European Commission

Direct Taxation:

Court's Rulings, General EU Taxation Principles in the Area of Direct Taxation

Explanatory meeting Albania and North Macedonia

3-4 June 2019

TAXUD D3

European Commission

These slides accompany the explanation of the acquis to Albania and North Macedonia and can only be used for that purpose. Their content is subject to further development of the acquis and interpretation by the Court of Justice of the European Union.

Overview

- Nature of EU law: Supremacy and direct effect
- EU institutional framework
- Structure of the ECJ case-law
- Fundamental freedoms & the principle of non-discrimination
- Justifications
- Principle of Proportionality

Nature of EU law

- ***Supremacy (Case C-26/62,Van Gend en Loos)***
- ***Direct Effect (Case C-6/64, Costa Enel)***

„It must be stated firstly that Article [52] of the [EC] Treaty [now Art. 49 TFEU] embodies one of the fundamental principles of the Community and has been directly applicable in the Member States since the end of the transitional period"(Case 270/83, Commission v France, i.e. Avoir Fiscal case, para. 13)

EU institutional framework

Harmonisation = positive integration

- *Legal basis used for direct taxation: Article 115 TFEU- unanimity*
- *Little harmonisation*

Jurisprudence of the Court of Justice of the EU (ECJ) = "negative" integration *:(first judgment of the ECJ in direct tax field from 1986:* ***Avoir Fiscal****)*

- *EU law constraints on exercise of national tax competence*
- *Application of the fundamental freedoms of the TFEU*

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Direct Taxation and the TFEU

Direct Taxation falls within the competence of the Member States,

BUT

the Member States must exercise that competence consistently with EU law

In other words:

Member States are free to design their tax system as they see fit as long as they comply with the fundamental freedoms /do not discriminate; i.e. cross-border situation shall not be treated less favourably than a comparable domestic situation

ECJ case-law in direct tax area

You can find a complete overview of [all] **direct tax cases** and related cases on the website of DG TAXUD, with hyperlinks to each case:

https://ec.europa.eu/taxation_customs/sites/taxation/files/20171116_court_cases_direct_taxation_en.pdf

Difference of treatment vs allocation of taxing rights

In the absence of unifying rules or harmonising measures Member States are competent to determine the criteria for taxation of income with a view to eliminate double taxation by means of bilateral agreements:

Case C-336/96 Gilly, para. 35, C-527/06 Renneberg, para. 48, C-602/17 Sauvage, para.22

*But: The **exercise** of the taxing rights must be consistent with EU law: Case C-307/97 Saint Gobain*

Difference of treatment vs disparities of tax systems

Member States not required:

1. to prevent double taxation (C-513/04, Kerckhaert&Morres, C-128/08 Damseaux and Case C-67/08 Block),

2. to draw up their tax rules on the basis of those of another MS (Schempp, C-403/03, para 34)

Disparities** arising from the **parallel exercise of national tax rules** are permissible, **as long as non-discriminatory.

Structure of cases

- *EU law/fundamental freedom at stake?*
- *Obstacle → discrimination or restriction?*
- *Justification?*
- *Proportionality?*

The fundamental freedoms (1)

- **Cross-border situations** vs internal situations (outside the scope of EU law)
- **The right to move and reside** freely within the territory of the Member States (Article 21 TFEU
- **Free movement of workers** (Article 45 TFEU)
- **Freedom of establishment** (Articles 49 and 54 TFEU)
  - of nationals of a Member States
  - of companies

The fundamental freedoms (2)

- **Freedom to provide services** (Article 56 TFEU):*C-76/05 Gootjes-Schwartz, C-56/09 Zanotti, C-39/04 Laboratoire Fournier*
- **Free movement of capital** (Article 63 TFEU):

"… all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited."

→ The only freedom that also applies to non-member countries; greater scope for justifications→ exchange of info. ?

Applicable freedom

- *"The **purpose** of the legislation concerned must be taken into consideration" C-436/08 and C-437/08 Haribo, para 34*
- *Freedom that **is primarily/predominantly affected** should be taken into account **exclusively** (Case C-452/04 Fidium Finanz, C-31/11 Scheunemann)*
- *"[N]ational legislation intended to apply only to those shareholdings which enable the holder to exert a definite influence on a company's decisions and to determine its activities falls within the provisions of the Treaty on freedom of establishment (….). On the other hand, national provisions which apply to shareholdings acquired solely with the intention of making a financial investment without any intention to influence the management and control of the undertaking must be examined exclusively in light of the free movement of capital. (Haribo C-436/08 and C-437/08, para. 35)*

"A restriction on a fundamental freedom is prohibited by the Treaty, <u>even if it is of limited scope or minor importance</u>" (Case C-589/13 Eisenstadt, para.43)

Discrimination

Different treatment of persons in the **same** or **similar situations or same/similar treatment** of persons **in different situations**

1. **direct/overt discrimination** (nationality; location of registered office of a company) and
2. **indirect/covert discrimination** (residence for individuals; other criteria of differentiation which lead to the same result → Case C-385/12, *Hervis*; pending cases Google, Tesco)

Difference of Treatment (I - Individuals)

Residence irrelevant *for some rules:*

- **rate of tax***(C-107/94, Asscher; C-234/01, Gerritse),*
- **allowance for professional expenses** *(Gerritse, C-346/04 Conijn),*
- **refund of overpaid tax** *(C-175/88, Biel)*

Difference of Treatment (II - Individuals)

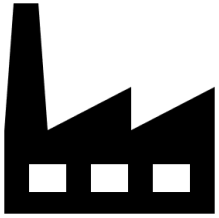
Residence relevant *in relation to* ***personal allowances:***

- *Refusal of personal relief to a non-resident is not as a rule discriminatory because the situations of residents and non-residents are not comparable (Case C-279/93,* ***Schumacker****, ECR 1995, I-225)*
- *State of residence taxes the worldwide income and has to take account of the personal situation of the taxpayer*
- *But where the non-resident receives* ***almost all his income*** *in the state of activity there is no objective difference*

Schumacker (C-279/93)

Belgium

Germany

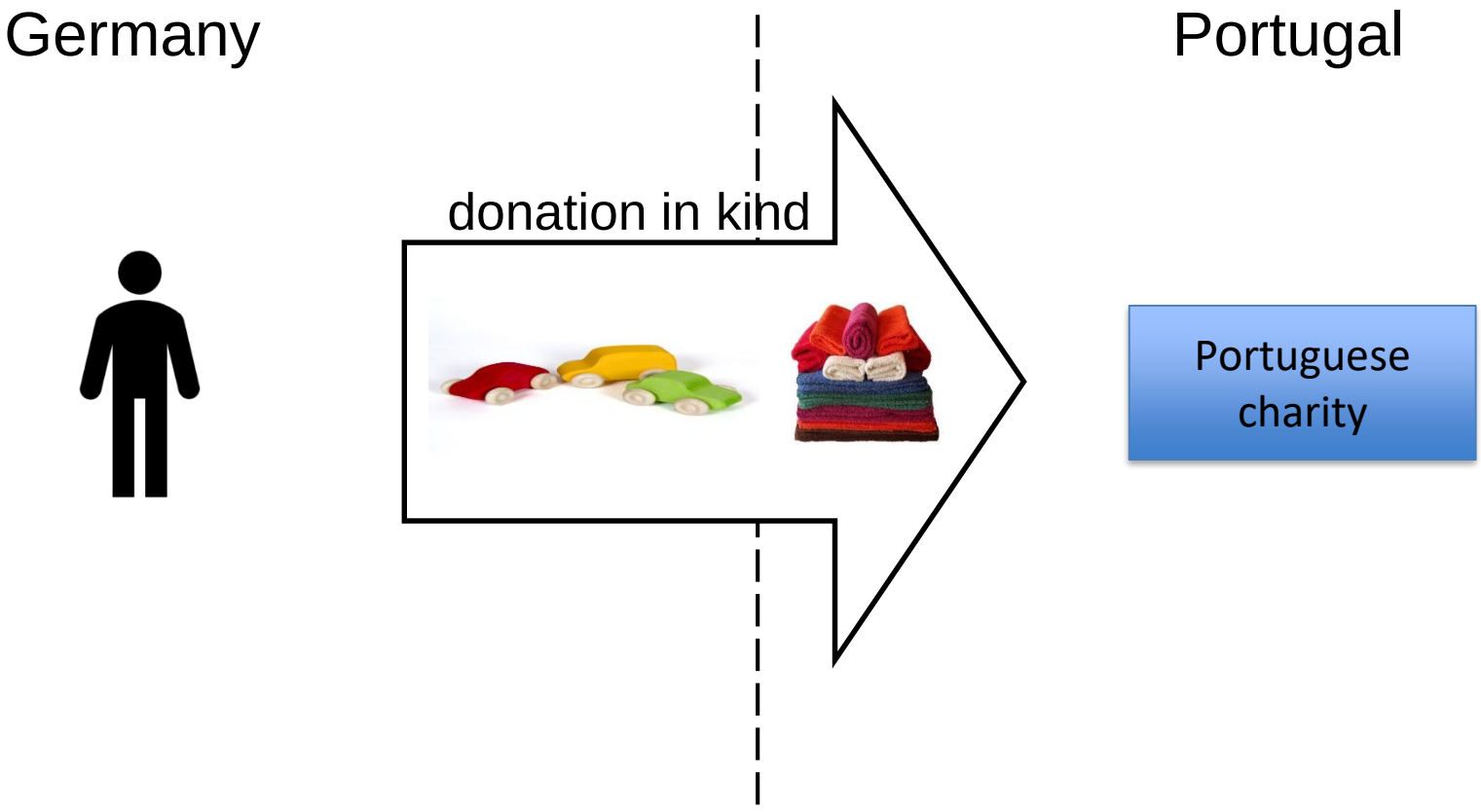


Schumacker principle: extended to all types of income & all types of tax benefits

- ***Gschwind C-391/97***
  - **90% of all income** in the state of employment as a threshold to trigger the Schumacker principle;
- ***Wallentin C-169/03***
  - Schumacker principle applicable to **students** earning income in summer jobs with no taxable income in their state of residence;
- **Tourpeinen C-520/04: also to retirement pensions**
- ***Lakebrink C-182/06***
  - Extension of the Schumacker rule to **all the tax advantages connected with a non-resident's ability to pay tax**, in this case to negative rental income;
  - Non-resident's ability to pay tax forms part of his/her personal situation within the meaning of Schumacker;

  • ***Renneberg C-527/06:*** *deductibility of mortgage interest in respect of a personal dwelling*
- ***Commission v Estonia C-39/10:*** *Schumacker principle not limited to the idea that "all or almost all" of the income has to be earned in the Source State. Instead it must be ensured that* ***the income derived in the residence State is sufficient so that personal and family circumstances can be taken into account.***
- ***Kieback, C-9/14***

Persche (C-318/07)



Difference of Treatment (III - Companies)

„… different treatment solely by reason of the fact that the registered office is situated in another Member State would deprive Article 52 EC [now Art. 49 TFEU] of all meaning"

Case 270/83 Commission v France; i.e. ***"Avoir Fiscal"***

Anti-abuse Rules

- CFC RULES: Cadbury Schweppes C-196/04

*Difference in treatment, but can be justified on **grounds of prevention of abuse** when meeting the proportionality principle, i.e. targeting only **wholly artificial arrangements which do not reflect economic reality;** this is not the case if despite the existence of tax motives the CFC corresponds with an actual establishment intended to carry on genuine economic activity- premises, staff , equipment*

-TRANSFER PRICING RULES: SGI C-311/08, Hornbach Baumarkt C-382/16

*Difference in treatment, but can be justified on grounds of **balanced allocation of the power to tax**, when meeting the proportionality principle; taxpayer has to have an opportunity to provide evidence of **any commercial justification** for an agreement on non-arm's length terms*

Final losses

C-446/03 Marks & Spencer

C-414/06 Lidl Belgium

C-157/07 Krankenheim

C-48/13 Nordea

C-123/13 A Oy

C-172/13 Commission v UK (Marks & Spencer II)

C-388/14 Timac Agro

C- 650/16 Bevola

Justifications (I)

*„ According to settled case-law, a restriction of freedom of establishment is permissible only if it is **justified by overriding reasons in the public interest**. It is further necessary, in such a case, that it should be **appropriate** to ensuring the attainment of the objective in question and **not go beyond what is necessary** to attain that objective ."*

Case C-371/10, National Grid Indus, judgment of 29 Nov.2011, para. 42

Justifications (II)

No justification:

- *Lack of harmonisation (Com v France, para. 24, 25)*
- *Counterbalancing advantages (Com v. France, para. 26, C-196/04, Cadbury Schweppes, para. 49)*
- *Loss of tax revenue (Case C-436/00 X and Y ECR 2002, I-829, para. 50; C-264/96 ICI ECR 1998, I-4695, para. 26, Case C-385/12, Hervis, para.44)*
- *Lack of reciprocity (joined cases C-436 and C-437/08 Haribo and Österreichische Salinen)*

Justification (III)

Accepted justifications:

- *Preserving cohesion of a tax system*
- *Preventing tax avoidance/abuse of rights*
- *Effectiveness of fiscal supervision*
- *Territoriality*
- *Balanced allocation of taxing rights*

Cohesion

- *„… in Bachmann …, a **direct link** existed, in the case of one and **the same taxpayer**, between the grant of a tax advantage and the offsetting of that advantage by a fiscal levy, both of which related to **the same tax** …*

  Case C-204/90, Bachmann
- *„Where there is no such direct link, because … one is dealing with different tax payers, … the coherence of the tax system cannot be relied upon …"Case C-168/01 Bosal,, para. 29 – 30*
- *Accepted in Case C-253/09, Commission v Hungary and Case C-250/08, Commission v Belgium*
- *C-371/10 National Grid Indus, para 80: "(…)the requirements of coherence of the tax system and the balanced allocation of powers of taxation coincide".*

Preventing tax avoidance

- *The fact that the company was established in a Member state for the purpose of benefiting from more favourable legislation does not in itself suffice to constitute abuse of that freedom (Cadbury Schweppes, para 37)*
- *A national measure restricting freedom of establishment* ***may be justified*** *where it specifically relates to* ***wholly artificial arrangements*** *aimed at circumventing the application of the legislation of the Member State concerned (C-196/04, Cadbury Schweppes, para. 51)*
- *Prevention of* ***wholly artificial arrangements which do not reflect economic reality*** *(C-196/04, Cadbury Schweppes, para. 55)*

Fiscal supervision

- *„The Court has repeatedly held that the effectiveness of fiscal supervision constitutes an overriding requirement of general interest capable of justifying a restriction …"*

  Case C-386/04, Stauffer, para. 47

- *But: „Directive 77/799 concerning mutual assistance in the field of direct taxation provides adequate means …"*

  Case C-279/03 Schumacker, ECR 1995, I-225

Fiscal supervision with respect to 3rd States

Persche *, para 70: As regards charitable bodies in a non-member country, it must be added that it is, as a rule, legitimate for the Member State of taxation to refuse to grant such a tax advantage* ***if, in particular, because that non-member country is not under any international obligation to provide information, it proves impossible to obtain the necessary information from that country****.*

Fiscal territoriality principle

- *Principal of territoriality cannot be regarded as discrimination – only profits and losses arising from the activity in the territory can be taken into account for a permanent establishment (non resident) Case C-250/95 Futura, para. 18-22*
- *C-371/10 NGI*
- *C-646/15 Panayi, para.52: "…in accordance with the principle of fiscal territoriality linked to a temporal consideration…justified by the* ***allocation of powers of taxation between the MS****"*

Preservation of the allocation of powers of taxation between the MS

- *"… preserving the allocation of powers of taxation between the Member States is a legitimate objective recognised by the Court. …"*
- *Principle of fiscal territoriality linked to a temporal component*

Case 371/10, National Grid Indus, para. 45 and 46

Proportionality

Twofold proportionality test:

- *the measure must be **appropriate** for attaining the objective*
- *the measure must not be disproportionate to its aim – must not go beyond what is **necessary** for attainment of its aim (proportionality in the narrower sense)*

C-371/10 National Grid Indus (1)

- *Immediate exit taxes on transfer of residence/assets is a restriction (cash flow disadvantage);*
- *Justification grounds: principle of **fiscal territoriality** linked to a temporal component, **balanced allocation of taxing power;***
- *Exit taxes are **an appropriate measure**: capable of protecting tax base;*
- ***Main question: proportionality**?*

C-371/10 National Grid Indus (2)

- *Assessment of exit tax(''definitive establishment of the amount of tax'')is considered proportionate*
- *Immediate recovery is disproportionate*
- *As it is burdensome to follow assets after exit, taxpayer should have **the choice**:*
  - ***Payment at the moment of actual realisation***
  - ***Immediate payment***
- *Exit State may ask for*
  - ***Interest***
  - ***Bank guarantee***

Exit tax case law (NGI, DMC, Verder LabTec,…)

- *If a MS loses its tax jurisdiction it can tax unrealised capital gains*
- *Immediate recovery not allowed save as* ***an option***
- *Chargeable events other than the actual realisation of unrealised capital gains allowed (DMC, para 53 and Case C-261/11 Commission v Denmark, para 37); e.g. payments in 5 yearly instalments*
- *Interest payments for deferred taxes*
- *Bank guarantees*