Cambridge University Press
978-1-108-83902-0 — European Union Corporate Tax Law
Christiana HJI Panayi
Excerpt
More Information

1

A Historical Trajectory of EU Corporate Tax Law

1.1 INTRODUCTION

Member State corporate tax regimes are heavily influenced by European Union law. What is notable, however, is the absence of comprehensive harmonising legislation. This is attributed to a number of factors.

Arguably, the most important factor is the lack of Union competence in direct tax matters. Under the principle of attribution of powers,[1] a cornerstone of the European legal structure, the Union[2] and its institutions only enjoy competence in the areas of law assigned or conferred to them under the Treaties. This principle of attribution of powers must be respected both internally and in the Union's external sphere of affairs. Therefore, every act must be based on a general or specific Treaty provision (the legal basis) empowering the Union, expressly or impliedly, to act.

It is widely acknowledged that Member States have retained competence in direct tax matters. Successive European Treaties have been silent on direct tax and more generally on EU taxes. While the Treaties dealt with indirect taxes to some extent,[3] there were never any references to direct taxes. As a corollary, there has never been an explicit legislative base for the harmonisation of direct taxes.[4] General legislative bases under Articles 115 and 352 of the Treaty on the Functioning of the European Union (TFEU) have been used for direct tax legislation. These legislative bases focus on the attainment of the Internal Market and their use is strictly policed by the Court of Justice.[5]

[1] Art 5 Treaty on European Union (TEU).

[2] Following the Lisbon Treaty, the TEU was amended and the Treaty establishing the European Community (EC Treaty) was amended and renamed as the Treaty on the Functioning of the European Union (TFEU). Thereafter, the name 'European Union' replaced and succeeded the 'European Community'.

[3] See Art 28 TFEU, which provides for a Union based upon a customs union. See Arts 30 and 110 TFEU, which led to the harmonisation of excise duties.

[4] By contrast, there is an explicit tax base for harmonisation of indirect taxes under Art 113 TFEU.

[5] There have been a number of cases where the EU legislation was challenged on the basis of misuse of one of these general Treaty bases. See Annette Schrauwen, 'Sources of EU Law for Integration in

Article 115 TFEU authorises the Council to issue directives for the approximation of laws, regulations or administrative provisions of Member States directly affecting the establishment and functioning of the Internal Market. Directives can only be adopted under Article 115 on the basis of unanimity. In addition, Article 352 TFEU authorises the Council, on a proposal from the Commission and after obtaining the consent of the European Parliament,[6] to adopt appropriate measures when Union action is necessary to attain one of the objectives of the Treaties. Again, the Council (i.e. all Member States in Council) has to act unanimously. There is another general legal basis for harmonisation under Article 116 TFEU, which could be used for legislative action when differences in Member State laws are distorting the conditions of competition in the Internal Market. Although this legislative base does not require unanimity and does not exclude direct tax measures,[7] it has never been used for tax harmonisation purposes.

Overall, the fiscal veto, that is the power of even one Member State to object to a harmonising measure in direct tax law, is a fiercely guarded prerogative that has survived successive Treaty amendments and previous attempts to move to qualified majority voting.[8] In general, the Commission has always tried to base its proposals on one of the general legislative provisions that require unanimity – Articles 115 or 352 TFEU.[9] Therefore, lack of explicit competence combined with the fiscal veto under 'proxy' bases meant that the regulation of direct taxes was left within the competence of the Member States. Although the fiscal veto was reiterated (by default) with the ratification of the Treaty of Lisbon, recently, there have been attempts to overcome the limitations of the unanimity requirement, which at the time of writing have not reached fruition.[10]

Another contributing factor to the scarce legislation is that international (direct) taxation was historically not as regulated as other areas such as trade or investment. In principle, every country has jurisdiction to tax however it pleases. Whilst there are model tax treaties, such as the OECD Model Tax Convention[11] or the UN Model

Taxation', ch 1 in Dennis Weber (ed), *Traditional and Alternative Routes to European Tax Integration* (Amsterdam: IBFD, 2010).

6 Under ex-Art 308 EC there was only a duty to consult the European Parliament.

7 Contrast with Art 114 TFEU, where it is expressly stated that it cannot be used for direct taxes.

8 See, for example, the draft Treaty establishing a Constitution for Europe (Constitutional Treaty), which provided for qualified majority voting for measures on company taxation when the Council unanimously found that these measures related to administrative cooperation or combated tax fraud and tax evasion. See Art III-63. The Constitutional Treaty was never ratified by all Member States and the Treaty of Lisbon was drafted to replace it.

9 The same approach was followed with ex-Art 293 EC, which provided that Member States must as far as possible enter into negotiations to secure, inter alia, the abolition of double taxation. This provision has been interpreted as not having direct effect. See Case C-336/96 Gilly [1998] ECR I-2793, para 16. Therefore, ex-Art 293 EC could not be used as a legal basis for direct tax legislation. In any case, this provision has now been abolished from the TFEU. See analysis in 3.3.3.

10 See Commission Communication, *Towards a More Efficient and Democratic Decision Making in EU Tax Policy*, COM(2019) 8 final (15.01.2019); Commission Communication, *An action plan for fair and simple taxation supporting the recovery strategy*, COM(2020) 312 final (15.07.2020), p 2, discussed at 1.6.

11 OECD Model Tax Convention on Income and on Capital, last updated 2017.

Tax Convention (UN Model)[12] that recommend ways of allocating tax jurisdiction between the country of source and the country of residence, these models are not binding on countries[13] and are regularly updated. It is, therefore, quite understandable why, when the EEC was created in the mid-1950s, the regulation of direct taxes was not seen as a priority; nor as an option for that matter. The main priority was the removal of the distortions caused by trade barriers – hence the concentration on the harmonisation of indirect taxes.

However, it has long been recognised that there are tax obstacles that create serious impediments to the integration of the market – tax obstacles for which the international tax community and the OECD Model Tax Convention do not offer solutions, or not very good ones. As far as corporate taxes are concerned, many of the problems arise from the interaction of different systems of taxation of Member States, who have different approaches to the integration of shareholder and corporate taxes. For example, under the classical system profits are taxed independently in the hands of the company and its shareholders. This leads to the phenomenon of economic double taxation – that is where there is more than one tax imposed in respect of the *same income*, even if the taxes are paid by different persons, and which affects domestic and foreign shareholders the same way. By contrast, under an imputation (or tax credit) system, part of the corporation tax on distributed profits is credited against income tax, so relief to mitigate economic double taxation on dividends is given at shareholder level. Under a split-rate system, relief for economic double taxation on dividends is given at company level, as a lower rate of corporation tax applies for distributed than for retained profits. To the extent that the tax credit or the lower tax rate for distributed dividends is reserved for resident shareholders, then non-resident shareholders would incur economic double taxation. As shown in this book, the OECD Model Tax Convention does not offer any solutions on economic double taxation, deferring to states' discretion in dealing with it.

Cross-border investments lead to further problems. The same person may be taxed twice by two different states over the same income. This is juridical double taxation. In the Introduction to the OECD Model Tax Convention this is defined 'as the imposition of comparable taxes in two (or more) States on the same taxpayer in respect of the same subject matter and for identical periods'.[14] For example, if a company is taxed on a worldwide basis, then foreign profits may be taxed in the state in which they accrue (source state or, in this book, host state). The same profits may also be taxed in the state of residence of the company (residence state or, in this book, home state) leading to juridical double taxation. Similarly, cross-border passive investment income such as dividends may be taxed both in the state of the

12 United Nations Model Double Taxation Convention between Developed and Developing Countries (2017).
13 Some countries, such as the USA, have their own models. The US Model was last updated in 2016.
14 Introduction to the OECD Model Tax Convention, para 1.

distributing company (the host state) and the state of residence of the shareholder (the home state). As will be shown in later chapters of this book, usually in such situations either the host state does not tax or does not fully tax the income, or the home state *exempts* foreign profits or gives a *credit* for the foreign (withholding) tax paid. The exemption method and the credit method are important double taxation relief mechanisms.[15]

The reliefs can be provided either on a unilateral basis or a bilateral basis (through tax treaties) or on a multilateral basis (through multilateral tax agreements). Some of these reliefs are contained in the OECD Model Tax Convention, whose avowed purpose is to eliminate or mitigate juridical double taxation but not economic double taxation.

From an EU perspective, whilst both types of double taxation are problematic as the increased tax burden creates economic distortions and inefficiencies,[16] in the absence of EU legislation to remove the distortions, action cannot be taken unless the general Treaty provisions are breached. As shown in later chapters, the major point of conflict that has empowered the Union (indirectly) to act is derived from a different stance on non-discrimination and the comparability of residents and non-residents. Under established international tax law and the OECD Model Tax Convention, residents and non-residents are not in a comparable situation. Under EU law, this cannot be assumed and has to be proved in each case.

As shown throughout this book, this deceptively simple issue of the (non–) comparability of residents and non-residents has had a huge impact on how juridical double taxation and economic double taxation are dealt with in the European Union and the ability of Member States to choose between classical systems and imputation systems of taxation. The non-discrimination principle, on its own and through the medium of specific fundamental freedoms, as interpreted by the Court of Justice, has also led to further developments, circumscribing Member States' overall powers to structure their corporate tax systems. For example, a host state may not be able to tax branches of foreign companies more heavily than resident companies. In addition, a home state may not be able to limit the availability of loss relief to resident group companies or domestic branches only – it may have to extend it to non-resident companies or branches. Similar restrictions may arise in the taxation of inbound and outbound passive investment income. A host state may no longer be able to impose withholding taxes on outbound dividends when domestic dividends are exempt. Or a home state may have to extend the imputation credit to

15 See also analysis in 5.1.

16 See, for example, the OECD Commentary on the harmful effects of juridical double taxation in Introduction to the OECD Model Tax Convention, para 1. See also American Law Institute, *Integration of the Individual and Corporate Income Taxes* (Philadelphia: Federal Income Tax Project, 1993); Treasury Department, *Report on Integration of the Individual and Corporate Tax Systems: Taxing Business Income Once* (Washington Government Printing Office, 1992); Christiana HJI Panayi, *Double Taxation, Tax Treaties, Treaty Shopping and the European Community*, EUCOTAX Series (Alphen aan den Rijn: Kluwer Law International, 2007), ch 1.

shareholders receiving foreign dividends as well. Furthermore, reliefs and deferrals granted for domestic reorganisations may have to be extended to cross-border ones. Finally, although Member State tax avoidance regimes have to be drafted in a specific way so as to be EU-compatible and proportional, there is also new legislation which forces Member States to adopt some *de minimis* anti-abuse rules. Apart from discriminatory tax burdens assessed on the basis of fundamental freedoms and/or the relevant directives, the book also considers what is, to an extent, the reverse situation: tax reliefs given to selected undertakings contrary to the state aid prohibition. All these issues are examined in Chapters 3 to 8.

This book strives to show how EU law has become of prime importance as far as the cross-border movement of companies and the cross-border investment in such companies is concerned. Topics such as the harmonisation of the corporate tax base, the taxation of subsidiaries and branches, the taxation of passive investment income, economic and juridical double taxation, corporate reorganisations, anti-abuse rules and the impact of the state aid rules are considered in detail. What becomes evident is that, notwithstanding the lack of competence in direct tax matters, this has become an area densely regulated as a result of both positive and negative integration. It is shown in Chapter 2 that the Union has legislated in a number of areas, including corporate tax law, where it was deemed expedient for the proper functioning of the internal market. Therefore, integration through proper legislative routes, that is positive integration, *does* exist, but it is scarce compared to the growing volume of case law. Topics discussed in this book illustrate how the legislative vacuum was addressed by the Court of Justice by interpreting and applying several general provisions of successive EU Treaties in the direct tax context. This is also called negative integration. In the analysis, the pivotal role of the Commission in some of the legislative and judicial developments also becomes obvious. This EU institution has long been vocal on the detrimental effect of tax obstacles to the completion of the Single Market and later on the Internal Market.[17]

Notwithstanding these developments, it will be shown that the limitations of international tax law in these areas have not been addressed under EU law. This is understandable given that the main generator of developments until recently – the Court of Justice – can only respond to specific questions referred to it. It cannot act as a substitute legislator and construct a comprehensive tax system. As a result, there are still many tax obstacles that impede the completion of the Internal Market. This book considers some of these obstacles from a corporate angle. The book also considers new developments, in the aftermath of the BEPS project, which seem to go some way in strengthening the rights of Member States to protect their tax bases, rather than force them to remove tax obstacles to cross-border movement, as was traditionally the case.

[17] Although technically the two terms (as well as 'common market') are not synonymous, they tend to be used interchangeably. Broadly, these terms reflect steps towards the EU's economic integration, the common market being first, leading to the Single Market, which ultimately led to the Internal Market.

In order to understand the current situation, an overview of the historical background to some of the legislative proposals is apt. It is shown that efforts to put in place a comprehensive system for corporate taxation have long been debated, though so far not many materialised, at least not the ones that were focused on corporate tax harmonisation. By contrast, piecemeal legislative solutions (e.g. directives, conventions) and soft law have always been more feasible.[18] In fact, the use of soft law has more recently intensified in the context of developing a common external tax policy and beyond.[19]

1.2 THE HISTORICAL BACKGROUND

The main concern of the Community, now called the Union, as far as corporate tax law was concerned, has always been the degree of harmonisation needed. Proposals for the harmonisation of corporate taxes have a long history. Whilst initial proposals recommended the unification of Member States' corporate tax systems with a single tax rate and a uniform tax on distributed profits, subsequent proposals moved away from harmonisation to coordination and ad hoc legislative solutions.[20] What is evident early on is that the Community oscillated between the classical system and the imputation system, with its main focus being harmonisation rather than coordination. This is reflected in the recommendations of the various reports produced in the last fifty years.

1.2.1 *The Neumark Report*

In 1960 the Commission set up a committee of taxation and financial experts, under the chairmanship of Professor Fritz Neumark, to investigate all aspects of taxation in relation to the common market. The Neumark Report,[21] published in 1962, broadly recommended harmonisation of income tax, capital gains tax, corporation tax and indirect taxes, though the committee insisted that the aim was not uniformity.[22]

According to the Neumark Committee, harmonisation was not a synonym for unification to the committee and the latter should have been avoided.[23] Complete

[18] See Franco Roccatagliata, 'The European Commission's Soft-Law Approach and Its Possible Impact on EC Tax Law Interpretation', in Pasquale Pistone (ed), *Legal Remedies in European Tax Law* (Amsterdam: IBFD, 2009). See also Chapter 2 of this book.

[19] See 1.6.1.

[20] See Christiana HJI Panayi, 'The Early Proposals for a European Corporate Tax Policy', in *Studies in the History of Tax Law* (Hart Publishing, 2019) 365–89.

[21] 'Report of the Fiscal and Financial Committee' in *The EEC Reports on Tax Harmonisation* (Amsterdam: IBFD, 1963) (*Neumark Report*). For general commentary see Alex Easson, 'Harmonisation of direct taxation in the European Community: from Neumark to Ruding' (1992) 40 *Canadian Tax Journal*, 600–38, 604.

[22] *Neumark Report*, p 102.

[23] See also analysis in Adolfo Martin Jimenez, *Towards Corporate Tax Harmonization in the European Community: An Institutional and Procedural Analysis*, Series on International Taxation (London: Kluwer Law International, 1999), p 108.

unification of the tax systems of the Member States was not considered to be 'as necessary from the aspect of integration policy, since experience proves that on many grounds moderate differences limited to the nature (structure) and to the rate of taxes do not hinder the free play of competition'.[24]

Adopting a clearly centralist approach, the Neumark Committee considered it desirable to levy the same type of single tax on income in all Member States, with the same structure of scales, even if the rates were different.[25] As far as company taxation was concerned, the committee recommended a special tax on companies. Under this proposal, retained profits would be taxed at 50 per cent,[26] whereas distributed profits would be taxed, in the form of withholding tax at source, at a recommended rate of 25 per cent and not less than 15 per cent.[27]

For distributed profits, a relatively low rate of 10–20 per cent was to be applied to EEC-resident recipient persons, who owned either registered or bearer shares. A higher rate of at least 25 per cent would apply to all other persons.[28] The Neumark Committee further suggested that, if dividend recipients provided information of their identity, then the withholding tax should be reimbursed to the state in which the shareholders were domiciled.[29] It would seem that incentives for information exchange were considered very early on.

Dividends distributed from subsidiaries to parent companies would be exempt from withholding tax, unless the parent company was established outside of the EC, or there was uncertainty whether the beneficiary of the dividends was a company or an individual. Under certain circumstances[30] dividends received by parent companies from their subsidiaries would also be exempt, to the extent that the parent company intended to distribute the dividends received to its shareholders.

The Neumark Committee recognised the importance of double tax treaties and the OECD Model Tax Convention in resolving double taxation.[31] However, the OECD rules had to be amended and supplemented 'in such a way that they respond more adequately to the specific needs of the Common Market'.[32] It was further recommended that a multilateral tax convention should replace the network of bilateral conventions.[33]

24 *Neumark Report*, p 102.
25 Ibid, p 119.
26 That would have been a split-rate system as existing at the time in Germany. See *Neumark Report*, pp 122–3, 139. See also Appendix F: Harmonization of the Taxes on Companies and on Dividends, written by Prof Bernard Schendstok, who discussed in greater detail how specific elements of the proposed system could be applied.
27 *Neumark Report*, p 139.
28 Ibid, pp 139–40.
29 Ibid.
30 There had to be a participation of at least 15–20 per cent of the capital of the distributing company, held at least one or two years before distribution of the dividend. See generally ibid, pp 140–1.
31 Ibid, p 143.
32 Ibid.
33 Ibid, pp 143–4.

Tax harmonisation was seen as a dynamic process, divided into stages over time and put into effect in successive steps.[34] The Neumark Committee set out a timetable for tax harmonisation measures. Three phases were identified. The first phase would entail the reform of turnover taxes. There would also be preparatory work on company tax reform and the conclusion of a multilateral convention. The second phase would entail the harmonisation of company taxes and personal income taxes, as well as the conclusion of a multilateral convention. Wealth taxes and death duties would also be considered. In the third phase all proposed reforms would be put into application. A common information service as well as a specialist tax court for appeals at European level would be explored.[35]

The Community never went past the first phase. This is not surprising given the hostility of Member States to rules that seek to harmonise corporate tax rates – not just back then but throughout the Community's existence. Notwithstanding this well-known fact, subsequent reports also recommended the imposition of uniform corporate tax rates. Unsurprisingly, again none of these proposals were ever adopted.

1.2.2 *The Segrè Report*

The Segrè Report was produced by a committee of experts, under the chairmanship of Professor Claudio Segrè. The committee was asked to examine the general measures that should be taken to develop a European capital market and its implications for Member States.[36] Chapter 14 of this report examined the tax obstacles to the development of 'a capital market of truly European dimensions'[37] and made suggestions as to how to eliminate them.

The Segrè Committee identified as a general aim the attainment of a 'degree of fiscal neutrality that will allow capital movements to take place within the Community in conditions similar to those on a domestic market'.[38] For this aim to be achieved, the tax system had to be neutral as to the location of the investment, the type of investment (direct investment or through an intermediary) and methods of financing. There were three major obstacles to this; namely, double taxation,[39] preferential treatment of investments made in the country of residence[40] and different treatment (from Member State to Member State) of income paid to non-residents.[41] To date these obstacles still plague the Internal Market.

34 Ibid, p 152.
35 Ibid, pp 154–5.
36 *EEC Commission, The Development of a European Capital Market* (Brussels: EEC Commission, 1966) (*Segrè Report*), p 11.
37 *Segrè Report*, p 293.
38 Ibid, p 293.
39 This included international double taxation and double taxation of investments made through a financial intermediary. See *Segrè Report*, pp 294–6.
40 Ibid, pp 296–7.
41 Ibid, pp 297–8.

Similar to the conclusions of the Neumark Report, here the Segrè Committee found that the ideal way of eliminating double taxation was through the conclusion of a multilateral convention. As this could take some time, it was deemed appropriate in the interim to look for temporary solutions such as unilateral or bilateral measures.[42]

As regards dividends paid to non-residents, host states could impose a withholding tax, provided that this tax was wholly allowable for the purposes of the shareholders' tax liability in their country of residence and any excess was refundable.[43] 'To the shareholder, the withholding tax would then always be simply an advance payment of tax, and hence would hardly influence his choice of country of investment whatever the rate of the tax.'[44] It was preferable that the rate be the same in all countries and identical with that of the withholding taxes levied on resident shareholders.[45]

As regards inbound dividends, rather than exemption, which was the recommendation of the Neumark Report, this committee recommended the extension of the tax credit to foreign dividends, otherwise there would be discrimination 'between income from "national" shares and income from foreign shares, and between residents and non-residents'.[46] An even better solution was to give non-residents a refund of corporation tax equivalent to the tax credit.[47] Although at the time the extension of a tax credit to non-resident shareholders may have appeared to be a very drastic recommendation, it will be shown in later chapters that the case law of the Court of Justice has led to very similar, if not more drastic, results.

1.2.3 *The Programme for the Harmonisation of Direct Taxation*

In 1969, under its Programme for the Harmonisation of Direct Taxation,[48] the Commission looked at direct taxes in the context of, inter alia, the movement of capital, company restructurings and inter-corporate payments. Again, as the title of the Programme suggests, the emphasis was on harmonisation. The Programme proposed a number of harmonisation measures such as the harmonisation of withholding taxes on dividends and interest, elimination of discriminatory tax

42 Ibid, p 296.
43 Ibid, p 300.
44 Ibid.
45 Ibid. There was a similar suggestion in the conclusions in that Member States in their capacity as host states or home states should either tax income in one country only or divide revenue between the two by imposing a withholding tax in the host state and systematically allow it for tax purposes in the beneficiary's home state. Ibid, p 311.
46 Ibid, p 301.
47 Ibid, p 301.
48 'Programme d'harmonisation des impots directs', Commission Communication of 26 June 1967, Bulletin Supplement No. 8. This was a follow-up to the more general 'Program on Tax Harmonisation' (Commission Communication of 8 February 1967, Bulletin Supplement No. 8). See Jíménez, *Towards Corporate Tax Harmonization in the European Community*, pp 109–11.

rules against non-residents, removal of tax obstacles to cross-border mergers, elimination of double taxation in parent-subsidiary relationships and use of tax incentives.[49]

This Programme led to proposals for a directive on cross-border corporate restructurings and a directive on the taxation arrangements applicable to parent companies and subsidiaries – the precursors to the Merger Directive[50] and the Parent-Subsidiary Directive[51] enacted twenty years later.

1.2.4 *The Van den Tempel Report*

This report[52] was produced by Professor A. J. van den Tempel at the request of the Commission. Similar to the previous reports, this report approached the issues from a tax harmonisation perspective. However, contrary to the Segrè Report, here the classical system of corporation tax was recommended as the best solution.

The report considered the structures of corporation tax in the Community and the taxation of undistributed and distributed corporate profits. Three[53] systems were considered: the classical system, the imputation system and the split-rate system. As discussed above, under the classical system, which was called the 'classic' system in this report, profits were taxed independently in the hands of the company and its shareholders.[54] Under the imputation (or tax credit) system part of the corporation tax on distributed profits was credited against the income tax charge on the shareholder.[55] Under the split-rate system a lower rate of corporation tax applied for distributed than for retained profits.[56]

In the Van den Tempel Report it was argued that the imputation and split-rate systems were in certain respects preferable to the classical system. As noted in the report, they were more neutral as far as the choice of the legal form of the enterprise was concerned and the choice of debt or equity financing.[57] However, they were

49 Jíménez, *Towards Corporate Tax Harmonization in the European Community*, p 110.
50 See Chapter 6.
51 See Chapter 2.
52 A. J. van den Tempel, *Corporation Tax and Individual Income Tax in the European Communities*, Competition: Approximation of Legislation Series (Brussels: 1970) (*Van den Tempel Report*).
53 Three other systems diverging from the above were also summarily discussed. These were the system of complete avoidance of economic double taxation on dividends, either by not imposing the corporation tax on the distributed profit or by fully crediting the corporation tax on the distributed profit (ibid, pp 32–3), the system of fiscal transparency whereby all corporate profits are treated as if accruing to shareholders (ibid, pp 33–4) and the system of deduction from corporate profit of a primary dividend corresponding to the return on debt financing (pp 34–6). All three were rejected as unworkable.
54 This system applied, at the time, in the Netherlands, Luxembourg and the UK and formerly, to the Federal German Republic and in France. See ibid, p 7.
55 This system applied in France and Belgium. Ibid, p 7.
56 This system applied at the time in Western Germany.
57 *Van den Tempel Report*, p 40.