

Workshop on “EC Law and Tax Treaties”
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1st panel – Tax treaties between Member States

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I have read the Commission’s working document with great interest, and would like to take this opportunity to give my response.

To start with, I would like to comment on two statements in the Working document.

The first is its description of the relationship between international tax law and Community law given in the introduction. The Commission says that these two branches of the law relate to different objectives. My own conviction is that nothing could be further from the truth. In concluding tax treaties, the aim of member states is to prevent the application of two or more tax systems impeding the movement of persons, services and capital between member states – but this is also the aim of creating a common market.

Second, the Commission states in paragraph that there is almost no Community legislation in the field of international tax law. However, it is overlooking the fact that the Community has already adopted the following legislation in this field: the Parent-Subsidiary Directive, the Interest and Royalty Directive, the Savings Directive, the Exchange of Information Directive, and the Mutual Assistance in Collection of Tax Directive. The member states have also concluded the Arbitration Convention on the basis of article 293 of the EC Treaty. These instruments go much further towards abolishing double taxation and preventing tax evasion than the OECD model convention currently does.

I now want to look at the impact of EC freedoms on international tax law and at what action the Commission might take in this regard.

I. Impact of EU freedoms on international tax law

In section 3 of the working document, the Commission discusses the impact of the judgments handed down by the European Court of Justice on international tax law. The Commission makes a useful distinction between the exercise of powers of taxation by member states on the one hand, and the allocation of powers of taxation on the other. Member states are not allowed to discriminate on the basis of nationality or impede free movement when either exercising or allocating their tax powers.

a. Exercise of powers of taxation

The first point I want to make is that powers of taxation should be exercised in accordance with EC freedoms. A tax convention can restrict the way member states exercise their tax powers according to how it allocates the power of taxation between the states in question. If this power is already limited by primary or secondary Community legislation, a tax convention has no added value. Let me illustrate this with two examples.

Example 1:

Many member states tax dividends, interest and royalties from their own state. If a member state treats its own residents who receive such income more favourably, in tax terms, than a recipient residing in another member state, it will probably be obliged on the basis of EC freedoms to allocate this benefit to the non-resident taxpayer as well. In such a situation, the power of taxation is limited by the application of EC freedoms, allowing any double taxation to be partly or entirely eliminated. The Commission's Communication on dividend taxation of individuals in the internal market is important in this regard. Moreover, a French court has asked the European Court of Justice for a preliminary ruling on this matter in the *Denkavit* case.

Example 2:

An entrepreneur established in one member state undertakes activities in another member state. The other member state taxes the profit attributable to these activities. But the entrepreneur's own member state also taxes the same profit, resulting in double taxation. It might be argued that the member state of the entrepreneur is obliged to eliminate this double taxation unilaterally, on the basis of the principle of mutual recognition derived from the EC freedoms, in line with international tax practice. This raises the question of whether member states are required to recognise the tax status of an entity assigned by its state of incorporation in order to avoid double taxation. I would like to suggest that the Commission publishes a communication on the significance of the principle of mutual recognition for direct taxation.

b. Allocation of powers of taxation

The second point I want to make is that member states should also take EC freedoms into account when allocating their powers of taxation. The Commission says that member states set certain conditions governing access to the benefits arising from their tax treaties, in violation of EC freedoms. These conditions mean that:

1. a permanent establishment has no access to the treaty network concluded by the state of establishment;
2. a resident can be refused access to a convention on account of its foreign shareholders, for example, as is the case with the 'limitation on benefits' provision; and
3. there is in principle no right to invoke the most favourable tax treaty (known as most-favoured-nation treatment).

As regards the first two points, I support the Commission's position that, in principle, such conditions are incompatible with EC freedoms. This is also shown by the Saint-Gobain and Open Sky judgments, for example. What practical significance does this have?

Under the Saint-Gobain judgment, states should grant access to the benefits arising from their treaty network to permanent establishments located there. Permanent establishments also have access to the recently amended Parent-Subsidiary Directive and the Interest and Royalty Directive. Finally, it is often possible to invoke the treaty network concluded by the state where the head office is located. Since the treaty network within the EC is virtually complete, I do not see an urgent need to present a specific solution for triangular cases. But the Commission could make proposals to the member states on what specific provisions they might include in their tax conventions to deal with such cases.

As regards the second point, the conventions so far concluded by the member states contain virtually no provisions directed against treaty shopping. There is however a trend towards including them. I would therefore like to ask the Commission to think about drafting an anti-treaty-shopping clause that would be acceptable to all.

This brings me to my third subject. If the European Court of Justice holds today in the D case or in another future judgment that a right to the most favourable treatment can be derived from EC law, the granting of that right will lead, in my view, to the economic disintegration of Europe in the short and medium term. This is because by concluding treaties, member states are contributing to the economic integration of Europe. They are eliminating barriers by abolishing double taxation. If a member state is required, on the basis of EC freedoms, to grant the benefits that are assigned to another member state in a tax treaty to all the other member states, member states that are unwilling to give up their rights of taxation to avoid double taxation will be rewarded for their behaviour. If the Court gives such a judgment, these member states will have absolutely no incentive to give up their taxation rights in their relations with other member states. Furthermore, granting this right might create situations in which little or no tax is levied. Instead of bringing about the intended integration of national markets, this will lead to disintegration.

If the Court grants the right to the most favourable treatment, it will force the member states to take action. However, harmonisation of direct taxes is an extremely sensitive issue in some member states. It is not for nothing that harmonisation directives can only be adopted unanimously. Far-reaching judgments will put member states in an awkward position: they will be under an obligation to take measures but will be unwilling to do so for various reasons. The Court will then run the risk of its jurisdiction being curtailed at any time. Member states have already made such efforts in the past. According to former judge at the European Court of Justice, Melchior Wathelet, the suggestion was made at the Intergovernmental Conference on the European Constitution to exclude any tax implications from the provisions of the Treaty relating to the fundamental freedoms or to limit the powers of the European Court of Justice.

II. Other action to be taken in the field of international tax law

This brings me to the second part of my presentation: What further action might the Commission take in the field of international tax law? Where intra-Community double taxation is not eliminated by EC freedoms, existing EU directives or treaties based on the OECD model convention, the Commission has the task of making suggestions, in consultation with the member states.

Examples include payments – such as interest, pension contributions, social security contributions and maintenance – which are made in one member state, but are not deductible there or are taxed there in due course and whose benefit is taxed by another member state. The Commission could examine whether there is support in the member states for its findings in the Communication on the elimination of tax obstacles to the cross-border provision of occupational pensions. Similar solutions could be applied to other types of payments in order to avoid double taxation.

Double taxation can also occur when capital assets within a company are transferred from one member state to another. Working Party IV is currently seeking a solution, in the light of the De Lasteyrie judgment.

Finally, in cases not involving transfer pricing, consideration should be given to ways of ensuring that terms and taxable events in existing treaties are interpreted uniformly. The experience gained in preparing the Code of Conduct for the effective implementation of the Arbitration Convention by the EU Joint Transfer Pricing Forum might be helpful in this regard.

Conclusion

Allow me to conclude. The ideal, comprehensive way to ensure an efficient common market would be to introduce a European income tax and a European corporation tax or a Common Consolidated Tax Base for all transnational companies. However, the introduction of a European income tax is very unlikely in the short or medium term, and perhaps even in the long term. I am more optimistic about the introduction of a Common Consolidated Corporate Tax Base either in the whole of the European Union or in part of it. It might be introduced in part of the EU in the medium term. The European legislature should therefore continue as before – one step at a time, by adopting directives to eliminate the double taxation situations I described earlier.

In my view, the Commission should also suggest ways in which member states could modify their national tax systems and tax conventions to meet their obligations arising from EC freedoms. Where member states fail to meet their EU obligations, the Commission should institute infringement proceedings to ensure a level playing field in the EU. As regards the obligations arising from EC freedoms, I would particularly like to see a Commission communication on the significance of the principle of mutual recognition for direct taxation in the member states.

In the light of what I have said, I believe that the Commission should not pursue the development of a European model or tax convention.