

# **Movement of Persons and Tax Mobility in the EU: Changing Winds**

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## Chapter 1

# Tax Mobility in the European Union: Present and Future Trends

Ana Paula Dourado

### 1.1. Tax mobility and tax good governance on the global policy agenda and in the European Union

On the international political agenda, the expression “tax mobility” is currently associated with the joint efforts by the G20, the OECD and the European Union in increasing tax transparency, identifying the extent to which profit shifting to low-tax jurisdictions is being carried out by multinational companies (foreign direct investment) and combating base erosion and the decrease of corporate income tax revenues by those companies.<sup>1</sup>

This joint action will be referred to here as the “anti-BEPS” agenda. Enhancing administrative cooperation and developing good tax governance, interacting with tax havens and tackling aggressive tax planning are part of supranational concrete recommendations and action plans.

The anti-BEPS focus also results from the transnational impact of mainstream media,<sup>2</sup> which act as global opinion makers and determine to

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1. In 2012, the G20 asked the OECD to analyse the topic of base erosion and profit shifting by multinationals and to report about the progress of the work for their February 2013 meeting: as a response, the OECD issued *Addressing Base Erosion and Profit Shifting – Report: 2013* (OECD 2013), International Organizations’ Documentation IBFD (hereinafter Addressing BEPS). The European Union reacted with Communication from the Commission to the European Parliament and the Council, An Action Plan to Strengthen the Fight against Tax Fraud and Tax Evasion, (187637/12) Brussels (6.12.2012), COM(2012) 722 Final, EU Law IBFD; Commission Recommendation of 6.12.2012, Brussels (6.12.2012), C(2012) 88006 final; Conclusions of the European Council, Brussels (22.5.2013), EUCO 75/13, pp. 6-8; ECOFIN, Conclusions on Tax Evasion, Brussels (14 May 2013), 9549/13, FISC 94. See the follow-up in *Action Plan on Base Erosion and Profit Shifting – Report: 2013* (OECD 2013).

2. OECD 2013, *Addressing BEPS*, *supra* n. 1, ch. I: “There is a growing perception that governments lose substantial corporate tax revenue because of planning aimed at shifting profits in ways that erode the taxable base to locations where they are subject to a more favourable treatment. Recent news stories such as Bloomberg’s ‘The Great Corporate Tax Dodge’, the New York Times’ ‘But Nobody Pays That’, the Times’ ‘Secrets of Tax Avoiders’ and the Guardian’s ‘Tax Gap’ are only some examples of the increased attention mainstream media has been paying to corporate affairs.”

a great extent the political agendas.<sup>3</sup> The news in the media has increased the public perception that governments lose corporate tax revenue because of tax planning by multinationals – these are accused of dodging taxes worldwide by breaking domestic and international rules on the taxation of cross-border profits.<sup>4</sup>

In the report Addressing BEPS, the OECD acknowledges that current international standards did not accompany the changes in global business practices, especially in the areas of intangibles and the digital economy.<sup>5</sup> Scientific research on the topic is not conclusive on the amount of profits shifted to low-tax jurisdictions, but evidence indicates that BEPS behaviour is widespread in a world where global value chains and fragmentation of production are dominant features.<sup>6</sup>

BEPS behaviour consists in increasing segregation between the location where actual business activities and investment take place and the location where profits are reported for tax purposes, the shifting of risks and intangibles, the artificial splitting of ownership of assets between legal entities within a group, and transactions between such entities that would rarely take place between independent entities.<sup>7</sup>

Whereas in respect of tax transparency and combating tax evasion and aggressive tax planning opinion makers are mainly focused on showing the lack of fairness and equity as a disruptive effect provoked by the global economy, states should also worry about the inefficient allocation of resources created by such aggressive tax planning, namely in respect of domestic corporations that have no access to the same planning possibilities.<sup>8</sup>

The aim to increase tax transparency and to decrease tax evasion and aggressive tax planning does not necessarily imply international tax

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3. Id., p. 13: “This increased attention and the inherent challenge of dealing comprehensively with such a complex subject has encouraged a perception that the domestic and international rules on the taxation of cross-border profits are now broken and that taxes are only paid by the naïve.” See criticism to the short-term political agendas in J. Habermas, *Ach, Europa, Kleine politische Schriften XI* pp. 96-108 (Frankfurt-am-Main, Suhrkamp Verlag 2008).

4. OECD, id.

5. OECD, id., p. 7; R.M. Visconti, *Exclusive Patents and Trademarks and Subsequent Uneasy Transaction Comparability: Some Transfer Pricing Implications*, 40 *Intertax* 3, pp. 212-220 (2012).

6. OECD, id., ch. 2.

7. Id., at 6 and 15-21.

8. Id., at 8.

harmonization<sup>9</sup> or an EU harmonization of the tax base and rates (even less of tax subjects), but tax coordination is necessary<sup>10</sup> and allocation of taxing rights between source and residence is to be revisited.<sup>11</sup>

## 1.2. The meaning of tax mobility in the EU/EEA and in international tax law

Tax mobility has a specific meaning in EU/EEA law: it is related to tax harmonization and to the fundamental freedoms and the principle of non-discrimination,<sup>12</sup> and, from a policy perspective, it would presumably require complete neutrality of tax measures in domestic and cross-border situations.<sup>13</sup> Tax mobility involving different jurisdictions to tax and where EU/EEA law is not applicable refers to cross-border investment and to the tax rules applicable to it in the current context of globalization.

### 1.2.1. National revenue interests and the protection of EU/EEA taxpayers

The world is divided, more than in 1998, into high- and low-tax jurisdictions. Tax transparency has increased, but nominal tax rates have also decreased (although the latter did not lead to a fall in the corporate tax burden because the tax base was often broadened).<sup>14</sup> The interests protected are

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9. See the discussion on the OECD Report *Harmful Tax Competition: An Emerging Global Issue* (1998) and the reactions to it; and A.P. Dourado, *Exchange of Information and Validity of Global Standards in Tax Law: Abstractionism and Expressionism or Where the Truth Lies*, EUI Working Papers 11, pp. 1-18 (2013).

10. Cf. for tax evasion cases, N. Johannesen, *Taxing Hidden Wealth – Lessons for Policy Making*, EUI Working Papers 25, p. 5 et seq. (2012); see R. Eccleston, *Revolution or Evolution: Sovereignty, The Financial Crisis and the Governance of International Taxation*, JALAP, pp. 13-24 (2011).

11. A.P. Dourado, *Is it Acte Clair? General Report on the Role Played by CILFIT in Direct Taxation*, in *The Acte Clair in EC Direct Tax Law*, pp. 28-31 (A.P. Dourado & R.P. Borges eds., IBFD, 2008), Online Books IBFD; F. Vanistendael, *The ECJ at the Cross-Roads: Balancing Tax Sovereignty against the Imperatives of the Internal Market*, 46 Eur. Taxn. 9, p. 413 et seq. (2006), Journals IBFD.

12. I.e. to the interaction between negative and positive integration; see B. Terra & P. Wattel, *European Tax Law* pp. 36-39 (Wolters Kluwer, 6th ed., 2012).

13. Tax neutrality cannot be achieved alone by the ECJ case law: R. de la Feria & C. Fuest, *Closer to an Internal Market? The Economic Effects of EU Tax Jurisprudence*, Oxford University Centre for Business Taxation, CBT Working Papers 11/12 WP (2011).

14. Statutory corporate income tax rates in OECD Member countries dropped on average 7.2 percentage points between 2000 and 2011 (32.6% to 25.4%) – rates have been reduced in 31 countries; tax rates have decreased, OECD 2011, *Addressing BEPS*, *supra* n. 1, pp. 15-16.

still the national interests and this is also true for the European Union, since corporate taxes are national taxes and there is tax competition among Member States.

The current international trend towards more fairness and transparency in the tax treatment of foreign direct investment complies with the constitutional principles of rule-of-law states and illustrates the necessity to revisit international tax law rules.

When discussing tax mobility and the anti-BEPS agenda, it should not be forgotten that EU/EEA taxpayers are entitled to the fundamental freedoms under the TFEU/EEAA provisions (which grant rights to the aforementioned taxpayers) and according to which there can be non-discriminatory treatment based on source or residence.

The difference between an EU/EEA taxpayer that has cross-border activities in the EU/EEA (exercising one of the fundamental freedoms foreseen in the TFEU) and an EU taxpayer with cross-border activities in a non-EU country (a third country) and a third-country taxpayer, is that the first taxpayer is entitled to a non-discriminatory treatment both in the EU/EEA state of residence (home country) and in the EU/EEA state of source (the host country), whereas the second and the third taxpayers will only be entitled to a non-discriminatory treatment if they fall under the free movement of capital rules.<sup>15</sup>

In most of the direct tax cross-border situations taking place within the EU/EEA territories a resident and a non-resident are considered to be in comparable positions.<sup>16</sup> To the extent that tax discrimination by an EU/EEA Member State occurs (as a rule implying a less favourable treatment of the cross-border situation in comparison to a domestic situation), the national

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15. A third-country national is entitled to free movement of capital within the European Union, which, in tax situations, applies (at least) to cases of portfolio investment. See the discussion in, inter alia, P. Baker, *UK: The FII GLO (II) and FII GLO (III) Cases*, in *ECJ – Recent Developments in Direct Taxation 2012* pp. 244-247 (M. Lang et al. eds., Linde 2013); S. Hemels et al, *Freedom of establishment or free movement of capital, Is there an order of priority?* EC Tax Review 1, pp. 19-31 (2010); S. Smit, *The Relationship between the Free Movement of Capital and the other EC Treaty Freedoms in Third Country Relationships in the Field of Direct Taxation: A Question of Exclusivity, Parallelism or Causality?* EC Tax Review 6, pp. 252-267 (2007); A. Cordewener, *Free Movement of Capital between EU Member States and Third Countries: How Far Has the Door Been Closed?* EC Tax Review 6, pp. 260-263 (2009).

16. Exceptions occur in the field of tax rates, comparability under personal income tax (the rule is that a resident is not comparable to a non-resident, unless most of the income is earned in the state of source – the so-called virtual residence) and comparison of treatment

interest (loss of tax revenue) cannot, in principle, be validly invoked before the TFEU/EEA: the loss of national tax revenue cannot justify a discriminatory treatment.<sup>17</sup>

In contrast, with regard to the difference between resident and non-resident taxpayers (or residence and source), article 24 of the OECD Model, although providing for non-discriminatory treatment, still relies to a major extent on the difference between source and residence.

### 1.2.2. The meaning of tax mobility and why EU law is not (yet) to be taken seriously in respect of tax mobility

The existing mobility in Europe results to a great extent from the efforts of the ECJ to overcome the constraints raised by the legislative decision-making process. This is especially true for tax matters where the unanimity rule is still valid under the Treaty on the Functioning of the European Union (TFEU).

The European Commission still tries hard to put forward proposals for tax harmonization,<sup>18</sup> aimed at achieving a deeper level of integration in the

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granted by a Member State to residents of different states (horizontal comparability); see, F. Vanistendael, *EU at the Crossroads in 2011: EMU and/or Internal Market?* ch. 2 in this volume.

17. S. van Thiel, *Justifications in Community Law for Income Tax Restrictions on Free Movement: Acte Clair Rules that Can Be Readily Applied by National Courts*, in *The Acte Clair in EC Direct Tax Law*, supra n. 11, pp. 87-93. See, among many others, the following ECJ cases: UK: ECJ, 16 July 1998, Case C-264/96, *Imperial Chemical Industries (ICI) v. Kenneth Hall Colmer*, ECJ Case Law IBFD; DE: ECJ, 21 Sept. 1999, Case C-307/97, *Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v. Finanzamt Aachen-Innenstadt*, ECJ Case Law IBFD; UK: ECJ, 8 Mar. 2001, Case C-397/98, *Metallgesellschaft Ltd and Others, Hoechst AG and Hoechst (UK) Ltd v. Commissioners of Inland Revenue and HM Attorney General*, ECJ Case Law IBFD; NL: ECJ, 6 June 2000, Case C-35/98, *Staatssecretaris van Financiën v. B.G.M. Verkooijen*, ECJ Case Law IBFD; FI: ECJ, 7 Sept. 2004, Case C-319/02, *Petri Manninen*, ECJ Case Law IBFD; UK: ECJ, 12 Sept. 2006, Case C-196/04, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, ECJ Case Law IBFD. However, the justification of “allocation of taxing rights”, related to cross-border losses and exit taxes, is not substantially different from a “loss of revenue” argument (or a protectionist argument) because it relies on the traditional international tax law concept. See M. Poulsen, *Freedom of Establishment and the Balanced Allocation of Taxing Rights*, 40 *Intertax* 3, pp. 203-204 (2012): the author contends that the ECJ is “prepared to accept an allocation of tax jurisdiction based on the traditional international tax interpretation” (p. 203).

18. See COM(2011) 211 CCCTB: Proposal for a Council Directive on a Common Corporate Consolidated Tax Base (CCCTB), COM(2011) 121/4 2011/0058 (CNS), EU Law IBFD; COM(2008) 727: Proposal for a Council Directive Amending Directive 2003/48/

European Union, and the Council, represented by national interests, relies on tax competition to assure those national interests, which can range from discriminatory taxes justified on the basis of the need to collect tax revenue to the reduction of the corporate income tax burden.<sup>19</sup>

Notwithstanding the differences between EU law and international law briefly described in the previous section, it is therefore also true that tax mobility as a policy goal has not yet been achieved in the European Union. As many of the subsequent chapters illustrate in detail, mobility of nationals and tax mobility in the European Union are far from having been achieved, in spite of the Herculean work carried out by the ECJ in recent decades.

The EU decision-making instances have to bear this in mind, even though the EU policy focus has shifted. It now aims at being at the forefront in addressing BEPS rather than setting up the internal market, in spite of some initiatives regarding double taxation.<sup>20</sup>

The multiple inconsistencies in the EU integration process weaken the EU position in the world: in the current state of affairs, EU law (which includes primary law, secondary law and their interpretation in settled case law by the ECJ) is hardly to be recommended as a standard either in respect of tax mobility or as an international or regional standard regarding an anti-BEPS reaction and tax competition.<sup>21</sup> This will also be better explained in the following sections.

### 1.3. Tax mobility in the EU: Source and residence revisited

Apart from a few directives on specifically identified constraints to the internal market (economic double taxation, restructuring of companies, mutual

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EC on Taxation of Savings Income in the form of Interest Payments, EU Law IBFD.

19. P. Pistone, *Smart Tax Competition and the Geographical Boundaries of Taxing Jurisdictions: Countering Selective Advantages Amidst Disparities*, 40 *Intertax* 2, pp. 85-91 (2012).

20. Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee, *Double Taxation in the Single Market*, COM(2011) 712 Final. M. Aujean, *Fighting Tax Fraud and Evasion: In Search of a Tax Strategy?*, 22 *EC Tax Review* 2, pp. 64-65 (2013); Communication from the Commission of 6.12.2012; Commission Recommendation of 6.12.2012; Conclusions of the European Council, of 22.5.2013; ECOFIN, *Conclusions on Tax Evasion*, *supra* n. 1.

21. On the validity of international standards, see Dourado, *supra* n. 9, at 13 et seq.



assistance, double taxation of interest and royalties between associated companies), tax competition in the European Union is the rule and non-discrimination of cross-border situations is the limit.

In the absence of a regular legislator on direct tax issues, the ECJ has assumed a prominent role in the protection of taxpayers' fundamental freedoms and has been focusing on the tax restrictions to those fundamental freedoms.<sup>22</sup> On the basis of the non-discrimination principle of EU nationals (and third-country nationals in the case of free movement of capital), which is included in the treaty provisions governing the fundamental freedoms (in the TFEU and in the EEAA), the ECJ has rightly managed to address the obstacles deriving from a direct tax legislation that does not discriminate against non-nationals, but instead against non-residents (inbound situations) and foreign sources of income (outbound situations), independently of their nationality.<sup>23</sup>

It is undeniable that the interpretation of the fundamental freedoms provisions in the TFEU and the EEAA by the ECJ has very much contributed to reducing the tax rules discriminating against inbound and outbound investment and other cross-border income. It is also true that although these tax rules were firmly grounded on the distinction of taxation between residents and non-residents, Member States are still competent to rely on residence and source to design their tax codes.

However, because, according to the reasoning of the Court, residents and non-residents are in principle comparable<sup>24</sup> and a different treatment will imply discrimination incompatible with the TFEU, source and residence as connecting elements have in reality become obsolete in the European Union to a great extent, even if they are kept in written law that is in force. Or, in other words, the fact that Member States may not exercise their taxing rights in a discriminatory manner has partially led to erasing the international tax law difference between residence and source.

This is illustrated by various regimes that were more or less settled in international tax law and that were considered to be discriminatory by the ECJ. Among others, the following can be recalled: different (discrimi-

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22. See the list of cases in K. van Raad ed., *Materials on International & EU Tax Law*, International Tax Center Leiden 2 (2013).

23. This has become clearer since the Maastricht Treaty, see, inter alia, A.P. Dourado, *Lições de Direito Fiscal Europeu* pp. 56-57 (Coimbra Editora 2010).

24. Except in the personal income tax cases (but see the criticism to this position in Terra & Wattel, *supra* n. 12, at 979-985).

natory) treatment of permanent establishments in comparison to subsidiaries (although the OECD also recommended non-discrimination of triangular situations);<sup>25</sup> withholding taxes levied on the gross income of non-residents;<sup>26</sup> non-deductibility of object-related costs by non-residents (or discriminatory measures on tax objective elements regarding non-residents);<sup>27</sup> discriminatory cross-border economic double taxation;<sup>28</sup> deduction of losses by a parent company incurred by an affiliate in another jurisdiction;<sup>29</sup> irrefutable anti-abuse rules exclusively applicable to cross-border situations;<sup>30</sup>

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25. *Saint-Gobain* (C-307/97).

26. DE: ECJ, 12 June 2003, Case C-234/01, *Arnoud Gerritse v. Finanzamt Neukölln-Nord*, ECJ Case Law IBFD; DE: ECJ, 3 Oct. 2006, Case C-290/04, *FKP Scorpio Konzertproduktionen GmbH v. Finanzamt Hamburg-Eimsbüttel*, ECJ Case Law IBFD; DE: ECJ, 15 Feb. 2007, Case C-345/04, *Centro Equestre da lezíria Grande Lda v. Bundesamt für Finanzen*, ECJ Case Law IBFD; NL: ECJ, 18 Oct. 2012, Case C-498/10, *X NV v. Staatssecretaris van Financiën*, ECJ Case Law IBFD.

27. BE: ECJ, 22 Mar. 2007, Case C-383/05, *Raffaele Talotta v. Kingdom of Belgium*, ECJ Case Law IBFD; NL: ECJ, 18 Mar. 2010, Case C-440/08, *F. Gielen v. Staatssecretaris van Financiën*, ECJ Case Law IBFD; NL: ECJ, 16 Oct. 2008, Case C-527/06, *R.H.H. Renneberg v. Staatssecretaris van Financiën*, ECJ Case Law IBFD; DE: ECJ, 22 Apr. 2010, Case C-510/08, *Vera Matner v. Finanzamt Velbert*, ECJ Case Law IBFD.

28. The inbound dividends cases: *Verkooijen* (C-35/98); *Manninen* C-319/02; BE: ECJ, 14 Nov. 2006, Case C-513/04, *Mark Kerckhaert and Bernadette Morres v. Belgische Staat*, ECJ Case Law IBFD; UK: ECJ, 12 Dec. 2006, Case C-446/04, *Test Claimants in the Franked Investment Income Group Litigation v. Commissioners of Inland Revenue*, ECJ Case Law IBFD; DE: ECJ, 6 Mar. 2007, Case C-292/04, *Wienand Meilicke, Heidi Christa Weyde and Marina Stöffler v. Finanzamt Bonn-Innenstadt*, ECJ Case Law IBFD; AT: ECJ, 15 July 2004, Case C-315/02, *Anneliese Lenz v. Finanzlandesdirektion für Tirol*, ECJ Case Law IBFD; AT: ECJ, 24 May 2007, Case C-157/05, *Winfried L. Holböck v. Finanzamt Salzburg-Land*, ECJ Case Law IBFD. The outbound dividends cases: FR: ECJ, 14 Dec. 2006, Case C-170/05, *Denkavit Internationaal BV, Denkavit France SARL v. Ministre de l'Économie, des Finances et de l'Industrie*, ECJ Case Law IBFD; NL: ECJ, 8 Nov. 2007, Case C-379/05, *Amurta SGPS v. Inspecteur van de Belastingdienst/Amsterdam*, ECJ Case Law IBFD; ES: ECJ, 3 June 2010, Case C-487/08, *European Commission v. Kingdom of Spain*, ECJ Case Law IBFD.

29. UK: ECJ, 13 Dec. 2005, Case C-446/03, *Marks & Spencer plc v. David Halsey (Her Majesty's Inspector of Taxes)*, ECJ Case Law IBFD; DE: ECJ, 29 Mar. 2007, Case C-347/04, *Rewe Zentralfinanz eG v. Finanzamt Köln-Mitte*, ECJ Case Law IBFD; FI: ECJ, 18 July 2007, Case C-231/05, *Oy AA*, ECJ Case Law IBFD; DE: ECJ, 15 May 2008, Case C-414/06, *Lidl Belgium GmbH & Co. KG v. Finanzamt Heilbronn*, ECJ Case Law IBFD; FR: ECJ, 27 Nov. 2008, Case C-418/07, *Société Papillon v. Ministère du budget, des comptes publics et de la fonction publique*, ECJ Case Law IBFD; UK: ECJ, 6 Sept. 2012, Case C-18/11, *The Commissioners for Her Majesty's Revenue & Customs v. Philips Electronics UK Ltd*, ECJ Case Law IBFD.

30. E.g. DE: ECJ, 12 Dec. 2002, Case C-324/00, *Lankhorst-Hohorst GmbH v. Finanzamt Steinfurt*, ECJ Case Law IBFD; *Cadbury Schweppes* (C-196/04); UK: ECJ, 13 Mar. 2007, Case C-524/04, *Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue*, ECJ Case Law IBFD.

allowances exclusively granted to residents even if a non-resident incurred most of his income in the non-residence state;<sup>31</sup> and exit taxes.<sup>32</sup>

It is then clear that EU nationality entitles EU nationals resident in a Member State to benefit from the fundamental freedoms without being submitted to discriminatory taxation based on residence or source. When comparing non-residents to residents and EU/EEA cross-border situations to domestic ones, the ECJ is protecting tax mobility and therefore building up the internal market.

The methodology followed by the Court is normally based on a sequence of logical steps: comparison between residents and non-residents; assessment of the different treatment applied; justification in case of discriminatory treatment and proportionality of the justification if accepted.<sup>33</sup>

According to the ECJ, residents and non-residents are comparable under corporate income tax, e.g. when they belong to the same group of companies (*Marks & Spencer* line of reasoning<sup>34</sup>). This position is centred on the right of secondary establishment but can also be justified on the basis of economic allegiance in the global economy: because of transfer pricing relations, each associated company has economic allegiance to its own country of establishment and to all the other countries where the associates are esta-

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31. See, e.g. DE: ECJ, 14 Feb. 1995, Case C-279/93, *Finanzamt Köln-Altstadt v. Roland Schumacker*, ECJ Case Law IBFD; NL: ECJ, 11 Aug. 1995, Case C-80/94, *G.H.E.J. Wielockx v. Inspecteur der Directe Belastingen*, ECJ Case Law IBFD; NL: ECJ, 27 June 1996, Case C-107/94, *P.H. Asscher v. Staatssecretaris van Financiën*, ECJ Case Law IBFD; DE: ECJ, 14 Sept. 1999, Case C-391/97, *Frans Gschwind v. Finanzamt Aachen-Außenstadt*, ECJ Case Law IBFD; DE: ECJ, 21 Feb. 2006, Case C-152/03, *Hans-Jürgen Ritter-Coulais, Monique Ritter-Coulais v. Finanzamt Gernersheim*, ECJ Case Law IBFD; DE: ECJ, 6 July 2006, Case C-346/04, *Robert Hans Conijn v. Finanzamt Hamburg-Nord*, ECJ Case Law IBFD; *Renneberg* (C-527/06). M. Greggi, *Revisiting "Schumacker": The Role of Limited Tax Liability in EU Law*, in *Allocating Taxing Rights in the European Union* pp. 43-62 (I. Richelle, W. Schön & E. Traversa eds., Springer 2013).

32. NL: ECJ, 7 Sept. 2006, Case C-470/04, *N. v. Inspecteur van de Belastingdienst Oost/kantoor Almelo*, ECJ Case Law IBFD; NL: ECJ, 29 Nov. 2011, Case C-371/10, *National Grid Indus v. Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam*, ECJ Case Law IBFD; ES: ECJ, 12 July 2012, Case C-269/09, *Commission of the European Communities v. the Kingdom of Spain*, ECJ Case Law IBFD; PT: ECJ, 6 Sept. 2012, Case C-38/10, *European Commission v. Portuguese Republic*, ECJ Case Law IBFD; LU: ECJ, 6 Sept. 2012, Case C-380/11, *DI VI Finanziaria SAPA di Diego della Valle v. Administration des contributions directes*, ECJ Case Law IBFD; NL: ECJ, 31 Jan. 2013, Case C-301/11, *European Commission v. Kingdom of the Netherlands*, ECJ Case Law IBFD; HU: ECJ, 12 July 2012, Case C-378/10, *VALE Épitési Kft.*, ECJ Case Law IBFD.

33. See, following this same methodology, O. Marres, *Exit Taxes on Companies*, ch. 7 in this volume.

34. *Marks & Spencer* (C-446/03).

blished. If a parent company is entitled to deduct losses incurred in the same jurisdiction by an affiliate, this right is extended to cover losses incurred by an affiliate abroad (secondary freedom of establishment).

Nevertheless, the ECJ does not always consider non-residents comparable to residents and, in that case, it still accepts the international tax law distinction. For example, in personal income taxes, residents are not, in principle, comparable to non-residents (*Schumacker* (Case C-279/93) line of reasoning). This position can also be justified in the perspective of economic allegiance, under the current international rules on allocation of taxing rights (the state of residence is the state with which his personal and economic relations are closer – the centre of vital interests) and by the ability-to-pay principle: because the state of residence taxes worldwide income and progressively, it has the whole picture of the taxpayer's accrued income and is in the ideal position to distribute the tax burden among the resident taxpayers, applying parameters of equality.

The Court also traces a distinction between object-related costs (where the comparability of residents and non-residents is valid) and personal-related costs (where residents and non-residents are not comparable), but the frontier in this case is blurred and the distinction leads to complexity and not to clarification.<sup>35</sup>

### 1.4. The ECJ self-restraint on the scope of tax mobility

There is a difference between creation and interpretation of law and the ECJ has set its own limits:<sup>36</sup> the comparability test does not include two or more non-residents or the so-called horizontal comparison (it is limited to residents and non-residents or the vertical comparison); disparities result from the interaction of two non-harmonized pieces of legislation and therefore do not constitute discrimination (this is caused by one Member State); less favourable treatment as a result of juridical double taxation or different tax rates in the residence and the source Member States amount to disparities.

There are many good reasons to consider that juridical double taxation is discriminatory (it does not apply to domestic situations) and it is certainly

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35. See *Vera Mattner* (C-510/08).

36. See Vanistendael, *supra* n. 16.

an obstacle to the exercise of a fundamental freedom.<sup>37</sup> There are also many reasons in favour of horizontal comparison and a most-favoured-nation clause.<sup>38</sup>

By deciding that a Member State had to eliminate juridical double taxation (either the source or the residence state) or that a favourable treatment would have to be granted multilaterally, the Court, however, would interfere greatly in the allocation of taxing rights – which the Court considers to be in the competence of the Member States in the absence of tax harmonization (and this is in fact the first self-limit set by the Court to its interpretation of the non-discrimination principle). In both examples, unilateral and treaty rules would be at stake.

It can be argued that this interference occurred in other cases: one example is *Manninen*, regarding the indirect credit for economic double taxation.<sup>39</sup> Another example is *De Groot* (Case C-385/00), where the ECJ forced the deduction of allowances proportionally to the worldwide income earned by the taxpayer, whereas that income was not taxed in the Netherlands.<sup>40</sup> And even the *Schumacker* line of cases<sup>41</sup> and the cross-border losses cases<sup>42</sup> interfere with the allocation of taxing powers by ignoring or overcoming the principle of territoriality applicable to non-residents.

But it is herein contended that it is legitimate for the ECJ to set its own limits – it has discretion to do this – and the limits mentioned constitute, so far, *acte clair*.<sup>43</sup> However, as recalled above, the ECJ has not expressly accepted the loss of tax revenue as a valid justification for discriminatory treatment. The question is whether the allocation of taxing rights arguments and the situations identified as disparities do not also mean a legitimate preoccupation with the national revenues: if horizontal discrimination, juridical double taxation and tax rates were considered to be discriminatory,

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37. See the confiscatory results of DE: ECJ, 12 Feb. 2009, Case C-67/08, *Margarete Block v. Finanzamt Kaufbeuren*, ECJ Case Law IBFD.

38. S. van Thiel, *Why the EU Should Interpret Directly Applicable European Law as a Right to Intra-Community Most-Favoured-Nation Treatment – Part 1*, 47 Eur. Taxn. 6, pp. 263-269 (2007); *Part 2*, 47 Eur. Taxn. 7, pp. 314-327 (2007), Journals IBFD. See also A.R. Ribes, *Tax Residence and the Mobility of Companies in the European Union: The Desirable Harmonization of the Tax Connecting Factors*, 40 Intertax 11, pp. 606-615 (2012).

39. *Manninen* (C-319/02).

40. NL: ECJ, 12 Dec. 2002, Case C-385/00, *F.W.L. de Groot v. Staatssecretaris van Financiën*, ECJ Case Law IBFD.

41. *Schumacker* (C-279/93).

42. *Supra* n. 29.

43. On the meaning of *acte clair*, see Dourado, *supra* n. 11, at 17-28.

they could increase BEPS behaviour and, in the ECJ's words, they would "jeopardize the allocation of taxing rights".<sup>44</sup> The Court has applied this argument to cross-border financial transfers and cross-border transfers of losses and costs, not at the comparison moment, but at the justification level.<sup>45</sup> The outcome is the same if the argument is valid on its own (i.e. if it is not one among other conditions).

### 1.5. Tax mobility and inconsistencies

#### 1.5.1. The principle of territoriality and the allocation of taxing rights as one and the same single argument

A more serious problem regards the inconsistencies in the methodology adopted by the Court, which can be a result of the intricacies of each case and facts (each non-harmonized national tax law) and lead to undesirable complexity and uncertainty, but often imply overruling of the previous (settled) case law.

One example regards the evolution of the interpretation of the territoriality principle. The ECJ first departed from the international tax law principle of territoriality to consider that non-deductibility of losses or costs incurred abroad when the tax base of the taxpayer was determined according to the aforementioned principle was not discriminatory (lack of comparison between taxpayers taxed on a worldwide basis and taxpayers taxed on a territorial basis).<sup>46</sup> It then considered the principle of territoriality irrelevant to the comparison test, by assessing that residents and non-residents are in a comparable position, even if the Member State could not tax the income of the non-resident – losses incurred abroad by a subsidiary could then be deductible in the state of the parent company if that right was granted in respect of losses incurred by a resident subsidiary. This also means that the design of the taxable base as such does not matter and that each provision in the taxable base is checked on its own against the non-discrimination principle.

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44. See e.g. *Marks & Spencer* (C-446/03) para. 46 and *Philips Electronics* (C-18/11) paras. 23-26.

45. Schön, *supra* n. 31, at 75-80.

46. LU: ECJ, 15 May 1997, Case C-250/95, *Futura Participations SA and Singer v. Administration des contributions*, ECJ Case Law IBFD.

Territoriality implied some domestic coherence of the tax design (symmetry between profits and losses), accepted by international law, but did not hinder an analysis of compatibility with the fundamental freedoms in EU Law. Comparison between resident and non-resident taxpayers is valid, because otherwise, and ultimately, income tax could never be scrutinized by the ECJ (since income tax codes lie in the distinction between source or territoriality and residence) and income taxes would continue to hinder free movement. EU law has primacy over domestic and international law and taxpayers are entitled to operate in the internal market without discriminatory obstacles. However valid this reasoning may be, the Court opened the backdoor to territoriality in the justifications step, by accepting the allocation of taxing rights (and even symmetry<sup>47</sup>) as a valid justification. When later on, the ECJ justifies discrimination of cross-border losses, expenses or financial transfers on the basis of the allocation of the taxing rights and the risk of abuse, in practice it goes back to its departure point: the principle of territoriality. The group of cases regarding exit taxes (some of which are analysed in this book) also illustrates increasing worries regarding the allocation of taxing rights and the protection of tax revenue.<sup>48</sup> It is difficult to argue that bank guarantees required by a Member State will be less restrictive obstacles than the exit tax collected immediately.

The principle of territoriality ultimately aims at protecting the national interest, but it is dubious whether it effectively avoids a decrease of national revenue or BEPS.

Summing up, the principle of territoriality is still valid in the European Union, in the absence of tax harmonization of corporate tax bases. This has a contradictory or twofold effect: if it avoids jeopardizing the allocation of taxing rights and BEPS, it leaves open aggressive and less transparent BEPS behaviour, for the simple reason that the principle of territoriality does not correspond to the economic reality of multinationals.<sup>49</sup>

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47. *Philips Electronics* (C-18/11) paras. 23-26.

48. See R. Lyal, *Taxation of Unrealized Profits on the Occasion of a Transfer of Company Seat or Assets* ch. 8, pp. 190-200 in this volume.

49. See Y. Brauner, *Formulary Taxation and Transfer Pricing: The Good, the Bad and the Misguided* ch. 16, pp. 390-391, 394 et seq. in this volume.

## 1.6. Comparison between a source state and a residence state: The case of withholding taxes on interest

In other cases, the ECJ has compared the position of the Member State – whether it is acting as a source or as a residence country – in order to justify different treatment of cross-border income. That is the case of withholding taxes on interest paid by a resident debtor to a creditor abroad, whereas interest paid by a resident debtor to a resident creditor was exempt.<sup>50</sup>

The TFEU/EEAA provisions on the fundamental freedoms are not targeted at Member States; they protect EU nationals and the analysis of the non-discrimination principle therefore has to be centred on the taxpayer and not on the position of the Member State.

This position also ultimately leads to the protection of national revenue.

## 1.7. Universal tax law standards and the importance of protecting loss of tax revenue

So far, the EU instances considered together have not managed to find a balanced approach to the role of national taxes in the (still to be achieved) internal market. In contrast to national principles of administrative law that have been incorporated or even upgraded as EU constitutional principles,<sup>51</sup> constitutional principles of tax law have been regarded as irrelevant.

That is the case of the principle of practicability. This principle could ground a valid justification for the traditional withholding taxes on gross income of non-residents, in the case of cross-border services, instead of forcing the withholding agent to deduct the “inextricably related costs”; the principle of practicability would also justify a preference for the unilateral approach in the case of outbound dividends, instead of the internal market approach. It

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50. BE: ECJ, 22 Dec. 2008, Case C-282/07, *Belgian State v. Truck Center SA*, paras. 41-41, ECJ Case Law IBFD: the application of different tax arrangements to resident companies and non-resident companies relates to situations which are not objectively comparable, because the position of the Belgian state is different.

51. This is due to the fact that the administrative principles are related to the EU governance: see A. von Bogdandy, *Gegenstand, Grundlagen und Grundbegriffen*, in *Europäisches Verfassungsrecht, Theoretische und dogmatische Grundzüge* pp. 15-50 (A. von Bogdandy & J. Bast eds., Springer 2010); in the same book: C. Möllers, *Verfassungsgebende Gewalt – Verfassung- Konstitutionalisierung* pp. 268-269; Wyatt & Dashwood's *European Union Law* ch. 7 (Sweet & Maxwell 2006).



is virtually impossible for a withholding agent to gather the relevant information and skills on the tax rules of the residence country and to decide on that basis whether or not it should withhold taxes on dividends (assuming it is not sufficient to take into consideration a tax treaty).

But that is also the case of the principle of ability to pay that is challenged by aggressive tax planning and abuse. There has not been a consistent policy that considers together, as it should, the fundamental freedoms, sound finances in Member States, ability to pay, control of loss of revenue and allocation of taxing rights.

In many relevant cases involving groups of companies, national anti-abuse rules (anti-BEPS rules) have been tackled as exceptions to the fundamental freedoms (they are justifications to restrictions) and only considered to be proportionate if they are not designed as irrebuttable presumptions. The cross-border losses and expenses cases have been the object of a different line of reasoning (the mere risk of abuse is a valid justification, together with the aforementioned risk of jeopardizing the allocation of taxing rights). But the ECJ does not explain why it follows a different reasoning in the two groups of cases (it does not handle them as a different group of cases). Thus, the precedence rule is valid to all subsequent tax cases.

## **1.8. Imperfect tax mobility, BEPS and tax competition within the EU/EEA**

The previous sections illustrate that tax mobility is far from having been achieved in the European Union and that the ECJ cannot replace the legislator in achieving this goal. The ECJ has been accused of either protecting the taxpayer without paying due attention to the risk of tax avoidance and loss of national revenue or, recently, of protecting the revenue interests.<sup>52</sup> The problem does not lie in the interpretation of the law, but in the insufficient policy action and harmonization of direct taxes.<sup>53</sup>

The fact that mobility has not yet been achieved within the European Union and the European Economic Area and therefore creates obstacles to the

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52. E.C.C.M. Kemmeren, *Recovery of Income Taxes: ECJ Tends to Allow Member States more Leeway*, 22 EC Tax Review 1, pp. 2-8 (2013).

53. See e.g. alternative reform options on cross-border taxation of portfolio dividends: C. Spengel & L. Evers, *The Cross-Border Taxation of Dividends in the Case of Individual Portfolio Investors: Issues and Possible Solutions*, EC Tax Review 1, pp. 17-32 (2012).

setting up of an internal market stimulates BEPS behaviour – they would not exist within the European Union if corporate taxation was completely neutral (whether harmonized or not), or if a CCCTB directive with formulary apportionment would be in force, even if other abusive behaviour would occur;<sup>54</sup> imperfect mobility also leads to tax competition between EU Member States (as well as between the EEA Member States).

The features of BEPS behaviour and tax competition in the aforementioned regional areas do not differ substantially from the situation towards the rest of the world and in the rest of the world. This can be demonstrated by the anti-abuse rules in the national corporate tax codes, in the Parent-Subsidiary Directive and in the Merger Directive, and by the public outcomes of the transfer pricing forum, such as the Code of Conduct on the Arbitration Convention and the recommendation to Member States to conclude advanced pricing agreements (APAs):<sup>55</sup> none of them are different from the rules used in respect of non-EU cross-border situations, although EU hard and soft law instruments aim at multilateral instead of bilateral solutions.

### 1.9. BEPS, the EU and the OECD

Because the European Union has its own governance (policymaking institutions and legal instruments), its own agenda and primary law obligations to achieve mobility, as well as its own cases of tax abuse, it could decide to address the above-mentioned BEPS behaviour autonomously. It could respond by harmonizing regimes or enacting codes of conduct anticipating the OECD work.

The past decades show us that the Council and the European Commission do not normally anticipate solutions to cross-border problems when these are being addressed by the OECD. There is no “technical” advantage for the European Union to tackle those topics on its own, before solid progress has been made at the OECD level: the issues that have to be addressed in respect of BEPS are primarily global problems that have to be tackled by global answers.

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54. See W. Hellerstein, *Formulary Apportionment in the EU and the US: A Comparative Perspective on the Sharing Mechanism of the Proposed CCCTB*, secs. 17.2., 17.3.3., 17.4.2. and 17.5.2., pp. 415-421, 430-438, 442-447 and 450-453 in this volume.

55. A.C.M. Zaidan, *The External Tax Treaty Making Powers of the Member States: Defining Limits and Obligations under the Current European Legal Order*, 41 Intertax 5, pp. 274-293 (2013).

But it could still be counter-argued that any potential EU law out-of-the-box solutions to mobility and its responses to transnational problems could bring external political recognition to the European Union. Those solutions could be recommended to groups of other third countries, as inspiring examples of supranational law – best practices – to the rest of the world. An inspiring example to the rest of the world can, to a certain extent, be granted by the new mutual assistance directive which moves towards automatic exchange of information: taken together with the Savings Directive, the European Union shows ambition in this area and has been at the forefront of the tax transparency movement; however, also in respect of tax transparency, there has been an EU/OECD hand-in-hand progress.<sup>56</sup>

Moreover, in the current stage of EU integration and mobility, and as long as the CCCTB proposed directive is not approved, BEPS behaviour is not yet to be dealt with within the European Union substantially differently from the manner in which it is being addressed in the OECD Report. This does not hinder the European Union from taking the forefront in implementing some of the OECD recommendations, as has happened in respect of mutual assistance.

### **1.10. International reaction to BEPS: Out-of-the-box versus step-by-step solutions**

Taking into account the current situation as described in the OECD Addressing BEPS Report – increased mobility in its international meaning – and assuming that the widespread aggressive tax planning is a fact, it is herein contended that tax rules on allocation of taxing rights should, whenever possible, be improved instead of being radically changed.

This is the case of transfer pricing rules as compared to a world corporate consolidated tax base (CCTB) where allocation of revenues is implemented by formulary apportionment. In order to work perfectly, the latter system recommends harmonization of tax bases, a common currency and trust between national tax administrations. The greater the number of states

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56. See K. Spies, *Influence of International Mutual Assistance on EU Tax Law*, 40 *Intertax* 10, pp. 518-530 (2012). There are, however, serious problems in EU Member States, not caused by EU Law, concerning taxpayers rights and related to the use in some Member States of information illicitly obtained and to other taxpayers' fundamental rights; see Dourado, *supra* n. 9, at 17 et seq.; A. Rust, *Data Protection as a Fundamental Right*, in *Exchange of Information and Bank Secrecy* pp. 180-181 (A. Rust & E. Fort eds., Wolters Kluwer 2012).

involved, the more difficult it is to implement a common CCTB.<sup>57</sup> Even in the European Union, a CCCTB will be difficult to implement without a federal budget, where the corporate income tax revenue would be at least partially an EU tax<sup>58</sup> because Member States (mainly the tax administrations and governments) react suspiciously to different rules on allocation of taxing rights (not to mention other existing obstacles) and the possibility of revenue decrease.<sup>59</sup>

Thus, an anti-BEPS agenda aiming to set out international standards and acknowledging the interests of and difficulties faced by emerging and developing countries must have very specific targets and must be sufficiently realistic. Such standards need to be implemented quickly and any radical alteration of the allocation of taxing rights rules will lead discussions to a halt.

Both the League of Nations and the OECD Models are a post-war product, a result of new world orders. Full tax reforms at the national level, as opposed to partial tax reforms, also occur after a radical change in the constitutional order or in times of serious economic and social crisis.<sup>60</sup> In contrast, in times of peace and stable international relations, it will be hardly possible to enact a new tax treaty model introducing a different balance to the current rules on allocation of taxing rights.

Actions have to be coordinated, but they will have to simultaneously respect national sovereignties. Joint audits, improvement of anti-abuse rules and corporate responsibility are examples of measures to be taken that are mentioned in the OECD Report and will not imply a limitation of national sovereignty.

A response to the current BEPS behaviour corresponding to an out-of-the-box thinking implies an alternative tax, such as a destination-based

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57. The same is true for the constitution of a political union: J. Habermas, *Um Ensaio sobre a Constituição da Europa*, Edições 70 (2012) (Essay zur Verfassung Europas, Suhrkamp, 2011) pp. 61-114.

58. See the proposal by M.P. Maduro, *A New Governance for the European Union and the Euro: Democracy and Justice*, RSCAS PP (2012/11).

59. See the results achieved by R. Koch et al., *Possible Effects of a Common Consolidated Corporate Tax Base on EU Tax Budget* ch. 15, pp. 378-384 in this volume.

60. See the Portuguese proposal for a corporate income tax reform, T.C. Neves, *Opening Pandora's Box: Ten International Dimensions of the Portuguese Corporate Tax Reform*, Tax Notes International, Special Reports (23 September 2013).

corporate tax. This will have to be first tested at national level, and if corporate taxation is effectively replaced in one OECD jurisdiction, it will take long before this is duly reflected in international coordination.

### **1.11. Fair distribution of tax burdens, allocation of taxing rights and harmful tax competition**

It can be safely concluded that if the policy debate is targeted at decreasing tax evasion and aggressive tax planning, the fair distribution of the tax burden is still to be determined according to national parameters – i.e. in each jurisdiction, at the state level, which implies that the meaning of equality among taxpayers is to be defined, as usual, by national law, in compliance with constitutional principles. Tax equality can then pursue either capital export or capital import neutrality or none of them.

And in fact, the allocation of taxing rights among jurisdictions is not questioned in the current agenda, unless there is harmful tax competition. If the latter occurs, states are encouraged by the OECD to take anti-abuse measures.<sup>61</sup>

In the European Union, this so far implies the prohibition of existing State aid.<sup>62</sup> However, because harmful tax competition is characterized by the ring-fencing of the regime<sup>63</sup> (broadly corresponding to selectivity in the European Union), it does not avoid a race to the bottom that covers domestic companies investing abroad: national tax measures fostering conduit companies do not fall per se in the definition of harmful tax competition, provided there is no ring fence and no discrimination.

All this means that the anti-BEPS agenda aims at protecting the national fiscal interest (i.e. at collecting national tax revenue). There is, however, strong awareness that this interest cannot be achieved without global governance. Global tax governance is a condition to address BEPS and to assure tax mobility (they are two faces of the same coin), since unilateral measures will either prove to be inefficient to tackle abuse or to provoke double taxation and other tax obstacles, economic distortions and inefficiencies.

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61. OECD, *supra* n. 1, at ch. 5.

62. R. Luján, *(Re)shaping Fiscal State Aid: Selected Recent Cases and Their Impact*, 40 *Intertax* 2, pp. 120-131 (2012).

63. OECD, *supra* n. 1, at 29.

## 1.12. Global tax governance and EU tax governance

Global tax governance is to be achieved by concerted action towards enactment of international standards and subsequent transposition in legally binding instruments (i.e. hard law). In the European Union, the Commission has enacted two recommendations on 6 December 2012 in order to address BEPS that do not differ substantially from the broad suggestions in the OECD Report. They include a model of a GAAR that converges with the ECJ case law on artificial arrangements and which is to be adopted by all EU Member States.

The EC recommendations constitute soft law<sup>64</sup> but may have binding effects if adopted by the Member States. In that case, the ECJ will be competent to interpret whether the recommendations, as enacted under national law, comply with the TFEU (e.g. with the fundamental freedoms) and contribute to a uniform interpretation of the recommendations in the EU Member States.<sup>65</sup>

In the international public law frame, the exchange of information standard has been granted legal value by means of conclusion of TIEAs and renegotiation of exchange of information provisions in tax treaties, implementation of peer reviews to assess whether the standard has been effectively implemented, and to some extent, also the US FATCA measures.<sup>66</sup> Moreover, both the OECD approach to BEPS, as well as the transfer pricing forum in the European Union, seem to be willing to keep the arm's length principle and to look for solutions based on substance versus form approaches, adapting that principle to today's global business environment.

## 1.13. Consequences for the EU of a global reaction to BEPS

The fact that the reaction to BEPS must be granted globally can have two implications for EU influence on global tax governance. It can be argued that global governance and global answers do not eliminate multi-decision

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64. D. Sarmiento, *The Function of EU Soft Law*, in *Traditional and Alternative Routes to European Tax Integration* pp. 53-65 (D. Weber ed., IBFD 2010), Online Books IBFD.

65. Cf. ECJ, 13 Dec. 1989, Case C-322/88, *Salvatore Grimaldi v. Fonds des maladies professionnelles*.

66. A.G. Soriano, *Toward an Automatic but Asymmetric Exchange of Information: The US Foreign Account Tax Compliance Act (FATCA) as Inflection Point*, 40 *Intertax* 10, pp. 540-555 (2012).

levels and, consequently, the European Union will still have to tackle BEPS, whether working in parallel to the G20/OECD response or after what the right answers are, having been clarified, for a global dimension.

That would be the best way for the European Union to fulfil its own policies constitutionally required (the creation of the internal market) and to comply with its constitutional principles (the non-discrimination principle). One way of addressing BEPS in the European Union would be to approve the CCCTB Directive. The G20 worries and the OECD Report could reinforce the need to abandon the arm's length principle within the European Union.

In a more critical approach to the inefficient EU decision-making process, a global reaction to BEPS, led by the G20 and the OECD, would mean that tax mobility in the European Union is not, after all, a constitutional right (derived from a principle), requiring a specific answer (an EU answer) but merely a policy goal. If that is the case, tax mobility within the European Union can be compatible with global standards and national answers to abuse of that mobility.

In other words, the global recommendations to address BEPS could be freely adopted by each EU Member State, according to its own policy targets (to be more or less competitive) and revenue interests (anti-abuse rules targeted at cross-border situations would be admissible provided they are proportionate).

This would also mean that the degree of integration within the European Union – the internal market and the fundamental freedoms – is still far from assuring tax mobility to EU nationals, that the goal of achieving tax mobility within the European Union can be postponed *sine die* and that the Member States are still competent to address tax mobility. Both viewpoints and related arguments are valid to a certain extent and are not the end of the story.

#### **1.14. The deficit of EU tax governance and the increasing tax competition**

The fact that tax harmonization in direct taxes is so difficult to achieve (because of the unanimity rule which is effectively used by the Council to divide itself) seems to lead Member States to an increasing tax competition, of which the patent-box regimes introduced by some Member States are an

example,<sup>67</sup> and where the adoption of participation exemption regimes by some of them follows the worldwide trend.<sup>68</sup> This tax competition, taking place not only within the European Union but also worldwide, foments BEPS behaviour.

Participation exemption regimes, if not only directed at active business abroad and if not accompanied by harsh CFC and switch-over clauses, is attractive to the set-up of conduit companies in the European Union and to the laundering of exempted income in non-cooperative jurisdiction.<sup>69</sup> Tax competition in Europe does not contribute to tax mobility either, but, on the contrary, leads to the introduction of unilateral obstacles by the Member States that are negatively affected by those policies.

Finally, it can even be argued that the international standard on exchange of information, the US FATCA and the general move to tax transparency (including identification of beneficial owners of income) can contribute to increased global tax competition.<sup>70</sup> In fact, low-tax jurisdictions that were based on bank secrecy and lack of transparency in general may well cease to be attractive. In an (ideal) world of transparency, territorial tax systems or participation exemption systems will continue to increase and without proper global tax governance (and without EU tax governance) the entire world, including the EU Member States, will engage in tax competition.

Thus, it is herein contended that the European Union also has to react to BEPS behaviour, even if accompanying the progress achieved by the OECD and by means of soft law. An EU-wide GAAR, elimination of patent-box regimes and the list of actions already identified in the OECD Report must be implemented within the European Union: implementation of joint audits; joint risk assessment of MNEs; improved risk management; enhanced

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67. For the case of the Netherlands, see M. Boterman & B. van der Gulik, *Netherlands*, in *IFA Cahiers 2013 – Volume 98A. The Taxation of Foreign Passive Income for Groups of Companies* pp. 502-503, 515 (IFA 2013), Online Books IBFD.

68. See the examples of the Netherlands, *id.*, at 505-506 and France, N. Jacquot, *France*, *id.*, at 321 et seq.; and the comments on the proposal to introduce a participation exemption regime in Portugal, A.P. Dourado, *A Dupla Não Tributação, a Competitividade e o que Queremos Ser e Parecer*, *Jornal de Negócios* (28 August 2013); and Neves, *supra* n. 60, at 3.3.

69. M. Dahlberg & B. Wiman, *General Report*, in *IFA Cahiers 2013*, *supra* n. 67, at 20-22.

70. D. Dharmapala & J.R. Hines Jr., *Which Countries Become Tax Havens*, 93 *Journal of Public Economics*, p. 1058 (2009); D. Dharmapala, *What Problems and Opportunities Are Created by Tax Havens*, 24 *Oxford Review of Economic Policy*, p. 661 (2008); Dourado, *supra* n. 9.



relationship; spontaneous exchange of information; good corporate citizens; country-by-country reporting and elimination of mismatches between different tax systems.

### **1.15. The need for a European Constitution**

As a result of the financial crisis in late 2008 and the euro crisis in 2010, but especially in the context of the G20 and OECD initiatives, the EU policy focus related to the movement of persons in the context of tax mobility has switched from the necessity of creating an internal market with no obstacles to that movement, to the necessity of fighting cross-border tax evasion and aggressive tax planning. If we believe that good tax governance is not a mere slogan, we have to be aware that political agendas in the EU Member States are increasingly targeted at short-term goals linked to the electoral cycles.<sup>71</sup> For good and bad reasons, the latter pressure does not exist in respect of the EU agenda itself. The good reasons are linked to the role of a supranational entity that focuses on supranational interests and is therefore presumably more aware of the common interests in the Union. This role is played by the European Commission, but not by the Council. There are at least three bad reasons for the absence of electoral pressure within the European Union: they lie in the fact that political agendas ought to be determined by the public interest but that that interest does not necessarily coincide with the opinion makers' viewpoints (e.g. the mainstream media); in the democratic deficit in Europe and in a deep alienation of European citizens from the EU decision-makers.<sup>72</sup>

### **1.16. The current EU tax policy agenda and the good old tax debate: Tax justice and tax efficiency**

It is fair to recognize that, after all, the EU tax policy agenda (finally) reflects the good old national economic and fiscal law debate about tax justice and tax efficiency. Whereas mobility within the European Union is necessary for (efficient) economic growth and the increase of public revenue (if there is no tax abuse or evasion), a determined reaction to BEPS and any other cross-border tax abuse and evasion has to be taken. In fact, equality among taxpayers has to be guaranteed so that paying taxes is perceived as a public obligation. However, the aforementioned classic goals of justice

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71. See the criticism in Habermas, *supra* n. 3, at 102-104.

72. Cf. *id.*

and efficiency and the related principles of tax law will not be enforceable in the European Union in the absence of political integration and of EU taxes.<sup>73</sup> They have to be part of the globally sound finances. Alternatively, tax competition among Member States, BEPS behaviour and subsequent unilateral reactions will increase.

This chapter aimed at showing the inconsistencies and tensions regarding tax mobility in the European Union. The above-mentioned insufficient policy action and harmonization of direct taxes can only be solved with more Europe: a fiscal union and a political union, both of which require direct democratic legitimacy of the EU decision-making powers and a federal budget (in order to comply with the no taxation without representation concept).<sup>74</sup> Emergency or temporary federalism restricted to the Eurozone and relying on decisions taken by the Council and without sufficient discussion at the national parliamentary levels (an executive federalism) will not be sufficient to successfully overcome the euro crisis. The arguments in favour of a fiscal union will be developed in a subsequent GREIT book.

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73. A joint fiscal policy is also a condition for the EMU: See J. Luque, M. Morelli & J. Tavares, *A Volatility-based Theory of Fiscal Union Formation*, EUI Working Papers 21, pp. 1-41 (2012); see e.g. id., p. 28: "Either all or part of the countries move towards fiscal union; or the Euro might collapse and at least some countries will have to revert to autarky."

74. Habermas, criticizing the current decision-making rules for not granting enough democratic legitimacy to the EU decisions (or "output"), *supra* n. 72. Habermas cross-refers to Oeter and the concept of Executive Federalism as an insufficient one: Oeter, *supra* n. 51, at p. 103.