limitation of three years.²⁴ In 2008, the AvrL was updated and, inter alia, the carry-forward period was changed.²⁵ Even though unlimited carry-forward was still not accepted due to administrative issues, the period was lengthened to five years, three years having proven to be too short for a business to overcome a period of economic difficulties and losses.²⁶ The extension of the carry-forward period means that taxpayers who cannot credit foreign taxes due to an economic recession have the possibility to use the credit for another two years. In addition, five years usually equal a “normal” business cycle within which a company with losses usually becomes profitable.²⁷ It is, therefore, now possible to carry forward the amount of tax in excess of the maximum credit in section 2:9 of the AvrL for up to five years. Clearly, the Swedish legislator considered that it was not possible to carry forward a tax credit without a specific statutory provision. The possibility of using EU law or tax treaties as a legal basis for a carry-forward was never discussed during the legislative process. However, it must be noted that the Swedish method articles deviate from the OECD Model and regularly initially refer to national law.

3. Does EU Law Require a Tax Credit Carry-Forward?

Apart from Sweden, most Member States do not have any domestic rules on foreign tax credits.²⁸ Accordingly, the question arises as to whether or not these Member States are required by EU law to grant a foreign tax credit carry-forward. EU law prohibits the unequal treatment of comparable domestic and cross-border situations. A discrimination or restriction in respect of cross-border cases infringes the fundamental freedoms set out in the Treaty on the Functioning of the European Union (TFEU).²⁹ Considering the Example and placing it in an EU context, it is possible, at the first glance, to say that such a situation might be to the detriment of a taxpayer who invests abroad. While a cross-border taxpayer suffers from double taxation, a purely domestic taxpayer does not.

For a long time, the Court of Justice of the European Union (ECJ) did not rule on the issue of international double taxation in light of the fundamental freedoms. In the literature, different positions were advanced.³⁰ On the one hand, it was argued that the domestic law of each Member State must be regarded separately when it is tested as to whether or not it conforms to EU law. As a result, double taxation, as is the problem of the lacking harmonization of the domestic laws of two Member States, was not to be regarded as an EU Law issue.³¹ On the other hand, a position was held to the effect that the concurrence of the domestic laws must be taken into account. Following this view, the overall situation in both Member States must be analysed with regard to EU law. Accordingly, double taxation could constitute a restriction or discrimination that could be eliminated by means of the fundamental freedoms.³² Most likely, the reasoning was that the cost and burden resulting from double taxation could not be in line with the objectives of the Internal Market. Even within the Commission, there have been those who advocated the incompatibility of international double taxation with the TFEU.³³ All in all, sound arguments support the view that double taxation was incompatible with the Internal Market.³⁴ Following these arguments, double taxation arising due to timing distortions, such as in the Example, could also be considered to infringe EU law.

Eventually, the ECJ had to decide on cases concerning the compatibility of double taxation with EU law. Starting with *Kerckhaert & Morres* (Case C-513/04)³⁵ and confirming its decision in *Block* (Case C-67/08),³⁶ *Damseaux* (Case C-128/08)³⁷ and *CIBA* (Case C-96/08),³⁸ the ECJ has repeatedly held that double taxation did not infringe the fundamental freedoms.³⁹ *Kerckhaert & Morres* and

23. *Lag* (1990:1443) om ändring i lagen (1986:468) om avräkning av utländsk skatt.
 24. See Government Bill 1990/91: 54, p. 292.
 25. *Lag* (2008:1350) om ändring i lagen (1986:468) om avräkning av utländsk skatt. For a detailed analysis of the changes, see Berglund, *supra* n. 10.
 26. See Government Bill 2008/09: 63, p. 57.
 27. See Government Bill 2008/09: 63, p. 57.
 28. See H. Loukota, *Gebietet EU Recht einen DBA-Anrechnungsvortrag?*, 16 *Steuer u. Wirtschaft Int.* 6, p. 253 (2006).
 29. Treaty on the Functioning of the European Union (TFEU) OJ C 115 (2008), EU Law IBFD.

30. For an in-depth analysis, see G. Kofler, *Doppelbesteuerungsabkommen und Europäisches Gemeinschaftsrecht* p. 131 et seq. (Linde 2007). See also L. Cerioni, *Double Taxation and the Internal Market: Reflections on the ECJ's Decisions in Block and Damseaux and the Potential Implications*, 63 *Bull. Intl. Taxn.* 11 (2009), *Journals IBFD*.
 31. See, for example, M. Lang, *Double Taxation and EC Law*, in *Comparative Fiscal Federalism: Comparing the European Court of Justice and the US Supreme Court's Tax Jurisprudence* p. 17 (R. Avi-Yonah, J.R. Hines Jr. & M. Lang eds., Kluwer 2007) and *ECJ case law on cross-border dividend taxation – recent developments*, 17 *EC Tax Rev.* 2, p. 68 et seq. (2008).
 32. See, for example, F. Vanistendael, *Does the ECJ have the Power of Interpretation to build a Tax System compatible with the Fundamental Freedoms?*, 17 *EC Tax Rev.* 2, p. 52 (2008) and E.C.C.M. Kemmeren, *After repeal of Article 293 of the EC Treaty under the Lisbon Treaty: the EU Objective of Eliminating Double Taxation can be applied more widely*, 17 *EC Tax Rev.* 4, p. 156 (2008).
 33. See V. Heydt, *Das Verbot der Doppelbesteuerung – ein rechtsverbindlicher Bestandteil des Binnenmarktes*, 11 *Europ. Zeitschr. f. Wirtschaftsrecht* 2, p. 33 (2000).
 34. See G. Kofler, *Doppelbesteuerungsabkommen und Gemeinschaftsrecht* p. 232 (with further references in footnote 492) (Linde 2007).
 35. BE: ECJ, 14 Nov. 2006, Case C-513/04, *Mark Kerckhaert and Bernadette Morres v. Belgian State*, ECJ Case Law IBFD.
 36. DE: ECJ, 12 Feb. 2009, Case C-67/08, *Margarete Block v. Finanzamt Kaufbeuren*, ECJ Case Law IBFD.
 37. BE: ECJ, 16 July 2009, Case C-128/08, *Jacques Damseaux v. Belgian State*, ECJ Case Law IBFD.
 38. CZ: ECJ, 15 Apr. 2010, Case C-96/08, *CIBA Speciality Chemicals Central and Eastern Europe Szolgáltató, Tanácsadó és Kereskedelmi kft v. Adó- és Pénzügyi Ellenőrzési Hivatal (APEH) Hatósági Főosztály*, ECJ Case Law IBFD.
 39. For an overview, see V. Englmaier, *The relevance of the fundamental freedoms for direct taxation*, in *Introduction to European Tax Law on Direct Taxation*, 2nd ed., m.no. 247 et seq. (M. Lang et al. eds., Linde 2010).

Damseaux concerned the double taxation of dividend payments under the Belgian system. In *Block*, the double taxation of an estate was at issue. *CIBA* involved the Czech branch of a Hungarian company that had to pay a similar levy, which was not covered by the relevant tax treaty, in both Member States. Even though the underlying facts of the cases were quite diverse, the ECJ decided in a similar way, i.e. that double taxation is the result of the parallel exercise of taxing rights and a mere consequence of the Member States' fiscal sovereignty:

European Union law, in the current state of its development and in a situation such as that at issue in the main proceedings, does not lay down any general criteria for the attribution of areas of competence between the Member States in relation to the elimination of double taxation within the European Union.⁴⁰ [Therefore] the Member States enjoy a certain autonomy in this area provided they comply with European Union law, and are not obliged therefore to adapt their own tax systems to the different systems of taxation of the other Member States in order, inter alia, to eliminate the double taxation arising from the exercise in parallel by those States of their fiscal sovereignty.⁴¹

Double taxation alone does not constitute a restriction of the fundamental freedoms. Only if a provision also discriminates against a comparable cross-border situation is EU law infringed.

The ECJ has been very clear in denying that double taxation is an infringement of EU law. However, there are arguments as to why double taxation could still be a problem in light of the principles of the Internal Market.⁴² Levying taxes twice on the same transaction or income can be a significant burden for a taxpayer. Or as Advocate-General Ruiz-Jarabo Colomer put it in his Opinion in "*D.*" (Case C-376/03), "[t]he fact that a taxable event might be taxed twice is the most serious obstacle there can be to people and their capital crossing internal borders".⁴³ An area where this becomes particularly clear is that of inheritance and estate taxes. As most Member States have not concluded tax treaties with each other that cover these taxes, many situations arise where an estate is excessively taxed. The Commission has, therefore, recently published a communication in which it states that it:⁴⁴

is not proposing any harmonisation of Member States' inheritance tax rules. Instead it is recommending a broader and more flexible application of national double taxation relief measures so as to provide a pragmatic, speedy and cost-effective solution to the significant tax burdens facing many citizens.

This is not the first effort by the Commission to deal with the problem of double taxation in the Internal Market. In this regard, the work of the Commission dates back to the 1960s.⁴⁵ In a Communication of 2006, the Commis-

sion urged further cooperation in the field of direct taxation and showed its commitment to helping the Member States realize this objective:⁴⁶

International double taxation arises by definition because of a taxpayer being subject to more than one tax jurisdiction. It is a classic example of an obstacle to the Internal Market arising from a lack of co-ordination between national tax systems which can be solved only by co-operation between Member States.

In line with its previous case law, the ECJ recently decided a case concerning double taxation resulting from the absence of a tax credit carry-forward. In *Haribo and Salinen* (Joined Cases C-436/08 and C-437/08),⁴⁷ an Austrian company received dividend payments sourced in other Member States and from third countries. Two different questions had to be answered. First, did Austria have to provide a tax credit carry-forward for underlying taxes, i.e. in respect of the corporate income tax of the subsidiary, and, second, whether or not a tax credit carry-forward for the taxes withheld at source from the dividends was required under EU law. Only the second issue is important for this analysis.⁴⁸ In this respect, the ECJ held that any taxes withheld at source from the dividends, which due to the loss could not be credited, do not have to be creditable in future tax years. Following its previous case law, the ECJ held that such cases of juridical double taxation do not violate the fundamental freedoms, as the TFEU does not provide for rules that allocate taxing rights between Member States.⁴⁹ In this context, it should be noted that the ECJ considers the example to be a case of *juridical* double taxation.⁵⁰ From this statement, it can be concluded that, for the ECJ, it was irrelevant that the tax was not paid in the same period. As long as the tax is paid by the same taxpayer and can be traced back to the same source of income, the situation constitutes a case of *juridical* double taxation.

This analysis demonstrates that EU law cannot resolve the problems raised in the Example. The ECJ refers to this as a problem of juridical double taxation that it is not in a position to resolve. This suggests, however, that the solution might be found in treaty law, as tax treaties are intended to eliminate juridical double taxation.

40. *CIBA* (C-96/08), at para. 27.

41. *Id.*, at para. 28.

42. See also P. Pistone & C. Massoner, *Die gemeinschaftsrechtliche Verpflichtung zur Anrechnung von Quellensteuern im Ansässigkeitsstaat*, in *Quellensteuern* pp. 142-144 (M. Lang et al. eds., Linde 2010).

43. NL: Opinion of Advocate General Ruiz-Jarabo Colomer, 26 Oct. 2004, Case C-376/03, *D. v. Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen*, para. 85, ECJ Case Law IBFD.

44. European Commission, Press Release IP/11/1551, 15 Dec 2011, *Commission proposes measures to tackle cross-border inheritance tax problems*.

45. See, in detail, Kofler, *supra* n. 34, at p. 134 et seq.

46. European Commission, Co-ordinating Member States' direct tax systems in the Internal Market, COM (2006) 823, p. 5 et seq., EU Law IBFD.

47. AT: ECJ, 10 Feb. 2011, Joined Cases C-436/08 and C-437/08, *Haribo Lakritzen Hans Riegel Betriebs GmbH (C-436/08) and Österreichische Salinen AG (C-437/08) v. Finanzamt Linz*, ECJ Case Law IBFD.

48. First question was as follows. Under AT: Corporate Income Tax Act (*Körperschaftsteuergesetz*, KStG), sec. 10, National Legislation IBFD, Austrian Federal Gazette I No. 401/1988 as amended by No. 76/2011, a tax credit was granted for underlying taxes levied on the profits of the company paying the dividend to avoid economic double taxation. As long as the receiving company realizes profits, this method is, in general, equivalent to the exemption method applicable to domestic dividends (see B.J.M. Terra & P.J. Wattel, *European Tax Law* 5th ed., p. 487 et seq. (Kluwer L. Intl. 2008)). However, if the company realizes losses, there is no tax payable in Austria against which the underlying taxes can be credited. The dividend income from abroad reduces the loss in this year and, therefore, the loss carry-forward that could be taken into account in future periods. Consequently, the ECJ held that Austrian law must provide for a possibility to carry-forward such taxes to following years.

49. See D. Smit, *The Haribo and Österreichische Salinen Cases: To What Extent Is the ECJ Willing To Remove International Double Taxation Caused by Member States?*, 51 Eur. Taxn. 7, sec. 3.3. (2011), Journals IBFD.

50. *Haribo and Salinen* (Joined Cases C-436/08 and C-437/08), at para. 166.

4. The Treaty Law Perspective

4.1. The example of Austria

As EU law does not force a country to grant a foreign tax credit carry-forward, the next legal basis must be considered, i.e. treaty law. This could be relevant for all countries that do not have a domestic law on foreign tax credit carry-forwards, but conclude tax treaties. Austria is one such country and, therefore, serves as an example, especially, as this issue has been intensively examined by commentators⁵¹ in case law⁵² and administrative practice.⁵³

If Austria is the residence state in the Example, a tax credit carry-forward would not have been given. It has been argued that the tax treaties concluded by Austria cannot serve as a basis on which to grant a tax credit carry-forward. Austria, in general, prefers the exemption method⁵⁴ and, therefore, most Austrian tax treaties provide for the exemption method.⁵⁵ As far as dividend, interest and royalty payments are concerned, Austria uses the credit method as suggested in article 23A(2) of the OECD Model.⁵⁶ There are also a number of tax treaties in respect of which Austria uses the credit method for all types of income.⁵⁷ Accordingly, in Austria, double taxation is avoided by a mixed system of the credit and the exemption method⁵⁸ and the question of crediting foreign taxes is an important issue.

Where the credit method applies, the tax treaty itself is the legal basis for the credit.⁵⁹ It is necessary that the foreign tax was levied in accordance with the tax treaty. A maximum credit, such as that in article 23A of the OECD Model, applies. The allowable credit is calculated on the basis of a per-country limitation.⁶⁰ In addition,⁶¹ the Austrian tax administration applies a per-item limitation if this is more beneficial for the taxpayer.⁶² In this way, the tax administration tries to reduce the number of cases in respect of which a foreign tax cannot be credited.⁶³ Austrian tax treaties, as they generally follow the OECD Model, do not include explicit rules on tax credit carry-forwards.⁶⁴ Even in the proposal for a treaty implementation act,⁶⁵ which was never introduced, no rules for a tax credit carry-forward were included.⁶⁶ In general, the foreign taxes must be credited in the taxable period in which the related income is included in the Austrian tax base,⁶⁷ irrespective of when the taxable event in the source state occurs. This only requires that the foreign tax is actually paid,⁶⁸ but not necessarily that it is assessed and paid for the same tax period as in Austria.⁶⁹ Foreign taxes paid before the taxable event in Austria occurs can be credited in the later Austrian period only. As far as foreign taxes are paid after the taxable period in which the related income is included in Austria, the credit may be granted retroactively.⁷⁰ Such timing mismatches, therefore, do not impede the application of the credit method.

With regard to the situation in the Example, the Austrian tax administration⁷¹ and courts⁷² tend to take the posi-

51. See, for example, C. Nowotny, *Erkenntnis des VwGH zur Anrechnung ausländischer Quellensteuern bei Verlusten im Ansässigkeitsstaat*, 9 Steuer u. Wirtschaft Int. 9, p. 388 (1999); J. Schuch, *Die Zeit im Recht der Doppelbesteuerungsabkommen* p. 249 et seq. (Linde 2002); Loukota, *supra* n. 28, at p. 250 and *Verlustvortrag und Anrechnungsvortrag*, in Bundesministerium für Finanzen, *Festschrift Quantschnigg* p. 243 (Johannes Kepler Universität Linz eds., LexisNexis 2010); M. Petritz, *Gebieten Abkommens- und/oder Gemeinschaftsrecht einen Anrechnungsvortrag?*, 25 Recht d. Wirtschaft 5, p. 311 (2007); and R. Krickl, R. Jerabek & F. Rittsteuer, *BMF kippt Anrechnungsvortrag für ausländische Quellensteuern*, 20 Steuer u. Wirtschaft Int. 4, p. 160 et seq. (2010).

52. See AT: VwGH (*Verwaltungsgerichtshof*, Supreme Administrative Court), 20 Apr. 1999, 99/14/0012, Tax Treaty Case Law IBFD; AT: VwGH, 28 Sept. 2004, 2000/14/0172, Tax Treaty Case Law IBFD; AT: VwGH, 21 Oct. 2004, 2001/13/0017, Tax Treaty Case Law IBFD; AT: VwGH, 21 Oct. 2004, 2001/13/0264; and AT: VwGH, 28 Feb. 2007, 2003/13/0064. See also AT: UF (*Unabhängiger Finanzsenat*, Independent Fiscal Senate), 27 Feb. 2012, RV/0226-L/12 and AT: UF, 18 Feb. 2011, RV/0686-L/10.

53. See, for example, AT: EAS, 26 Mar. 2002, no. 2021; AT: EAS, 24 Mar. 2005, no. 2591; and AT: EAS 22 Jan. 2010, no. 3113.

54. See W. Gassner, *Die Abkommenspolitik Österreichs*, 9 Steuer u. Wirtschaft Int. 5, p. 195 (1999) and B. Prechtel, *Austria*, in *Key practical issues to eliminate double taxation of business income*, *supra* n. 5, at sec. 1.

55. It is Austrian treaty policy to conclude the exemption method even if the contracting state insists on the credit method for its resident persons. See K. Steininger, *Austria*, in Lang et al., *supra* n. 4, at p. 132 et seq., with further references.

56. Under Austrian domestic law dividends derived from substantial shareholdings are exempt from corporate tax (see sec. 10 of the KStG, Austrian Federal Gazette I No. 401/1988, as amended by No. 67/2011). A switch-over to the credit method might apply if one of the criteria of sec. 10, para. 4-6 of the KStG is fulfilled.

57. These tax treaties are mainly rather old tax treaties, for example, those with Canada, Finland, Iceland, Italy, Japan, Sweden and the United Kingdom, or tax treaties with tax havens, for example, those with Belize, San Marino and the Seychelles. See Loukota, *Verlustvortrag und Anrechnungsvortrag*, *supra* n. 51, at p. 245 and M. Lang, *Überlegungen zur österreichischen DBA-Politik*, 22 Steuer u. Wirtschaft Int. 3, p. 114 (2012).

58. Such a mixed system is common in most countries. See G. Blanluet & P.J. Durand, *General Report*, in *Key practical issues to eliminate double taxation of business income*, *supra* n. 5, at sec. 1.3.2.

59. See M. Lang, *Introduction to the Law of Double Tax Conventions* 2nd ed., m.no. 23 (Linde 2010) and J. Schuch, *Der Anrechnungshöchstbetrag, in Methoden zur Vermeidung der Doppelbesteuerung* p. 17 et seq. (W. Gassner, M. Lang & E. Lechner eds., Linde 1995).

60. See Schuch, *supra* n. 59, at p. 28 et seq.

61. See M. Lang, *supra* n. 59, at m.no. 448 et seq.

62. See Decree (*Richtlinie*) regarding the interpretation of AT: Individual Income Tax Act (*Einkommensteuergesetz*) 2000, m.no. 7584, National Legislation IBFD. As an example, this would be the case, if there is a loss according to the per-country method, although the individual source of income shows a positive result and withholding tax was levied. In such cases, the per-item limitation allows a credit. In both cases, though, the taxpayer must not have an overall loss. If the worldwide income is negative, there is no Austrian tax against which foreign taxes could be credited.

63. See K. Simader, *SWI Jahrestagung: Per-Item-Limitation*, 19 Steuer u. Wirtschaft Int. 5, p. 237 (2009).

64. See P. Verdino, *Die Problematik des Anrechnungszeitraums, in Freistellungs- und Anrechnungsmethode* p. 259 (F.P. Sutter & C. Wimpissinger eds., Linde 2002).

65. *Ministerialentwurf betreffend Bundesgesetz über die Durchführung von Abkommen zur Vermeidung der Doppelbesteuerung (DBA-Durchführungsgesetz)*, 146/ME (17 June 1997).

66. See, in detail, S. Bendlinger, *Ministerialentwurf eines DBA-Durchführungsgesetzes*, 7 Steuer u. Wirtschaft Int. 9, p. 393 (1997); M. Lang, *Neue Entwicklungen im Internationalen Steuerrecht*, 13. ÖJT Vol. III/2 p. 63 et seq. (Vienna 1999); and Gassner, *supra* n. 54, at p. 197 et seq.

67. See Prechtel, *supra* n. 54, at sec. 2.4. and C. Ritz, *BAO-Kommentar* 4th ed., sec. 295a m.no. 8 (Linde, 2011). Further see, for example, AT: VwGH, 21 Oct. 2004, 2001/13/0264.

68. See Schuch, *supra* n. 59, at p. 40.

69. See AT: EAS, 8 Aug. 1997, no. 1120 and R. Rindler, *Die anrechenbare ausländische Steuer*, in Sutter & Wimpissinger, *supra* n. 64, at p. 215.

70. See Ritz, *supra* n. 67, at sec. 295a m.no. 10.

71. See AT: EAS, 22 Jan. 2010, no. 3113; Prechtel, *supra* n. 54, at sec. 2.4.; and Krickl, Jerabek & Rittsteuer, *supra* n. 51, at p. 152.

72. See AT: VwGH, 20 Apr. 1999, 99/14/0012 and (following up) AT: VwGH, 28 Sept. 2004, 2000/14/0172. It should be emphasized, though, that these decisions did not concern an OECD Model style tax treaty. Further decisions on this issue were dismissed due to procedural shortcomings.

tion that there is no legal basis for granting a tax credit carry-forward.⁷³ The primary argument for this position, in addition to the lack of rules in domestic law,⁷⁴ is that, in cases such as in the Example, there is no juridical double taxation and, therefore, no need to avoid it.⁷⁵ In sections 4.2. and 4.3., the advantages and disadvantages of this view are analysed.

4.2. Scope and functioning of article 23A(2) and article 23B of the OECD Model

It is necessary to analyse the OECD Model to ascertain if a solution can be derived from treaty law. When the credit method is applied, the residence state first determines the tax due under domestic law, without taking into consideration a tax treaty in the first instance.⁷⁶ Most countries have implemented a worldwide taxation system and, therefore, calculate the national tax on a worldwide basis.⁷⁷ This tax is then reduced by the foreign tax paid. Under article 23A(2) of the OECD Model, a state should allow “as a deduction from the tax on the income of that resident, an amount equal to the tax paid in that other State”. This deduction is limited and should not exceed “that part of the tax, as computed before the deduction is given, which is attributable to such items of income derived from that other State”.⁷⁸ The credit is, therefore, restricted to the appropriate proportion of tax of the residence state.⁷⁹ This is also referred to as an ordinary or a maximum credit⁸⁰ and means that, for a credit to be granted, a tax on the same foreign income must first be due in the residence state.⁸¹ In other words, if the foreign income is not taxable in the residence state, any foreign tax paid cannot be credited. Similarly, if the foreign tax is greater than the tax in the residence state, the tax credit is capped at the level of the tax of the residence state. In other words, the foreign tax credit is limited to the amount of tax paid in the residence state.

The calculation of the credit limitation is usually applied according to either the overall or the per-country limitation. Under the overall limitation, the aggregate amount of taxes paid in all source states may be credited up to the

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 (see AT: VwGH, 21 Oct. 2004, 2001/13/0017; AT: VwGH, 21 Oct. 2004, 2001/13/0264; and AT: VwGH, 28 Feb. 2007, 2003/13/0064).
 73. See Krickl, Jerabek & Rittsteuer, *supra* n. 51, at p. 152; Schuch, *supra* n. 51, at p. 255 et seq.; and Petritz, *supra* n. 51, at p. 313.
 74. See, for example, AT: EAS 2021, 26 Mar. 2002; Bendlinger, *supra* n. 66, at p. 400 et seq.; and Petritz, *supra* n. 51, at p. 314.
 75. Currently, there are two cases pending at the Austrian Administrative Supreme Court, which will (hopefully) shed light on the issues which have been left unanswered by previous decisions. See AT: UF, 27 Feb. 2012, RV/0226-L/12 and AT: UF, 18 Feb. 2011, RV/0686-L/10, which have been contested by the taxpayers and are now pending as AT: VwGH, 2012/15/0080 and AT: VwGH, 2012/15/0002.
 76. See Lang, *supra* n. 59, at m.no. 432.
 77. See *Blanluet & Durand*, *supra* n. 58, at sec. 1.3.1.
 78. A similar wording is used in art. 23B of the *OECD Model* (2010).
 79. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 23A and B*, para. 57 (22 July 2010), Models IBFD.
 80. Paras. 16 and 23 *OECD Model: Commentary on Article 23A and B* (2010). The second method is a full credit, where the total amount of tax paid in the other state on income which may be taxed in that state can be deducted. If tax rates and, therefore, taxes are higher in the other state compared to the residence state, the full credit allows for a higher deduction than the ordinary credit, or even for a refund.
 81. See Lang, *supra* n. 59, at m.no. 448; para. 26 of the *OECD Model: Commentary on Article 23A and B* (2010); and Petritz, *supra* n. 51, at p. 313.

amount due in the residence state, whereas under the per-country limitation, the creditable tax is calculated for each country individually.⁸² The tax treaty, as a bilateral contract and its wording “income ... taxed in that other State”⁸³ can be understood as a reference to the per-country principle.⁸⁴ Finally, sometimes a per-item limitation is implemented in addition to one of the previously noted limitations.⁸⁵ This means that the tax paid on a certain item of foreign income may be credited up to the amount of tax due in the residence state on the same item of income.⁸⁶

Irrespective of the method of calculation of the ordinary credit, the limitation can result in double taxation in future years, as far as foreign taxes are not creditable but reduce a national loss carry-forward. If the worldwide tax base in the residence state is zero, there is no tax to allow a credit for in that year.

4.3. Treaty law as a legal basis for a foreign tax credit carry-forward?

A tax treaty is intended to avoid juridical double taxation. Juridical double taxation is defined in the Commentary on the OECD Model (2010) as “the imposition of comparable taxes in two (or more) States on the same taxpayer in respect of the same subject matter and for identical periods”.⁸⁷ In contrast to economic double taxation, the income is taxed twice in the hands of the same tax subject.⁸⁸ In practice, it is often argued that the Example is not a case of juridical double taxation and, therefore, the application of a tax treaty is denied.⁸⁹ The reasoning underlying this assumption appears to be based on the following two lines of reasoning. First, it is argued that it is not the same subject matter that is taxed twice. Second, it is claimed that the tax is not levied in respect of the same period.

It is necessary to consider the first issue and how it is possible to conclude that, in a case equivalent to the Example, the same subject matter is not taxed twice but, rather, two different subject matters are taxed once each. If an overall loss arises in the first year, the foreign income is only taxed in the source state and, therefore, only taxed once. The foreign income is attributable to this taxable period, but, due to the loss, it is not possible to give a foreign tax credit in this year.⁹⁰ As the credit method does not have any effect on the tax base in the residence state,⁹¹ it is obvious that foreign profits might reduce a domestic loss carry-forward, although the foreign tax was not credited.⁹² Assuming that there are profits in the residence state in year two,

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 82. See Lang, *supra* n. 59, at m.no. 450.
 83. Art. 23B(1) *OECD Model* (2010).
 84. See K. Vogel, *Double Tax Conventions* 3rd ed., art. 23 m.no. 167 (Kluwer L. Intl. 1998) and Schuch, *supra* n. 59, at p. 30.
 85. See Vogel, *supra* n. 84, at art. 23 m.no. 168.
 86. See Lang, *supra* n. 59, at m.no. 450. See also Schuch, *supra* n. 59, at p. 28 et seq.
 87. Para. 1, Introduction *OECD Model: Commentaries* (2010).
 88. See Vogel, *supra* n. 84, at art. 23 m.no. 3.
 89. See AT: UF, 27 Feb. 2012, RV/0226-L/12 and AT: UF, 18 Feb. 2011, RV/0686-L/10; and Loukota, *supra* n. 28, at p. 250.
 90. See Vogel, *supra* n. 3, at art. 23 m.no. 141.
 91. Whereas the exemption method looks at income and, therefore, influences the taxable basis, the credit method looks at tax (para. 17 of the *OECD Model: Commentary on Article 23A and B* (2010)).
 92. See Lang, *supra* n. 59, at m.no. 432.

these profits are subject to tax in the residence state in the second year. Consequently, it can be argued that it is a domestic profit that is taxed in the residence country in year two and not the income from the source state of year one. Following this line of reasoning, it does not matter whether or not the loss carry-forward is reduced, as the tax does not anymore relate to the same subject matter.

Alternatively, it can be argued that the reduced loss carry-forward results in a temporary deferral of the tax base into the future.⁹³ The foreign positive income of the first period gives rise to an increase in the tax in the residence state in the second period.⁹⁴ Although, in calculating the domestic income tax, all income has been aggregated and the foreign-source income cannot anymore be separated, it is still the reason why the tax increases in year two.⁹⁵ In other words, double taxation does not arise in the tax period in which the foreign income is received, but, rather, in the future tax period in which the (reduced) loss carry-forward is absorbed by other income and tax is levied. Although the taxable income at this time is not the “original” foreign-source income received in the earlier tax period, it can be traced back to this income. If the foreign-source income had not reduced the loss carry-forward, no tax would have been levied. From this perspective, there is no difference between the losses of the current and of previous periods, and, therefore, these should be treated equally for the purpose of the credit method.⁹⁶

An autonomous interpretation of the treaty provision is essential for the purpose of applying article 23A(2) of the OECD Model⁹⁷ and supports the view that the same subject matter is taxed twice when the foreign income in year one reduces the loss carry-forward and the source taxes cannot anymore be credited. Article 23B refers in a first step to “derive[d] income” and in a second step to “the tax on the income of that resident”. Leaving the interpretation of derived income to the domestic law of the individual states, this demonstrates that there are major differences in the application.⁹⁸ Usually, when income is derived in national law, this has tax consequences. However, these events can diverge, as the domestic rules of two different tax systems (of the contracting states) are applied. The tax consequences can, therefore, occur later in one state than in the other. An effective application of the treaty can only be assured, when “derived income” is interpreted, independent of the domestic law, as the income that results in tax consequences. This idea has been developed by Schuch (1998 and 2002), according to whom the phrase “the tax

on the income of that resident” refers to the amount of tax in the residence state, which was originated by the foreign income and is independent of timing issues.⁹⁹ Following this interpretation and applying it to the Example, the income from the source state is not derived until the taxpayer turns profitable, as this is only when it becomes (indirectly) taxable in the residence state. Consequently, the source taxes paid in respect of that income can also be credited as soon as there are profits.

With regard to the second issue, it must be analysed whether or not tax treaties only prevent double taxation in an identical period. In this respect, it is first necessary to have a closer look at the wording of article 23A(2) of the OECD Model. The OECD Model is silent regarding its application in respect of timing. Vogel (1998) also observed that “Arts. 23A and B fail to stipulate the period in respect of which foreign tax should be allowed as a credit”.¹⁰⁰ In an ideal treaty world, timing problems would not arise as the tax would be levied in the source and in the residence state at the same time and double taxation could easily be avoided. However, such ideal situations do not arise when the date of taxation differs between the countries.¹⁰¹ The fact that the wording of article 23A(2) does not refer to timing issues can be understood in two ways. On the one hand, it could be interpreted as a reference to a specific taxable period and, therefore, only taxes within this taxable period can be subject to a credit. On the other hand, the OECD Model can be understood such that its rules apply without any timing constraints. This second opinion would support a cross-period perspective and would, therefore, avoid double taxation due to timing distortions by allowing a tax credit for unused source taxes in the future. At first glance, the wording of the OECD Model supports both interpretations.¹⁰²

With regard to the historical development, it has been assumed in the literature that the drafters of the OECD Model could have avoided including specific timing requirements in the wording on purpose.¹⁰³ In this respect, the Commentary of the League of Nations to the Mexico and London Model stated that:¹⁰⁴

[t]axable years and tax collection dates differ from country to country. It is therefore desirable that regard should be made to this fact when determining, in tax treaties, the taxes which may be deducted or offset against one another.

As the drafters of the OECD Model based their work on these older models, it can be assumed that they were aware of the problem of timing distortions. This is confirmed in

93. The temporary deferral results from the fact that the reduction in the loss carry-forward alone does not give rise to a tax liability against which foreign taxes could be credited in year one. The mere potential of higher taxes in the future cannot be placed on the same level as the actual payment of taxes.

94. See Schuch, *supra* n. 51, at p. 256 and A. Philipp, *Befreiungssystem mit Progressionsvorbehalt und Anrechnungsverfahren*, p. 115 (Orac 1971).

95. Similar issues arise in respect of a domestic carry-over of hidden reserves. See C. Marchgraber, *Übertragung stiller Reserven und Unionsrecht*, 22 *Steuer u. Wirtschaft Int.* 8, p. 361 (2012).

96. See Schuch, *supra* n. 51, at p. 257.

97. See J. Schuch, *Verluste im Recht der Doppelbesteuerungsabkommen* p. 163 et seq. (Linde 1998) and *supra* n. 51, at p. 258.

98. Foreign taxes can be credited according to the accrual basis, the cash basis or maturity. See Vogel, *supra* n. 3, at art. 23 m.no. 141.

99. See Schuch, *supra* n. 51, at p. 257 et seq. and *supra* n. 97, at p. 163 et seq. In contrast, see Vogel *supra* n. 3, at art. 23 m.no. 141.

100. See Vogel, *supra* n. 84, at art. 23 m.no. 160.

101. Such timing mismatches can arise, for example, if one country determines tax according to the cash basis and the other according to the accrual basis.

102. See also E. Burgstaller, *Mitarbeiter-Stock-Options im Recht der Doppelbesteuerungsabkommen* (Linde 2006), pp. 239 et seq.

103. See Burgstaller, *supra* n. 102, at p. 239 et seq. See further Schuch, *supra* n. 51, at p. 257 et seq.

104. See the *Commentary on Article XIII of the Mexico and London Models (League of Nations' Fiscal Committee, London and Mexico Model Tax Conventions – Commentary and Text)* (1946) Official no. C.88.M.88.1946. IIA, p. 30.

the preliminary report of Working Party No. 15, where the question was raised as to:¹⁰⁵

whether the deduction should be restricted to the fiscal year in which the income is included for tax purposes, or whether, for practical reasons, the deduction might be given for any fiscal year in which the claim for relief may be made ("subsequent credit").

However, the drafters put the issue aside and, therefore, the historical interpretation does not favour either possibility, i.e. a cross-period application or a limitation to the same period.

The issue must also be regarded in the context of a tax treaty. All kinds of timing distortions arise because of the absence of harmonized domestic laws. Different methods for determining the taxable profit can result in mismatches, as well as different rules for the calculation of the tax base, different tax rates and different procedural rules.¹⁰⁶ With regard to timing issues, since the Commentary on Article 23A and B of the OECD Model (2005), it has been explicitly stated that it follows from article 23A and B that:¹⁰⁷

relief must be provided regardless of when the tax is levied by the State of source. The State of residence must therefore provide relief of double taxation through the credit or exemption method with respect to such item of income or capital even though the State of source taxes it in an earlier or later year.

Accordingly, the deduction of foreign taxes should not be restricted to taxes paid for the same taxable period to which the income is attributable in the residence state. This statement originates from the work of the OECD on Employee Stock Options Plans.¹⁰⁸ As the wording, though, is not restricted to stock options, it can be applied to similar situations.¹⁰⁹ A comparable problem, for example, arises if a taxable event gives rise to tax consequences in different years due to differing domestic rules. This can be the case if one state applies the realization principle and the other the cash-flow principle to the same taxable event, and realization and cash flow do not take place in the same year.¹¹⁰ Timing mismatches also occur if, for example, the contracting states have different tax years and taxes are not due in identical periods¹¹¹ and can, therefore, be subsumed under the OECD statement that requests the avoidance of double taxation.

With regard to the Example, it must be admitted that, at first glance, this appears to be different from the other timing mismatch examples noted previously. The income is taxed in the source state and reduces the loss carry-forward in the residence state. Once the remaining loss carry-forward has been absorbed in the residence state by future profits, income is taxed. However, if there was a common understanding that, in the Example, the same subject matter is taxed twice, it could finally be broken down into just a problem of a timing mismatch.¹¹² Consequently, it can be argued that the claim in the Commentary on Article 23A and B in respect of providing solutions in cases of timing mismatches similarly applies to cases of absorbed loss carry-forwards. In contrast to this opinion, it has often been advanced¹¹³ that the Commentary on Article 23A and B notes that this problem depends very much on domestic laws and practices¹¹⁴ and "the solution must, therefore, be left to each State".¹¹⁵ Following the line of argument that the problem in the Example is comparable to that of a timing mismatch, this statement must be seen in context with the general opinion of the Commentaries on the OECD Model on timing mismatches. This would mean that a solution should be found, for example, by granting a tax credit carry-forward.¹¹⁶

To summarize, juridical double taxation, which should be eliminated by a tax treaty, is defined as "the imposition of comparable taxes in two (or more) States on the same taxpayer in respect of the same subject matter and for identical periods".¹¹⁷ As the previous examples of timing distortions referred to in the Commentaries on the OECD Model show, this definition has been broadened to also cover such cases in respect of a tax treaty. The criterion of the imposition of taxes in identical periods is not applied here. As demonstrated previously, the Example can be considered to be a case of juridical double taxation. Consequently, it can be argued that juridical double taxation should be eliminated by the means of a tax treaty.

105. Working party No. 15 of the fiscal committee (Denmark-Ireland), *Preliminary report on methods for avoidance of double taxation of income*, FC/WP15(59)1, pt. I, p. 14. This document can be found online at www.taxtreatieshistory.org.

106. See Schuch, *supra* n. 51, at p. 252.

107. Para. 32.8 *OECD Model: Commentary on Article 23A and B* (2010). This paragraph was only first included in the *OECD Model Tax Convention on Income and on Capital: Commentary on Article 23A and B* (15 July 2005), Models IBFD. Consequently, this opinion is not relevant in interpreting tax treaties concluded before 2005.

108. See OECD, *Cross-border Income Tax Issues Arising from Employee Stock Option Plans* p. 8 (OECD 2008).

109. See F. Haase, *Internationales und Europäisches Steuerrecht* 3rd ed., p. 303 (Müller 2011).

110. See Vogel, *supra* n. 3, at art. 23 m.no. 141.

111. For instance, in the United Kingdom, the tax year deviates from the calendar year. Problems may also arise when the tax is not calculated on the income of the year in respect of which it is levied, but, rather, on the income of a preceding year. See para. 61 of the *OECD Model: Commentary on Article 23A and B* (2010) and Vogel, *supra* n. 3, at art. 23 m.no. 142.

112. See Schuch, *supra* n. 51, p. 252.

113. See para. 1, Introduction *OECD Model: Commentaries* (2010).

114. Para. 66 of the *OECD Model: Commentary on Article 23A and B* (2010) states: "In this context, it may be noted that some States are very liberal in applying the credit method. Some States are also considering or have already adopted the possibility of carrying over unused tax credits. Contracting States are, of course, free in bilateral negotiations to amend the Article to deal with any of the aforementioned problems".

115. Id. Para. 65 of the *OECD Model: Commentary on Article 23A and B* (2010)) gives the following example concerning losses in residence State R: "When the total income is derived from abroad, and no income but a loss not exceeding the income from abroad arises in State R, then the total tax charged in State R will be appropriate to the income from State S, and the maximum deduction which State R is to allow will consequently be the tax charged in State R. Other solutions are possible." According to this, the residence state does not appear to have to take further steps to avoid double taxation other than giving a credit for foreign taxes up to the amount of taxes paid in the same taxable period in the residence state. However, this example does not consider the existence of a loss carry-forward and, therefore, cannot be interpreted in a way that it would accept double taxation in such cases.

116. Para. 32.8 *OECD Model: Commentary on Article 23A and B* (2010).

117. Para. 1, Introduction 1 *OECD Model: Commentaries* (2010).

5. Conclusions

Double taxation can arise if foreign taxes are not credited due to an overall loss situation. A credit carry-forward would offer a solution to avoid such undesirable results. In this regard, Sweden has implemented such a carry-forward in its domestic tax law. The description of the Swedish rules demonstrates that a tax credit carry-forward can be regulated in a very detailed way under national law. However, no conclusions may be drawn from the authors' analysis with regard to the question of whether or not tax treaties per se could serve as a basis for a carry-forward. This is because Swedish tax treaties usually deviate from the OECD Model and contain a reference to national law for the purpose of applying the method article. Obviously, the possibility for a carry-forward of unused tax credits had also to be included in national law. However, the debate when the carry-forward was first introduced made clear the importance of such a rule in light of competitiveness of exporting businesses.

There is an interesting finding with regard to EU law. In *Haribo and Salinen*, the ECJ dealt with a case equivalent to the Example as a case of juridical double taxation. This should be emphasized, as, if the definition of juridical double taxation that can be found in the Commentaries on the OECD Model

were applied strictly, the Example would not qualify as a case of juridical double taxation. Admittedly, ECJ case law cannot influence the interpretation of bilateral tax treaties, but it is an indication that the concept of juridical double taxation can be applied widely.

Several arguments mitigate against the application of tax treaties to cases of double taxation that result from the Example. It has been suggested that, in such a case, a credit cannot be granted, as in the year in which the income from the source state is taxed in the source state no tax is paid in the residence state against which the credit could be granted. Good arguments, though, support the view that the object and purpose of a tax treaty, i.e. the avoidance of double taxation, is undermined if no credit is granted in later years when taxes are due in the residence state. It can be argued that, in this scenario, the same item of income is taxed twice and that the timing distortion should not impede the application of the credit method. Consequently, a tax credit carry-forward should be granted, even if national law does not explicitly provide for such a carry-forward. Admittedly, practical issues regarding the application of the loss carry-forward might then arise, especially with the restrictions regarding the amount of loss carry-forward that can be used each year.