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I. Introduction

Background in brief

1. *Tax treaty law* – i.e. the set of rules derived from tax treaties and transposed in domestic law – is currently the main source of international taxation law. *Community law* takes precedence over these national provisions, but explicitly acknowledges their role and importance.¹ However, so far these two branches of the law have had very little to do with each other.

The main reason for this is probably that Community law relating to taxation focused for the first thirty years of its existence on indirect taxation (turnover tax and excise duty), as this was a major obstacle to the establishment of the internal market. The tax treaties, on the other hand, deal almost exclusively with direct taxation (tax on income and capital and, less frequently, inheritance tax), a subject which the Community only began to look into seriously after the internal market had been established, in the context of measures to ensure its smooth functioning by eliminating remaining obstacles.

2. However, it is clear that for nationals of Community countries exercising their basic rights under the Treaty,² being taxed in different ways because of their nationality or place of residence and, in particular, the risk of being taxed twice on the same income because of the different, uncoordinated national tax arrangements existing within the Community, are obstacles to the smooth functioning of the internal market.

Furthermore, in the enlarged EU with its 25 – and soon 27 – Member States, there is a network of over 300 bilateral treaties governing cross-border tax relations, which represents a substantial difficulty for taxpayers wishing to benefit from their freedoms under the Treaty.

3. The relationship between Community law and international tax law – in particular treaty law – in the field of direct taxation has given rise to conflict on a number of occasions. These two branches of the law relate to different objectives and have different approaches. While the purpose of treaty law is above all to regulate inter-State relations through the allocation of powers of taxation between the contracting States, Community tax law serves the major project of establishing a single market without internal borders.
4. However, as the Court of Justice has said repeatedly, despite the absence of harmonising measures and although “*direct taxation does not as such fall within the purview of the Community, the powers retained by the Member States must nevertheless be exercised consistently with Community law*”.³

¹ Article 293 EC Treaty; See also the explicit references to bilateral treaties in the “mergers” Directive (90/434/EEC) and the “parent-subsidiary” Directive (90/435/EEC), both of 23 July 1990, as well as the extensive case law of the Court of Justice of the European Communities cited in this report.

² Freedom of movement of goods, persons, services and capital.

³ Judgment of the Court of 14 February 1995, Case C-279/93 (*Schumacker*), point 21; see also, inter alia, the judgments of 11 August 1995, Case C-80/94 (*Wielockx*), point 16; of 27 June 1996, Case C-107/94

5. In this respect, some of the recent judgments of the Court have highlighted cases of *discrimination* in the treatment of Community citizens and businesses, arising because treaties are formulated or applied in a way that is contrary to the principles of the Treaty. The Court has therefore required that certain provisions of the double taxation treaties and the national implementing provisions be adjusted to those principles.⁴ Furthermore, it appears that the existing network of bilateral treaties between Member States, that are designed essentially to avoid juridical double taxation, does not in fact succeed in totally eliminating all double taxation on the EU's Internal Market. Economic double taxation should, in particular, also be eliminated when it causes obstacles within the Internal Market.

Communications on company tax in the internal market

6. The European Commission, in its Communication *Towards an Internal Market without tax obstacles*,⁵ based on an in-depth study of company tax,⁶ focuses on a number of areas in which companies are likely to encounter tax obstacles penalising cross-border trade, establishment and investment or, more generally, hampering cross-border economic activity in the internal market. The Communication of October 2001 calls into question the tax treaties' compliance with all the provisions of the EC Treaty in so far as they entail additional tax burdens where activity is conducted in more than one Member State.
7. More recently, in its Communication *An Internal Market without company tax obstacles - achievements, ongoing initiatives and remaining challenges*,⁷ the Commission has stressed the importance of adhering to the principle of equal treatment enshrined in the Treaty, which would seem to conflict with the distinction between residents and non-residents currently made in many tax treaties between Member States⁸ and in some double-taxation treaties between Member States and third countries (provisions limiting advantages under the treaty).

(*Asscher*), point 36; of 15 May 1997, Case C-250/95 (*Futura*), point 19; of 28 April 1998, Case C-118/96 (*Safir*), point 21; of 16 July 1998, Case C-264/96 (*I.C.I.*), point 19; etc.

⁴ See, for example, the Court's judgments of 23 September 2003, Case C-58/01 (*Océ Van der Grinten*), point 54; of 12 December 2002, Case C-385/00 (*F.W.L. de Groot v. Staatssecretaris van Financiën*), points 84, 94, 99 et. seq; of 8 March 2001, Case C-397/98 (*Metallgesellschaft*), points 71 et seq; of 18 November 1999, Case C-200/98 (*X AB et Y AB*), points 10 and 31. See also Annex A.

⁵ Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee - COM(2001)582 final of 23 October 2001.

⁶ Commission staff report on *Company Taxation in the Internal Market*, SEC (2001) 1681 final, 23 October 2001.

⁷ Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee - COM(2003)726 final of 24.11.2003, point 3.5.

⁸ Although such a distinction can in principle be allowed where the situations of resident and non-resident taxpayers are not comparable, it is contrary to Community law where "there is no objective difference between the situations of such a non-resident and a resident such as to justify different treatment" (*Schumacker*, point 37).

Purpose of this document

8. Obligations under the Treaty, the existing tax Directives⁹ and the Arbitration Convention,¹⁰ and the interaction of these obligations with Member States' national and international tax provisions, particularly the tax treaties, raise a number of legal questions. The relations between these provisions should be clarified as soon as possible.
9. The Court of Justice has already ruled more than once on the interaction of Community law with the tax treaties. However, the lack of a systematic and consistent Community framework in this area gives rise to legal uncertainty, which threatens to restrict the advantages of the internal market for taxpayers and make national tax authorities' work difficult.
10. Thus, as things stand at present, a clear priority emerges:
 - to prevent and/or remedy incompatibilities between Community law and the provisions of the tax treaties,¹¹ particularly in cases of double taxation, to provide greater legal certainty - as the Court can only rule on specific cases.

This document will therefore first examine the interrelation of Community law and tax treaty law. It will then focus on the difficulties posed by the coexistence of these two legal systems. It will conclude with a presentation of existing and potential solutions to this type of conflict.

The purpose of this document is not, at this stage, to provide definitive solutions to the problems outlined, but simply material for discussion to help launch a debate between independent experts and Member States' representatives. The answers given to the questions asked today could inform the Commission's work on the Communication on this subject planned for next year.

II. The relationship between the tax treaties and Community law

Community law

11. Before looking at the effect of the tax treaties within the Community legal system, the situation regarding Community tax law and its force within the international legal system should be clarified.

The autonomy of Community primary legislation, not only in relation to national law, but also in the context of international law, has been affirmed on a number of occasions by the Court of Justice in what have become historic judgments. The Court has stated that *the European Economic Community constitutes a new legal order of international law for the benefit of which the States have limited their sovereign rights, albeit within limited fields* and that the EC Treaty is more than an

⁹ Directives 90/434/EEC ('mergers') and 90/435/EEC ('parent/subsidiary') of 23 July 1990; Directives 2003/48/EC ('savings') and 2003/49/EC ('interest and royalties') of 3 June 2003.

¹⁰ Convention 90/436/EEC on the elimination of double taxation in connection with the adjustment of profits of associated enterprises, signed on 23 July 1990.

¹¹ See Annex A.

agreement which merely creates mutual obligations between the contracting states.¹² Furthermore, by contrast with ordinary international treaties, the [EC] Treaty has created its own legal system which, on the entry into force of the Treaty, became an integral part of the legal systems of the Member States and which their courts are bound to apply.¹³ The Community is not subject to the bilateral treaty law of which its Member States are, individually, signatories.¹⁴

Tax treaties in the internal market

12. Most of the tax treaties cover only taxes on income and capital. As there is almost no Community legislation on this subject, the Member States are more or less free to determine the tax rules they consider appropriate. The Court of Justice has ruled on this matter on a number of occasions:

*“The Member States are competent to determine the criteria for taxation on income and wealth with a view to eliminating double taxation - by means, inter alia, of international agreements - and have concluded many bilateral conventions based, in particular, on the model conventions on income and wealth tax drawn up by the OECD.”*¹⁵

*“... in the absence of unifying or harmonising measures adopted in the Community ... the Member States are at liberty, in the framework of bilateral agreements concluded in order to prevent double taxation, to determine the connecting factors for the purposes of allocating powers of taxation.”*¹⁶

13. The Member States thus have sovereign power to determine the connecting factors bringing taxpayers within their respective powers of taxation. The factor connecting a taxpayer to a tax system may vary. Even *nationality* - on the face of it the least Community of the connecting factors - can, according to the Court, be used for the allocation of taxation powers without necessarily constituting discrimination within the meaning of the Treaty:

*“... such differentiation cannot be regarded as constituting discrimination prohibited under Article [39] of the Treaty. It flows, in the absence of any unifying or harmonising measures adopted in the Community context under, in particular, the second indent of Article [293] of the Treaty, from the contracting parties' competence to define the criteria for allocating their powers of taxation as between themselves, with a view to eliminating double taxation.”*¹⁷

Such allocation may result in tax disparities disadvantageous to Community citizens exercising their freedoms under the Treaty but these disparities are not necessarily discrimination within the meaning of Community law.¹⁸ Because of the lack of

¹² Judgment of the Court of 5 February 1963, Case 26/62 (*Van Gend & Loos*).

¹³ Judgment of the Court of 15 July 1964, Case 6/64 (*Flaminio Costa / ENEL*).

¹⁴ See also Articles I-5 and I-6 of the Treaty establishing a Constitution for Europe.

¹⁵ Judgment of the Court of 12 May 1998, Case C-336/96 (*Gilly*), point 24.

¹⁶ Judgment of the Court of 21 September 1999, Case C-307/97 (*Compagnie de Saint-Gobain*), point 56.

¹⁷ Case C-336/96 (*Gilly*), point 30.

¹⁸ In certain cases these disparities may constitute measures restricting exercise of the freedoms - obstacles which, without being genuinely discriminatory (since they apply equal treatment to nationals of the

Community harmonisation, the taxation system varies among Member States and Community commitments do not oblige the Member States to allow taxpayers making use of one of the basic freedoms to benefit from the most favourable possible scheme.¹⁹

14. The existing network of tax treaties should achieve the objective explicitly specified in the EC Treaty of avoiding double taxation. Article 293 of the Treaty,²⁰ which is addressed principally to the Member States, can be taken as a legal basis for the measures it refers to unless those measures are taken on the basis of other provisions of the Treaty, in particular Article 94.²¹ Article 293 of the EC Treaty does not, however, establish the elimination of double taxation as a sphere reserved to the Member States.²² This objective also falls within the sphere of competence of the Community since double taxation may in itself have a direct impact on the functioning of the internal market.

It also appears that some of the articles in the tax treaties do not entirely comply with Community law (primary and secondary legislation), which makes interpretation a tortuous business for those wishing to coordinate provisions of a different nature belonging to different hierarchies.

Tax treaties with third countries

15. When a treaty is concluded with a third country, its compatibility with Community law must be assessed on a different basis than that used when examining a legal act between Member States. A distinction must be made here between treaties signed before the entry into force of the EC Treaty (or the Accession Treaty in the case of the ten new Member States, for example) and those concluded after that date.
16. The EC Treaty contains a specific provision, Article 307, governing conflicts between Community law and bilateral tax agreements between a Member State and a third country concluded before the entry into force of the Treaty. The first paragraph of this Article provides that “*the rights and obligations arising from agreements concluded before [the entry into force of the Treaty (EC or Accession)] between one or more Member States on the one hand, and one or more third countries on the*

country concerned and of other Member States), impede the exercise of a fundamental freedom or make the exercise of that freedom less attractive; see, for example, the Court’s judgment of 11 March 2004 on Case C-9/02 (*de Lasteyrie du Saillant*), points 42-44. However, such obstacles may be justified by “*pressing reasons of public interest*”. See *inter alia* the Court’s judgment of 15 May 1997 on Case C-250/95 (*Futura*), point 31.

¹⁹ “... *the object of a convention ... is simply to prevent the same income from being taxed in each of the two States. It is not to ensure that the tax to which the taxpayer is subject in one State is no higher than that to which he or she would be subject in the other.* (Case C-366/96, *Gilly*, *op. cit.*, point 46).

²⁰ *Member States shall, so far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals ... the abolition of double taxation within the Community;* Article 293, second indent, EC Treaty.

²¹ *The Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament and the Economic and Social Committee, issue directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the common market;* Article 94, EC Treaty.

²² Case C-336/96 (*Gilly*), point 30.

other, shall not be affected by the provisions of this Treaty.” Its general application has been confirmed many times by the Court of Justice.²³

17. However, where there is an incompatibility between international law and Community law, the second paragraph of Article 307 expressly provides that Member States *must take all appropriate steps to eliminate the incompatibilities established*, i.e. to amend the international rule to make it compatible with the Community commitments they have taken on. The Member State concerned must try to renegotiate the provisions that are incompatible with Community commitments and take all appropriate steps to resolve the problem,²⁴ including, where necessary, denouncing the bilateral agreement.
18. There is no specific provision in the Treaty for agreements concluded by Member States with third countries after the entry into force of their Community commitments. However, the second paragraph of Article 10 provides that Member States *must abstain from any measure which could jeopardise the attainment of the objectives of this Treaty*. Concluding a bilateral agreement with a third country which contains provisions running counter to Community law undoubtedly involves a failure by the Member State concerned to meet its obligations under the Treaty.²⁵
19. Even if it is the third country which proposes the inclusion of a provision in the agreement which contains a material breach of Community law – for example, a provision which discriminates against the citizens of other Member States, as in certain anti-abuse clauses (e.g. limitation on benefits clauses)²⁶ – the Member State party to the agreement would be guilty of a violation of the Treaty if it agreed to enter into such a contractual relation and failed to meet the obligation of cooperation in good faith enshrined in Article 10 of the EC Treaty.

²³ Article 307 of the EC Treaty *applies to any international agreement, irrespective of subject-matter ... However, that duty of the Community institutions is directed only to permitting the Member State concerned to perform its obligations under the prior agreement and does not bind the Community as regards the non-member country in question*; Judgment of the Court of 14 October 1980, Case C-812/79 (*Juan Burgoa*), points 6 and 8.

²⁴ The second paragraph of Article 307 suggests, for example, mutual assistance between Member States, diplomatic pressure or adopting a common attitude to a third country which refuses to amend the tax treaty.

²⁵ See CJEC judgment of 27 September 1998 on Case 235/87 (*Matteucci*): “Article [10] of the Treaty provides that Member States must take all appropriate measures, whether general or particular, to ensure fulfilment of the obligations arising out of the Treaty. If, therefore, the application of a provision of Community law is liable to be impeded by a measure adopted pursuant to the implementation of a bilateral agreement, even where that agreement falls outside the field of application of the Treaty, every Member State is under a duty to facilitate the application of that provision and, to that end, to assist every other Member State which is under an obligation under Community law.”

²⁶ See point 29 of this document.

III. The tax treaties and the jurisprudence of the Court of Justice of the European Communities.

The Court of Justice

20. The tax treaties are designed primarily to eliminate (or at least restrict) international juridical double taxation,²⁷ and the elimination of juridical and economic double taxation within the Community is, as already pointed out, a Community objective. Tax treaties concluded for this purpose must, under Community law, comply with internal market requirements on non-discrimination and the four basic freedoms laid down in the Treaty establishing the European Community.

Before offering a brief analysis of the Court's jurisprudence on issues relating to the application of double taxation treaties, it may be useful to point out that the main function of the Court of Justice is to interpret the Community law in force as it applies to a particular case, taking account of the specific circumstances of that case. The Court's judgments are not therefore intended to create new, generally applicable and abstract rules, and so cannot provide, now or in future, a definitive solution to the problems described above.

Allocation of powers of taxation

21. The Court of Justice began examining legal issues concerning the compatibility of bilateral agreements with Community law in the 1960s,²⁸ but only much later, in the eighties, did it have occasion to deal with the tax treaties and their complex relationship with the EC Treaty.
22. In the “*Avoir Fiscal*” case²⁹ the Court stated clearly for the first time that “*the rights conferred by article [43] of the Treaty are unconditional and a Member State cannot make respect for them subject to the contents of an agreement concluded with another Member State.*”

And to make still clearer that the “bilateral” nature of the tax treaties could not restrict the rights of Community citizens, the Court added in the same judgment that “*that Article does not permit those rights to be made subject to a condition of reciprocity imposed for the purpose of obtaining corresponding advantages in other Member States.*”

23. In the *Gilly* judgment,³⁰ the Court clarified the scope of Article 293 of the EC Treaty, stating that it does not have direct effect.

“... Article [293] is not intended to lay down a legal rule directly applicable as such, but merely defines a number of matters on which the Member States are to enter into negotiations with each other `so far as is necessary'. Its

²⁷ Also double non-taxation.

²⁸ See, for example, the Court's judgment on Case 10/61, *op. cit.*, on customs duties and the free movement of goods; the Court stated that a Member State which, by virtue of the entry into force of the EEC treaty, assumed new obligations which conflicted with rights held under an earlier agreement, had to refrain from exercising such rights to the extent necessary for the performance of its new obligations. In this respect Article 307 of the EC Treaty only guarantees the rights held by third countries under earlier agreements.

²⁹ Judgment of the Court of 28 January 1986, Case 270/83 (*Commission v France*), point 26.

³⁰ Case C-336/96 (*Gilly*), *op. cit.*, points 24 to 30.

second indent merely indicates the abolition of double taxation within the Community as an objective of any such negotiations. Thus, although the abolition of double taxation within the Community is included among the objectives of the Treaty, it is clear from the wording of that provision that it cannot itself confer on individuals any rights on which they might be able to rely before their national courts.”

Exercise of powers of taxation

Free movement: tax benefits linked to personal and family circumstances

24. One must never lose sight of the subtle difference between the *allocation of powers of taxation*, which falls within the sovereign power of the Member States and the *exercise of powers of taxation*, which, when it is the responsibility of the Member States, is required to respect the Community freedoms enshrined in the EC Treaty.³¹
25. The *Schumacker* case³² is a prime example.

In its judgment on this case the Court did not object in principle to States designating, in their bilateral double taxation agreements, the State of residence as the State subject to the obligation to take account of the personal and family circumstances of cross-border workers and to grant the associated tax benefits, in line with the rule suggested by the OECD Model.³³ However, according to the Court this solution may lead to discrimination – and thus be in breach of Community law – as no alternative solutions are provided in the treaty itself or in national legislation for workers who do not receive significant income in their State of residence.³⁴

Right of establishment: tax treatment of permanent establishments

26. The obligation to grant non-discriminatory tax treatment to permanent establishments of Community origin in a situation which is objectively comparable to that of resident companies is another key point for the exercise of powers of taxation.

Since the “*Avoir Fiscal*” case referred to above,³⁵ the Court has ruled that Member States must grant the permanent establishments of Community undertakings located on their territory the same tax benefits that they grant to resident companies. This right is unconditional and cannot be limited by the effect of a tax treaty with another Member State.

³¹ The Court has consistently ruled that “*As far as the exercise of the power of taxation so allocated is concerned, the Member States nevertheless may not disregard Community rules*”; Case C-307/97 (*Saint-Gobain*) op. cit., point 57.

³² Case C-279/93 (*Schumacker*) op. cit., points 21 et seq.

³³ Articles 15(1) and 24(1) of the German-Belgian double taxation treaty of 11 April 1967. See also commentary to Article 24 of the OECD Model, points 3-4.

³⁴ In the *de Groot* case the Court stated that in exercising their powers of taxation Member States are obliged to *respect the principle of national treatment of nationals of other Member States and of their own nationals who exercise the freedoms guaranteed by the Treaty*. Judgment of the Court of 12 December 2002, Case C-385/00 (*de Groot*), point 94 et seq.

³⁵ Judgment of the Court of 28 January 1986, Case 270/83 (*Commission v France*), point 27.

27. In the *Saint Gobain* judgment the Court gave a better definition of the principle of *national treatment*: a permanent establishment must (like resident companies) be allowed all the benefits granted by the tax treaties concluded by the State where it is resident. In practice, if Member State A, under a tax treaty with State B (Member State or third country), grants tax benefits to its resident companies for income from State B, it must grant the same benefits to the permanent establishments on its territory of companies which have their principal place of business in Member State C. Conversely, however, at present most Member States' tax treaties confine application of the provisions of the treaty to undertakings resident in the two contracting States and exclude the permanent establishments of other Community partners from the benefits of the treaties, without giving any valid justification of this general restriction.³⁶ There is thus an obvious incompatibility between the provisions of the treaties and Community law.

Tax treaties and secondary Community legislation

28. The Court of Justice has also had occasion to rule on the compatibility of bilateral agreements with secondary Community legislation.³⁷

In the *Zythopoiia* case, the government of a Member State also invoked the provisions of a bilateral treaty to justify taxing the dividends distributed to a foreign parent company. Since Article 7(2) of the parent-subsidiary Directive³⁸ specifies that the Directive does not affect the application of domestic or *agreement-based* provisions designed to eliminate or lessen economic double taxation of dividends, the Member State concerned considered that the taxation was legitimate.

The Court limited the scope of this provision – Article 7 only refers to provisions specifically designed to avoid double taxation – ruling that an agreement could not reduce the effect of the exemption from withholding tax provided for in the Directive:

“... the rights conferred on economic operators by ... the Directive are unconditional and a Member State cannot make their observance subject to an agreement concluded with another Member State.”³⁹

Tax treaties with third countries: anti-abuse clauses

29. Some bilateral tax treaties between Member States and third countries contain clauses limiting some of the treaty's benefits to companies resident in the signatory

³⁶ The Court's judgment of 15 January 2002 on Case 55/00 (*Elide Gottardo v INPS*), concerning social security, may throw light on the Court's interpretation. According to the Community judges, when a Member State concludes an international bilateral agreement with a third country, the fundamental principle of equal treatment requires that Member State to grant nationals of other Member States the same benefits as those enjoyed by its own nationals under that agreement unless it can objectively justify its refusal to do so.

³⁷ See the Court's judgments of 4 October 2001 on Case C-294/99 (*Athinaiki Zythopoiia*), points 31 et seq., and of 25 September 2003 on Case C-58/01 (*Océ Van der Grinten*), points 54 et seq. concerning the interpretation of Article 7(2) of Directive 90/435/EEC with respect to the bilateral double taxation treaties signed by the United Kingdom.

³⁸ Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States

³⁹ Case C-294/99 (*Athinaiki Zythopoiia*) op. cit., point 32.

countries, explicitly excluding permanent establishments and even resident companies where they are “foreign [in relation to the two signatory countries] controlled”.

According to the interpretation of the Treaty in the Court's ruling on the *Saint Gobain* case, these clauses conflict with the right of establishment.⁴⁰ In the light of the recent judgments in the field of air transport,⁴¹ one might even take the view that in these scenarios it is not only Article 43 that is infringed by a Member State's *exercise* of its taxing powers, but also Article 10 of the EC Treaty through the act of *allocation of tax sovereignty* (obligation of cooperation in good faith), as it is against Community law for a State to adopt rules likely to affect Community provisions.

Justifications

30. The Member States have often tried to explain to the Court that some of the provisions of their bilateral treaties which did not comply with the Treaty were justified by *pressing reasons of public interest* such as combating tax evasion, loss of revenue, fiscal cohesion, etc. However, the Court has always rejected these arguments of the national tax authorities.⁴²
31. In the *Wielockx* case a national tax administration justified its refusal to concede certain tax benefits to non-residents (deductibility of pension contributions) by the need to preserve *fiscal cohesion*.⁴³ In rejecting this justification in the *Wielockx* case the Court invoked the “comprehensive” nature of the bilateral treaties:

“ ... *the effect of double-taxation conventions* [has not been to establish] *fiscal cohesion ... in relation to one and the same person by a strict correlation between the deductibility of contributions and the taxation of pensions but is shifted to another level, that of reciprocity of the rules applicable in the Contracting States. Since fiscal cohesion is secured by a bilateral convention concluded with another Member State, that principle may not be invoked to justify the refusal of a deduction such as that in issue.* ”

IV. Possible solutions

⁴⁰ In this connection the Court states that the obligation under Community law is not such as to pose a problem in terms of treaties with third countries. Indeed, “*the balance and the reciprocity of the treaties concluded* [between a Member State and a third country] *would not be called into question by a unilateral extension, [on the part of the Member State] of the category of recipients [in that State] of the tax advantage provided for by those treaties, ... since such an extension would not in any way affect the rights of the non-member countries which are parties to the treaties and would not impose any new obligation on them*”; Case C-307/97 (*Saint-Gobain*) op. cit., point 59.

⁴¹ Judgments of the Court of 5 November 2002; Cases C-466/98 - C-476/98 (*Open skies*).

⁴² See for example Case 270/83 (*Commission v. France, “Avoir Fiscal”*), point 25 and Case C-264/96 (*Imperial Chemical Industries*), point 26, for the *risk of tax evasion*; Case C-307/97 (*Saint-Gobain*), point 50 and Case C-264/96 (*Imperial Chemical Industries*), point 28 for *loss of revenue*; Case C-80/94 (*Wielockx*), points 23-25 for *fiscal cohesion*.

⁴³ *Fiscal cohesion* is one of the few justifications that the Court has been known to accept in tax matters. However, in the cases concerned the tax treaties played an entirely marginal role. See the Court's judgments of 28 January 1992 on Case C-204/90 (*Bachmann*), points 26-28 and Case C-300/90 (*Commission v. Belgium*), points 20-21.

Introductory note

32. The need to clarify tax relations between the Member States and the EU and to make them compatible with Community law is not new. As far back as the 1960s the Fiscal and Financial Committee chaired by Professor Neumark studied the problem of double taxation within the common market and stressed the importance of reforming the system of bilateral agreements. In its conclusions the Committee went so far as to propose adopting a multilateral double taxation treaty.⁴⁴

Apart from answering parliamentary questions,⁴⁵ the Commission had no further opportunity to address the question of bilateral treaties until the early 1990s.⁴⁶

33. In 1992 the Ruding Committee's report⁴⁷ noted that there were still certain gaps in the network of tax treaties between Member States and that taxation of capital was not always covered, and inheritance tax almost never covered by those treaties. The Committee also pointed out that the Member States concluded bilateral conventions with third countries which often gave rise to discrimination against businesses of other Member States.⁴⁸

34. The present situation is considerably different from that in which the first attempts at integrating agreement-based relations were made. There has been a steady convergence of tax systems and, thanks to the work of the OECD in this field, the tax treaties are more standardised than they used to be. Not only has the internal market been consolidated but many other obstacles have disappeared, leaving the tax obstacles more starkly apparent. The rulings of the Court of Justice have also highlighted the need for better coordination at Community level of Member States' tax policy in terms of preventive double taxation treaties in fields directly covered by Community law. Coordination is called for, not only concerning the negotiation of agreements between Member States, but also for the tax treaties concluded with third countries.

⁴⁴ European Commission, *Report*, 1962, Chapter VII, second phase, action A-3, page 90 (French version). In 1968 the Commission drew up a preliminary draft multilateral treaty which drew much of its inspiration from the 1963 OECD Model; doc.11.414/XIV/68-F) of 1.7.1968. However the major legal discrepancies between tax systems at the time meant that the project had to be abandoned.

⁴⁵ European Parliament, Question No 224/82 (*Y. Thebald-Paoli*), OJEC C 156, 21.6.1982, p. 33.

⁴⁶ In 1990, in response to a very specific question from a member of the European Parliament regarding the compatibility of certain provisions of the treaty between Germany and the United States with the principles of the EC Treaty concerning free movement – right of establishment and equal treatment – the Commission preferred not to take a definitive position on the subject, promising to examine the problem in depth and then inform those concerned of the result of its research. Parliamentary question PE No 2046/90 (*G. de Vries*), OJCE C 79 of 25.3.1991, p. 28.

⁴⁷ Report of the Committee of Independent Experts on Company taxation, March 1992.

⁴⁸ As well as calling on the Member States to close existing gaps, the Committee recommended in its conclusions that the Commission should act *in concert with Member States* [to define] *a common attitude with regard to policy on double taxation agreements with respect to each other and also with respect to third countries*. European Commission, *Report*, Chapter 10, page 206.

In a communication following up on the conclusions of the Ruding Committee the Commission endorsed the recommendations concerning bilateral tax treaties and confirmed its commitment to checking the compatibility of the treaties between Member States and between Member States and third countries. Commission Communication to the Council and to Parliament *subsequent to the conclusions of the Ruding Committee indicating guidelines on company taxation linked to the further development of the internal market*, 26 June 1992; SEC(92) 1118 final.

35. The Member States have also expressed an interest in any form of cooperation at Community level regarding tax treaties. One of the proposals of the High Level Group⁴⁹ concerned examining the role, functioning and possible coordination of double taxation treaties in the internal market.⁵⁰
36. To resolve double taxation problems in the internal market and provide answers to questions concerning the compliance of the existing network of bilateral treaties with Community law, the study annexed to the Commission Communication "*Towards an Internal Market without tax obstacles*"⁵¹ proposed enhanced coordination within a Community framework of Member States' policies on double taxation treaties.
- The study suggests possible approaches, such as the conclusion of a multilateral tax treaty between all the Member States; drafting an EU version of the OECD model convention (but taking account of the requirements of the EC Treaty) or a recommendation to the Member States containing guidelines on the most sensitive aspects of the agreements such as the definition of the concepts of "residence" and "non-discrimination".
- These suggestions are not exhaustive. One should not, for example, forget that the direct impact of tax treaties on the functioning of the internal market means that the Commission could propose a Directive on the subject under Article 94 of the EC Treaty.
37. The following paragraphs present in brief the different work scenarios in order of the degree of Community intervention required. There are many possible options, from actual legislative *harmonisation* at Community level to various forms of *coordination* of Member States' action.

"Communitisation" of the provisions of tax treaties to which Member States are parties

38. The Commission may present a proposal for a Directive to the Council for the purposes of ensuring the proper functioning of the common market or achieving a Community objective. This solution would involve replacing all the intra-Community tax treaties with a Community legal instrument.
- The value of this measure would be undeniable for European taxpayers in terms of legal certainty, simplifying procedures and reducing compliance costs. While such an instrument would not necessarily solve all the tax problems involved in cross-

⁴⁹ High Level Group of personal representatives of the EU's Finance Ministers, set up after discussion at the informal ECOFIN Council in Verona in 1996 (see SEC(96)487, *Tax policy in the European Union*", 20 March 1996).

⁵⁰ Commission report to the Council, *Taxation in the European Union - Report on the development of tax systems*; COM(96)546 of 22 October 1996: "*There was considerable discussion of the role of double taxation treaties between Member States (and with third countries) in contributing most effectively to meeting Single Market needs. Even though bilateral treaties based on the OECD Model Convention have gone a long way towards facilitating international trade world-wide, many representatives called for action to improve their functioning. It was suggested that certain areas of potential double taxation should be identified, and their treatment agreed upon at Community level. This would provide a common pattern to streamline the system.*"

⁵¹ SEC (2001)1681 final, *op. cit.*, IV, 9.2., p. 479 et seq.

border operations, there would be a major advantage in having a single instrument governing such operations in a uniform fashion.

A multilateral treaty

39. Apart from the issue of bilateral treaties' compliance with the Community treaty, the traditional concept of bilateral tax treaties is at issue in view of the way the economic environment is developing. The very nature of the Community's single market seems to call for a unified instrument better suited to the growing number of triangular and multilateral economic relations - resulting in part from the gradual removal of tax frontiers - which threaten to make the treaties obsolete.
40. A number of experts in this field have questioned whether bilateral treaties are any longer the most effective instrument for dealing with the new complexity of world economic relations, and whether a multilateral treaty would not be a more satisfactory solution.⁵² A multilateral treaty would make it possible to address problems that are insoluble under the system of bilateral treaties. It would reduce the complexity of relations and introduce greater legal certainty,⁵³ particularly if the Member States agree to give binding arbitration powers to the European Court of Justice under Article 239 of the EC Treaty.⁵⁴

Furthermore, the unanimous agreement of the Member States to a treaty of this kind, which would not be easy to obtain, although desirable, is by no means indispensable. It is conceivable for a multilateral treaty to enter into force for its signatories without having to wait for all the Member States to sign and/or ratify it, although this solution would indeed limit the advantages of such a treaty.⁵⁵

41. There are already a number of examples of the multilateral treaty.⁵⁶ In 1983 the EU's Nordic countries (Finland, Sweden and Denmark) signed a multilateral double taxation agreement⁵⁷ with the other members of the Nordic Council (Iceland and

⁵² In 1992 the Ruding Report stated that "it would be a possibility to overcome these problems of discrimination and distortions by concluding a multilateral tax treaty between all Member States either in the framework of the Treaty of Rome or in a special convention. Alternatively, these problems may also be solved by some form of coordinated action between Member States and the Commission." *Report of the Committee of Independent Experts on Company taxation*, Annex 6 (by Professor A. Rädler), page 378.

⁵³ The phenomenon of "treaty shopping" is a good example of the legal uncertainty that can be generated by a vast network of bilateral treaties. National tax authorities and legislators tend more and more to regard such practice as a real abuse of the rules. They therefore try, in one way or another, to withhold legal recognition. This problem is not confined to the Community, and needs to be addressed at international level.

⁵⁴ *The Court of Justice shall have jurisdiction in any dispute between Member States which relates to the subject matter of this Treaty if the dispute is submitted to it under a special agreement between the parties;* Article 239, EC Treaty. See in this connection Article 23 of the tax treaty between Germany and Austria.

⁵⁵ If bilateral treaties remained present alongside the multilateral treaty, this would allow "treaty shopping" to continue, in part at least.

⁵⁶ By way of illustration one may take the double taxation treaty between the Andean countries (Bolivia, Chile, Colombia, Ecuador and Peru), signed on 16 November 1971, and the Caribbean Community Double Taxation Agreement of 1994; there is also a Convention on Mutual Administrative Assistance in Tax Matters drawn up within the framework of the Council of Europe and the OECD, which was signed at Strasbourg on 25 January 1988 and entered into force on 1 April 1995).

⁵⁷ *Nordiska skatteavtalet* (Nordic convention), signed in Helsinki on 22 March 1983.

Norway) which replaced the previous bilateral treaties between the five countries. The Nordic Convention is a good practical example of a multilateral treaty between a group of countries which are members of the OECD and (some) of the EU. It follows closely the provisions of the current OECD Model Convention.⁵⁸ However, it should be borne in mind that convergence between the tax systems of the Nordic countries is particularly advanced. Even so, the Nordic Convention has to be frequently amended by protocols to maintain its effectiveness.

42. In conclusion, it should be noted that a multilateral treaty between Member States was the solution preferred by the group of experts drawn from business and the social partners which assisted the Commission in drafting its study on company taxation. Most of the experts consulted felt that the bilateral treaties “*no longer adequately address the increasingly complex multilateral structures of enterprises and that a multilateral convention is now required between EU Member States.*”⁵⁹
43. The OECD Committee on Fiscal Affairs considered the possibility of adopting a multilateral convention to replace the existing tax treaties. However, it has abandoned the idea for the time being in view of the difficulty of putting it into practice. Nevertheless, the OECD has not ruled out the possibility that a multilateral convention could be an attractive and technically feasible solution for a group of States with similar tax systems and common objectives.⁶⁰

A European model treaty

44. The idea is to create – along the lines of the Model Tax Convention drawn up by the OECD Committee on Fiscal affairs – a model treaty specifically for the EC, to be used by the Member States as a frame of reference when negotiating tax treaties between themselves and with third countries.
45. Most writers who have studied this scenario still consider that there should be a Community “standard bilateral treaty” as an intermediate step towards a multilateral treaty. Such a model would not aspire to replace the OECD model or compete with it. Its purpose would rather be to provide clear solutions for issues of specific interest to the Community.⁶¹
46. It seems sensible for most of the provisions to follow the OECD model. Thus the proposal might confine itself to the Articles (and their commentaries) requiring a “Community” interpretation, while referring to the provisions suggested by the OECD for the rest of the model.

⁵⁸ OECD Model Tax Convention on Income and Capital, Introduction, paragraph 38, Paris 2003.

⁵⁹ SEC/2001/1681 final, page 406.

⁶⁰ OECD Model *op. cit.*, Introduction, paragraph 37: “*the Committee on Fiscal Affairs considered whether the conclusion of a multilateral tax convention would be feasible and came to the conclusion that this would meet with great difficulties. It recognized, however, that it might be possible for certain groups of Member countries to study the possibility of concluding such a convention among themselves on the basis of the Model Convention, subject to certain adaptations they might consider necessary to suit their particular purposes.*” Despite this reservation, the Committee on Fiscal Affairs remains sceptical as to the feasibility of a multilateral convention and it concludes its remarks on this subject by saying that “*there are no reasons to believe that the conclusion of a multilateral tax convention involving all Member countries could now be considered practicable*”; OECD Model *op. cit.*, Introduction, para. 40.

⁶¹ SEC (2001)1681 final, *op. cit.*, IV, 9.2.2, p. 408.

47. This model could not be made legally binding⁶² but in tax matters the Member States have already experimented with solutions that depart from the traditional instruments of Community law.⁶³ On this matter some writers have suggested trying to find an appropriate legal formula for giving the European Commission a coordinating role to facilitate the task for the Member States. One could for example consider organising regular meetings in Brussels bringing together groups of tax treaty negotiators to bilaterally initial the amendments that need to be made to the treaties between Member States.

Recommendations to the Member States

48. This approach is structurally related to the EU model. The European Commission would formulate recommendations or deliver opinions within the meaning of Articles 249 and 211 of the EC Treaty⁶⁴ on matters of major interest for the Community. This applies, for example, to the provisions of the Treaty which have been clearly interpreted by the Court's jurisprudence. Recommendations could provide guidelines on residence and non-discrimination in particular. The Member States would be free to reproduce them in their tax treaties or domestic law.

This approach could also take the form of a series of *comments or reservations* on the OECD Model and its Commentary.

Amending national legislation

49. As a number of writers have observed, the tax treaties are not in theory indispensable. In the absence of such treaties the Member States may apply a system for the prevention of double taxation based directly on national legislation.⁶⁵

Each Member State would completely revise its tax legislation in the light of the EC Treaty, eliminating any discrimination against non-resident Community persons or entities and introducing provisions to eliminate double taxation.

The most favoured nation clause

50. Lastly we would draw attention to another scenario cited in the literature on the subject, which would allow double taxation and tax discrimination to be eliminated in the EU but would require radical changes to current practice in international tax law.

⁶² The standard provisions could be contained in a Commission Recommendation. Allowing reservations to be expressed and comments to be added – as in the OECD Model – could make it easier to obtain approval for the European model.

⁶³ See, for example, the "code of conduct" on company taxation.

⁶⁴ *In order to carry out their task and in accordance with the provisions of this Treaty, the European Parliament acting jointly with the Council, the Council and the Commission shall make regulations and issue directives, take decisions, make recommendations or deliver opinions ... Recommendations and opinions shall have no binding force.* Article 249, EC Treaty.

In order to ensure the proper functioning and development of the common market, the Commission shall ... formulate recommendations or deliver opinions on matters dealt with in this Treaty, if it expressly so provides or if the Commission considers it necessary, Article 211, EC Treaty.

⁶⁵ Many countries, for example, apply a tax credit system, akin to that used under their tax treaties, for income from States with which they do not have a treaty.

51. Under the most favoured nation (MFN) clause, a State is not in principle authorised to introduce discrimination among its international partners.⁶⁶ If a State grants someone an advantage, it must automatically extend it to all other partners to which it has previously granted the possibility of benefiting from this clause. This clause does not usually have a place in the bilateral tax treaties, which are essentially based on the principle of reciprocity. There are a few exceptions which show that introducing the clause into a tax agreement is not theoretically inconceivable.⁶⁷
52. Regarding this hypothesis the Commission study of 2001 confined itself to pointing out that some commentators believe that European taxpayers should have the right to claim the advantages of the most favourable tax treaty concluded by the Member State in which they are resident or the one from which they derive their income.⁶⁸
53. The insertion of an MFN clause for the benefit of all Community citizens in all bilateral treaties would, *de facto*, transform those treaties into a multilateral treaty without the need for long negotiations first. However, the Treaty's prohibition of discrimination does not explicitly provide for MFN treatment.
54. The Court of Justice may finally have to rule on this matter in a case currently pending: in case C-376/03 (*D. v. Rijksbelastingdienst*),⁶⁹ the 's-Hertogenbosch Court of Appeal (Netherlands) has put a question to the Court of Justice specifically concerning the compliance with the Treaty of unequal treatment of EU citizens arising from the implementation of different bilateral agreements.⁷⁰

Advantages and disadvantages of the possibilities discussed

55. All the solutions considered have advantages and disadvantages.
56. The model European treaty would allow the Member States to continue to settle strictly bilateral issues in (bilateral) tax treaties without necessarily having to establish Community-level solutions.

⁶⁶ The MFN principle has always been the pillar of the trade system (for goods) recommended by the GATT. Although it does not in itself require a particular degree of market opening, this principle ensures fair competition between trade partners.

⁶⁷ See, for example, Protocol IX, paragraph 3 of the tax treaty of 14 March 1994 between the Netherlands and Latvia concerning the treatment of royalties by a signatory State vis-à-vis other OECD members, and the general clause in the protocol to the treaties between Spain and certain Latin American countries.

⁶⁸ The idea of introducing an MFN clause in the tax treaties to resolve the problems of their compatibility with the Treaty is not new. The Ruding report has already stressed that "*It is absolutely unacceptable in the single market that bilateral tax treaties between Member States give preferential tax treatment to enterprises in one or several Member States and not to enterprises resident in the remaining Member States.*" (Report of the Committee of Independent Experts op. cit., Annex 6, p. 378).

⁶⁹ In the same vein see case C-8/04 (*E. Bujara v. Inspecteur van de Belastingdienst Limburg*).

⁷⁰ The Advocate General, in his conclusions of 26 October 2004, suggested that the Court should not give a ruling on the specific question concerning the MFN clause in view of its complementary nature, stressing that a positive answer would *severely fetter the complex system of bilateral agreements for the avoidance of double taxation*, although he pointed out that *it would not be the first time that a ruling of the Court of Justice caused upheaval in the legal systems of the Member States*. See also in case C-279/93 the conclusions of Advocate General Léger delivered on 22 November 1994, point 87; judgment of the Court of 8 March 2001, joined cases C-397/98 and C-410/98 (*Metallgesellschaft and Hoechst v Commissioners of Inland Revenue*)

Furthermore, unlike a multilateral treaty and like the OECD Model Convention, it could take a non-binding form⁷¹ and be used in negotiating tax treaties both between Member States and between Member States and third countries.

On the other hand, the model would maintain the bilateral type of solution and, by its nature, might be less effective in "triangular" situations, while the complexity of a vast network of treaties between States would remain.

57. A multilateral treaty would be technically capable of providing solutions to triangular situations and would eliminate root and branch the whole network of treaties between Member States. It could however be unimaginably complex given that it would undoubtedly necessitate a number of explanatory protocols to clarify the specific situations of the signatory States and the particular nature of the bilateral economic relations between the 25 – soon 27 – Member States. The danger is, then, that a multilateral treaty would be only a superficial, essentially contrived improvement.
58. The EC model, even if it were as structured and detailed as a directive, would not be Community law unless it were formally approved by the Community legislator. The most important consequence of this would be that any intervention by the Court of Justice under Articles 226 and 234 of the EC Treaty in respect of direct appeals or requests for preliminary rulings would be excluded in principle. The Court could nevertheless play a role in disputes between Member States on the interpretation of specific bilateral treaties, if that treaty expressly referred to Article 239 of the EC Treaty.

A multilateral treaty concluded under Article 293 of the EC treaty would be much more “Community” in character. If, however, the Court of Justice is not authorised to ensure uniform and correct application of that treaty, there is a serious danger that we may face the problems and legal uncertainties which characterise the current Arbitration Convention.

59. Without denying the indisputable advantages that a directive, a multilateral treaty, or other alternatives could offer, it seems that a model treaty – at least as a first stage – would be the easiest solution to apply. Such a project, on the face of it simpler, should nevertheless be carefully prepared with technical work involving all the Member States.⁷²
60. The services of the Commission have not, so far, arrived at a definitive position as regards what common step to recommend. They will be open to any suggestions emerging from this workshop for improving the compliance with Community law of the agreements and practices applied by the Member States to deal with cross-border taxation.

⁷¹ SEC/2001/1681 final, page 408.

⁷² In 2001 the Commission expressed the opinion that the most promising way forward towards improving compliance with the principles of the internal market enshrined in the Treaty was *in the long term, to agree an EU version of the OECD model convention and commentary ... which would meet the specific requirements of EU membership*. This is not a question of partiality, but simply a pragmatic opinion taking account of the many difficulties posed by drafting a multilateral treaty.

V. Questions

1. *Do delegates agree that there may be situations in which certain provisions commonly found in tax treaties come into conflict with Community law?*

2. *Do delegates agree that there is a need to reflect on how such conflicts might be avoided?*

3. *Would delegates consider it useful, for the purposes of that reflection, to establish working groups or sub-groups to examine specific issues or specific tax treaty provisions?*

4. *Of the broader long-term solutions outlined in this Paper, which would delegates consider to be the more appropriate to implement?*

5. *Do delegates have other suggestions as to the best way forward?*