Preface

This book is intended as a reference book for EU law and tax law practitioners, administrators, academics, the judiciary, and tax law or Union law policy makers. For students, an abridged textbook edition is available.

The present Volume I offers a systematic survey of the implications of the EU Treaties and of EU tax harmonization policy for national tax law, tax treaties and third State tax relations, a thorough and critical discussion of the EU Court's case law in direct tax matters, as well as a thorough discussion of the Union's direct tax rules in force. Volume II of this book will appear later and will cover harmonization of indirect taxation, energy taxation and capital duty, as well as administrative cooperation in the field of indirect taxation.

The present Volume I is divided into two parts:
1. General EU Law and Taxation
2. Integration of Direct Taxation

Part 2, in turn, is subdivided into three subparts:
2a. Harmonization of Corporate Income Taxation
2b. Exchange of Information and Recovery Assistance, and
2c. Negative Integration of Direct Taxation.

In addition to all relevant substantive aspects of taxation, also matters of cross-border administrative cooperation, procedural matters and judicial protection are covered, including tax implications of the EU Charter of Fundamental Rights.

Apart from some last-minute additions, such as the inclusion of the judgment of the Court of Justice of the EU of 22 February 2018 in Joined Cases C-398/16 and 399-16, *X BV and X NV*, copy was closed in January 2018.

Contents (Chapters)

Part 1 General EU law and Taxation

1 Introduction

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Articles 2-6 of the Treaty on European Union (TEU) contain the mission statement of the European Union. They enumerate, *inter alia*, the founding values of the Union, such as freedom, democracy, equality, rule of law, respect for human rights, etc., as well as Union objectives, such as the realization or at least promotion of these values, as well as peace, the well-being of the peoples, cohesion and solidarity, and an area of freedom, security and justice without internal frontiers. More mundane objectives are balanced and sustainable growth, price stability, full employment, social protection, competitiveness, etc. The Articles 3 and 4 TEU also mention two means to realize especially these more mundane objectives: the establishment of an internal market and of an economic and monetary union whose currency is the Euro.

An internal European market having the characteristics of a national market requires, in particular, free movement of goods, services, persons and capital irrespective of national borders (Art. 26(2) TFEU), undistorted conditions of competition within that EU market (the so-called 'level playing field'; Arts. 101-109 TFEU), as well as harmonization of national laws insofar as disparities between national laws impede the functioning of the internal market (Art. 114 TFEU). The most manifest tax obstacles to the proper functioning of an internal market are:

– taxes on the border-crossing of goods and services;
– differential tax treatment of domestic and imported goods and services;
– tax burdens on the cross-border relocation of (legal) persons (exit taxes);
– substantial differences (disparities) between national tax laws, leading to market distortions, especially excessive tax competition between Member States facilitating tax avoidance by mobile capital;
– (especially for EU-wide businesses:) having to comply with up to 28 different tax administrations and 28 different sets of substantive and procedural tax law;
– differential tax treatment of resident and nonresident taxpayers;
– differential tax treatment of domestic and foreign investment;
– differential tax treatment of domestic and foreign income;

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- international economic double taxation (same tax base; different taxpayer), i.e. as a result of profit distributions by a company in one Member State to a shareholder in another Member State
- International juridical double taxation (same tax base; same taxpayer) as a result of parallel exercise of taxing power by the source State and the residence State (e.g. uncreditable source taxation: 'excess foreign tax credit'), or as a result of mismatches, e.g. transfer pricing differences, income characterization mismatches, tax accounting differences, etc.

In the last decade, attention of politics has turned mostly to the fourth indent: the drawbacks of free movement of capital and the freedom of establishment (tax avoidance opportunities) and the drawbacks of not harmonizing direct taxes, especially corporate income taxes: distortive disparities and excessive tax competition, sometimes leading to prohibited State aid for (often non-EU, especially US) multinationals and to undertaxation of mobile capital. But even though some may improperly benefit, in general tax obstacles as the ones mentioned cause market fragmentation along national borders which may impel economic operators to stay on their home markets to avoid, e.g., international double taxation or excessive administrative burdens, and thus may improperly affect the decisions of undertakings, employees, and (portfolio) investors as to where to trade, where to accept a job, where to establish an undertaking, where to incorporate, and where to invest. Therefore, integration of the tax systems of the Member States is necessary to a certain extent. Such integration may be 'negative' (market integration, *i.e.* integration through prohibitions: the abolition of restrictive national tax measures (in)compatible with the TFEU, ultimately after a Court judgment to that effect) or 'positive' (policy integration, *i.e.* integration through legislation, coordination and cooperation at Union level: harmonization of national tax laws, or at least policy coordination between the Member States).

In the following chapters we will discuss both the current negative integration of tax law (mostly case law of the Court of Justice of the EU (CJEU, or: Court)) on the incompatibility of national tax measures with the Treaty Freedoms or the State aid prohibition) and positive integration of tax law (tax measures taken at Union level and pending proposals for Union action in the area of taxation).

This book is divided into two volumes. Volume 2 will cover indirect taxation. The present volume 1 covers (i) general Union law issues of importance for direct taxation, (ii) harmonization of direct taxation and (iii) negative integration of direct taxation:

Part I (Chapters 1-5) deals with general issues of EU law, (international) tax law and (external) EU policy and the way in which general (principles of) EU law and (international) tax law interact;

Part IIa and IIb (Chapters 6-13) cover the current and pending positive integration of direct taxation, including cross-border administrative cooperation, minimum harmonization of national anti-abuse legislation and tax aspects of the European

Company, the European Cooperative Company and the European Economic Interest Grouping;

Part IIc (Chapters 14-23) discusses negative integration of direct taxes, especially the extensive body of CJEU case law (more than 300 cases) on the (in)compatibility of national tax measures and bilateral tax treaties with the free movement rights and the State aid prohibition contained in the TFEU.

Positive integration (harmonization measures and coordination at EU level) is thus not the sole (and for direct taxes a modest) contributor to the abolition of tax impediments to the proper functioning of the internal market. Whereas most of the extensive integration of indirect taxes, especially of customs duties, turnover taxes and excises, has been achieved by way of positive integration measures (EU regulations and directives), most of the integration of direct taxes is a result of prohibitions, *i.e.* case law of the CJEU holding national tax measures incompatible with primary EU law. Generally speaking, indirect taxes have been harmonized at EU level because they are conspicuous and direct obstacles to free trade; they are taxes on transactions (taxes on trade in, or the border-crossing of goods and services). If one is to have free trade, one has no choice but to either abandon such taxes altogether (taxes on the intra-EU border-crossing of goods and services: customs duties), or to harmonize them to make them internationally neutral. Direct taxes, by contrast, are taxes on the income or wealth of (legal) persons, having a less direct and less visible effect on trade and services, although one may argue they distort trade just as much as transaction taxes: unlike indirect taxes, they are not refunded upon exportation, but remain locked in the price of the goods and services exported by the economic operators.

Direct taxation is viewed by most Member States as the last hardcore part of their sovereignty within the Union, implying very little political enthusiasm for positive integration, which would entail relinquishing political and budgetary sovereignty. The consequence is, however, a very large and rapidly expanding body of case by case and therefore uncoordinated case law of the Court, often fatal for the national direct tax measure at issue because it violates the TFEU free movement rights or the State aid prohibition.

Because of these marked differences in legal basis in legal integration (see Chapter 2) and in the degree of integration between indirect and direct taxes, the CJEU's case law in indirect tax matters is different in character from its case law in direct tax matters. For indirect taxation more or less comprehensive, technical and detailed secondary EU law has been enacted and implemented, and the indirect tax cases brought before the Court mostly concern implementation problems, *i.e.* the interpretation of these detailed, technical EU rules on indirect taxation. They are hardly ever on the significance of the free movement rights. This part of EU tax law is *tax* law rather than *EU* law: the rules to be interpreted and applied are detailed and technical rules of taxation, and to a much lesser extent Union law principles such as, notably, free movement, non-discrimination, proportionality, etc.

In the field of *direct* taxes, it is the other way around. Direct tax cases still rarely concern the implementation of dedicated EU legislation (although 2017 saw an increase in cases on the application of the few EU corporate tax directives), as there still is little such legislation. Rather, they concern the clash between the TFEU free movement rights and EU law principles on the one hand, and detailed, unharmonized domestic tax legislation and bilateral tax treaties on the other. Consequently, direct tax issues before the Court do not so much concern interpretation of *tax* law (as the Court is not competent to interpret national law or bilateral tax treaties) as they concern (principles of) *general EU* law, *i.e.* the general, sweeping Treaty rules of principle, such as free movement, market access, market equality, subsidiarity, proportionality, abuse of rights, level playing field (undistorted competition), Union loyalty, effectiveness of EU law, etc. In direct tax cases, the Court is a balancing artist between the interests of the internal market and the legitimate interests of 28 Member States to protect their separate national tax bases against base erosion, profit shifting, fiscal incoherence and mismatches. The national direct tax rules the Court is called upon to assess in the light of these very general principles of EU law are often extremely technical and detailed. This extreme difference in abstraction level of the two bodies of law confronting each other makes negative integration of direct taxes complex and chaotic, more so because of the sophisticated third set of rules in between involved: the bilateral tax treaty network between the Member States.

The TFEU contains several principles which must be respected in all areas affecting the objectives of the Union, therefore also in the tax area. One of these principles is the prohibition of discrimination against or hindering goods, services, workers, undertakings and capital from other Member States, and of any other discrimination directly or indirectly based on nationality of persons or on origin of goods, capital and services. This principle – and other principles, such as Union loyalty and undistorted competition – have significant consequences for national tax sovereignty. They considerably limit Member States' freedom to arrange their national tax systems in the way they see fit. We will discuss the far-reaching impact of these general (non-tax) TFEU provisions on national taxation in Chapters 3-5 (general principles and concepts) and 14-23 (negative integration of direct taxation). They are especially important in direct tax matters because of (i) the scarcity of substantive harmonization in that area and (ii) the fact that national direct tax systems tend to distinguish between domestic-source income and foreign-source income, and between resident taxpayers and nonresident taxpayers, whereas the TFEU in principle prohibits less favorable taxation of cross-border investment, establishment and employment than purely domestic investment, establishment and employment. Even non-discriminatory measures (national measures not distinguishing between cross-border and domestic cases) which nonetheless make cross-border market access excessively difficult, may be incompatible with the TFEU Freedoms.

Another harmonizing factor which still seems more important in direct tax matters than positive integration, is regulatory and ruling competition between

Member States. All Member States court the favors of foreign investors to attract economic activity, employment, and growth, from both third States and other Member States, *inter alia* by offering competitive company taxation legislation and individual tax rulings. Such tax competition between Member States causes spontaneous harmonization, especially in profits tax rates, since neighboring States featuring a comparable level of economic opportunity, infrastructure, social security and public services, cannot afford to diverge significantly in tax burdens, less so as the (other) obstacles to individual or corporate emigration and to cross-border economic activity have been removed, especially since the introduction of the Euro as a common currency, taking away currency risks. If Member States diverge significantly in tax burdens without offering corresponding levels of public service and economic opportunity, then mobile economic activity will move to more tax-efficient Member States. The ensuing economic and social necessity for less tax-efficient Member States to keep up with the rest of the Union is usually a more convincing argument for national tax policy makers than are abstract ideas, lofty objectives, or legal principles. It is striking to see how the levels of corporation tax in the 'old' fifteen Member States in a relatively short period came down from around 40% or higher to nowadays around 20% or lower (12,5% in Ireland), especially since the accession of the twelve eastern European Member States. At the same time – as the effective tax burden is the product of the tax base (corporate income) and the tax rate – most Member States broadened their tax base (fewer deductions, fewer exemptions and fewer credits) to compensate for the lower rate, overall sometimes implying only a modest reduction in effective tax burden. If most Member States are forced by each other's regulatory competition to follow this pattern, the result is a more homogeneous corporate fiscal landscape throughout the Union.

Tax competition, however, can also have a sinister side to it: excessive ('unfair') tax competition may lead to base erosion and fiscal degradation: Member States outbidding each other with tax incentives for foreign investors, but in doing so sponging on each other's tax bases. The result may be an unjustified and economically dysfunctional EU-wide loss of tax revenue, benefiting mainly those who were already very capable of looking after themselves (internationally mobile capital), at the cost of less mobile tax bases like wages, the cost of which was already higher than in the US and Asia.

Even if national tax systems are harmonized at Union level, or spontaneously aligned by 'fair' tax competition, the average taxpayer in one Member State may still consider the actual compliance with tax obligations a matter to be taken rather more lightly than the average taxpayer in another Member State does. By the same token, national administrative practice and tax recovery lenience are not automatically aligned by harmonization of statutory tax rates and tax bases. Harmonization of written legislation is not the same as harmonization of national habits and *couleur locale*. Member State compliance in enforcing tax legislation, whether or not ensuing from EU measures, has become a major concern of the Union institutions and of the

AAA-rated Member States because of the financial crises which brought some Member States close to bankruptcy.

Harmonization of taxes, especially of direct taxes, is a politically highly sensitive area. Tax sovereignty is a fundamental part of national sovereignty. One of the most basic rights of any parliament is the budget right: the right to vote on taxes. The European Parliament cannot, as yet, be considered an adequate substitute for national democratic parliamentary control, as there are, precisely, no European taxes, *i.e.* taxes levied at EU level by an EU tax administration on the spending of which the European Parliament votes. Taxation is the most important economic and social policy instrument for national governments. It may be used to redistribute income or wealth, to encourage investments or savings, to discourage the consumption or the use of certain goods (sin taxes; Pigouvian taxes), to protect the environment, etc. The more unavoidable harmonization and, with that, loss of national sovereignty as regards indirect taxes, the less Member States are inclined to forego their remaining tax sovereignty in the field of direct taxation.

As observed, a genuine *European* tax does not exist. There is no tax administrated, levied and collected at Union level by a Union tax authority (except the payroll tax on the salaries of the EU civil servants, the 'Eurocrats') on the spending of which the European Parliament votes. A Belgian proposal in 2000 to introduce a Eurotax met with skepticism and irony. Other Member States referred to historical examples of new taxes which led to war, such as the Spanish Duke of Alva's 'tenth penny', which led to the eighty-year Dutch-Spanish war, and the British tax on tea, which through the Boston Tea Party lead to the American War of Independence. But little did they know at that time that it is precisely the *absence* of (much) more fiscal (and political) union – to complete and bolster the monetary union – which in 2011-2012 almost lead to a budgetary war, and almost killed the monetary union. The successive credit, bank, Euro and debt crises revealed a very serious lack of fiscal and political integration in the hitherto so very successful Euro-area.

For the time being, the Union will have to make do with its traditional 'own resources', the most important of which are (i) a percentage of the national bases of the value added tax, capped to a percentage of the gross national product (GNP), (ii) the revenue from customs duties at the outside borders of the EU (minus perception costs), and (iii) agricultural levies, and with an *ad hoc* intergovernmental stability mechanism, funded by national revenue contributions of which every one of the 17 Euro Member States' parliaments had to approve (which lead to four government changes in the crisis years). The 'own resources' are not genuine EU taxes, as they are levied and collected by national tax administrations, and the revenue transmitted to the EU is small as compared to the percentage of Member States' GDP taken by national taxation. At Union level, taxation plays a very limited role as a policy instrument. Consequently, at present the Union hardly has a tax policy of its own. The present Commission policy is one of aligning national taxes and tax policies in so far as necessary for the functioning of the internal market, eliminating (the possibilities for) discriminatory, restrictive, and protective national taxation, but also (the possibilities for) excessive tax competition and fiscal State aid, if necessary by taking Member States to Court (see Art. 258 TFEU), and encouraging Member States to use taxation as a means to further economic development, especially of small and medium-sized enterprises (SMEs) and of research and development.

To date, the largest EU law impacts on national tax systems were for indirect taxation the abolition of internal customs duties, the introduction of common outside border customs duties (the customs union), and the introduction of the value added tax (VAT) system and a harmonized base for all national turnover taxes. For direct taxation, they were the CJEU's case law prohibiting national tax measures which make it less attractive to work, establish or invest abroad than at home, and the recent adoption of a series of directives greatly extending the automatic exchange of tax information between the Member States (see Chapter 13). Also, for the first time in more than 20 years, the Member States recently succeeded in adopting substantive tax law. Anti-abuse measures were inserted in the existing Parent-Subsidiary Directive (PSD; see Chapter 6) and adopted in a new separate Anti-Tax Avoidance Directive (ATAD; see Chapter 12). The Commission further recently relaunched its proposal for a common consolidated corporate tax base (CCCTB; see Chapter 11), but we doubt that it will be adopted, especially the second C (for 'consolidated'), even by an 'enhanced cooperation' group of at least nine Member States (see Arts. 22 TEU and 326-334 TFEU)

2 Constitutional Foundations: EU Tax Competences; Treaty Basis for Tax Integration; Sources and Enactment of EU Tax Law

Update and elaboration by Rita Szudoczky[1] and Dennis Weber[2]

2.1 Division of (Tax) Competences Between the Union and the Member States

Union competence is based on the principle of conferral: the Union has only the competences conferred on it by the Member States in the founding treaties, i.e. the Treaty on the European Union (TEU) and the Treaty on the Functioning of the European Union (TFEU) (see Article 5 TEU). The competences conferred upon the Union may be divided into three categories: (i) exclusive competences (Member States are not competent any more), listed in Article 3 TFEU; (ii) shared competences with 'preemption' (both the Union and the Member States are competent, but whenever the Union exercises its competence, the Member States lose their competence in the field on which the Union has exercised its competence), listed in Article 4 TFEU; and (iii) shared competences without preemption, meaning that the Union is only competent to support, coordinate or supplement, without superseding the competence of the Member States, listed in Article 6 TFEU.

Taxation is not expressly mentioned amongst the competences listed under Articles 3 to 6 TFEU. This does not mean that the Union does not have competences in the field of taxation. On the contrary, the customs union is listed as the first area in which the Union has exclusive competence (Article 3(1)(a) TFEU). A customs union is the mundane basis of the Union's genesis. In fact, the most basic idea of the European Union is a fiscal idea. Article 28 TFEU states that 'the Union shall comprise a customs union (…).' Indeed, custom duties at the border and discriminatory taxation of foreign goods and services are blunt and conspicuous restrictions of free trade. They are flagrantly incompatible with free movement of goods and services. Therefore, elimination of trade barriers within the (then) 'Community' began with the abolition of customs duties and other import restrictions, and the harmonization of indirect taxes. A customs union implies the total prohibition, between the Member States, of import and export duties, of any charges having an

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effect equivalent to a customs duty (Article 30 TFEU), and of all quantitative restrictions on imports and all measures having equivalent effect (Article 34 TFEU). Obviously, it also implies a common customs tariff at the *outside* borders of the Union (Article 31). That common customs tariff came into force on 1 July 1968.

Furthermore, since taxation affects intra-Union cross-border trade, investment, service provision and employment, it is clearly an internal market issue. Hence, both indirect taxation - other than customs duties - and direct taxation are caught under the competence heading 'internal market' in Article 4(2)(a) TFEU, which is a shared competence with preemption: as soon as and to the extent in which the Union has exercised its competence to regulate a tax matter by way of a regulation or a directive, the Member States have, to that extent, lost their individual competences to regulate that tax matter.

The Union, incited by Article 113 TFEU (see Section 2.3.2.) to harmonize indirect taxes, has done so extensively in respect of customs duties, excise duties and turnover tax. It has used its competence as regards direct taxation to a much lesser extent, but the adoption of the Anti-Tax-Avoidance Directive (see Chapter 12) and the reinvigoration of the CC(C)TB Proposal (see Chapter 11) may bring the measure of at least corporate income tax harmonization closer to that of indirect taxation. Nevertheless, the Court persistently emphasizes in its case law that direct taxation falls 'within the competence of the Member States,' to which it invariably adds: but they 'must none the less exercise that competence consistently with Union law,' meaning that they should respect the internal market free movement rights of taxpayers, and observe the State aid prohibition.[3]

Where the principle of conferral delimits the competences of the Union vis-à-vis Member States' sovereignty ("competences not conferred upon the Union in the Treaties remain with the Member States"), the principles of subsidiarity and of proportionality, also laid down in Article 5 TEU, regulate the *exercise* of the competences which have been conferred upon the Union. According to the principle of subsidiarity (Article 5(3) TEU):

> "…the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level."

3. In the context of the free movement provisions, see for example, Case C-446/03, *Marks & Spencer*, EU:C:2005:763, point 29; Case C-196/04, *Cadbury Schweppes*, EU:C:2006:544, point 40; Case C-279/93, *Schumacker*, EU:C:1995:31, point 21. In the context of the State aid prohibition, see for example: Case C-501/00, *Spain v Commission*, EU:C:2004:438, point 123. In the context of various general EU rules and principles, see Case C-417/10, *3M Italia*, EU:C:2012:184, point 25.