EU Tax Policy in the 21st Century

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Capital Import v. Capital Export Neutrality in the Eyes of the CJEU

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Agenda

- Capital (and labor) import and capital (and labor) export neutrality
- Internal market as benchmark
- Role of CJEU in relation to internal market
- Two examples
  - Relief from double taxation
  - Cross-border loss compensation
- Conclusions

Economic policies

- Capital (and Labour) Export Neutrality:

  An income *recipient* should pay the same total (domestic plus foreign) tax, irrespective of whether he receives a given labour or investment income from foreign or domestic sources.

- Capital (and Labour) Import Neutrality:

  Labour and capital funds originating in various states should compete on equal terms in the labour and capital markets, respectively, of any state, irrespective of the place of residence of the worker or the investor.

Internal market as benchmark

- Moving towards an internal market (Art. 3(3) TEU/Art. 26(2) TFEU)
    - Similar to a domestic/single market (e.g. *Polydor*)
    - Avoidance of double taxation (e.g. *Gilly*)
    - Increasing economic integration of MS economies
    - Competition must not be distorted
- 28 tax jurisdictions (e.g. *National Grid Indus*)
  - Balanced allocation of tax jurisdiction between Member States
  - Fiscal coherence
  - Territoriality principle
- Open market economy with free competition (Art. 119-120 TFEU)
- Efficient allocation of production factors (Art. 120 TFEU)
  - Tax neutrality: level playing field
    - International tax neutrality (ITN)
    - Capital and labour import neutrality (CLIN)
- Ability-to-pay principle (e.g. *Schumacker*)
- Direct benefit principle (e.g. *National Grid Indus*)
- Origin-based taxation (e.g. *National Grid Indus*)

Role of CJEU in relation to internal market

- Interpretation of Union law (Art. 19(1+3) TEU/Art. 267 TFEU)
- Protector of the establishment of the internal market (e.g. Case C-522/04 (*Commission v. Belgium*))
  - Constraints by 28 tax jurisdictions
- Under “internal market” principle, legal sources to be taken into account
  - Mix of residence-based and source-based taxation
    - Domestic tax law of Member States
    - Double tax conventions (DTC)
  - Residence-based taxation
    - Secondary EU law
- If, on balance, result of transnational situation is not worse than result of purely domestic situation, different treatment under domestic tax law of a MS should *not* be taken as infringing EU law (*Société Générale*)
- To be applied
  - Within the EU
  - In relation to third countries

Relief from double taxation

- Methods are reflections of economic political choices: CLIN or CLEN
- CJEU allows both exemption (CLIN) and (in)direct tax credits (CLEN)
  - No priority to residence or source state taxation: e.g. *Damseaux*, *Levy and Sebag*
  - Exemption (CLIN): e.g. *Kronos*
    - No obligation of MS of receiving company to offset tax disadvantage created by MS of distributing company if dividends are not taxed in receiving MS
  - Ordinary direct tax credit (CLEN): e.g., *Amurta, Amorim Energia,* joint cases *Miljoen, X and Société Générale*
    - Actual (full) compensation of source state taxation is sufficient to neutralize source state restriction
      - Full tax credit (CLEN) is not necessary
        - Previous case law indicated otherwise: e.g., C-540/07 (*EC v. Italy*), C-487/08 (*EC v. Spain*), C-284/09 (*EC v. Germany*), C-342/10 (*EC v. Finland*)
      - Must be included in DTC
        - Inconsistent with *De Groot*, *Denkavit Internationaal II*

Relief from double taxation

- Indirect tax credit (CLEN): e.g., *Manninen*, *Haribo, FII GLO 2*
  - EFTA Court *Fokus Bank*: indirect tax credit in source state
    - Inconsistent with CJEU case law: e.g., *ACT GLO, Glaxo Welcome*, *Fererro*
- Exemption in domestic situations next to indirect tax credit in transnational situations is allowed
  - Exemption resembles indirect tax credit at nominal tax rate
  - If equivalent treatment: tax rate on foreign income not > tax rate on domestic income
    - In exceptional cases allowed
    - *Effective* domestic tax rate of domestic subsidiary not by exception < *nominal* domestic tax rate: indirect tax credit is not equivalent to exemption
    - *FII GLO* 2: In order to main fiscal coherence of system to prevent economic double taxation, it is not necessary to apply *effective* tax rate on *foreign* dividends and *nominal* tax rate on *domestic* dividend

Relief from double taxation

- If equivalent treatment: tax rate on foreign income not > tax rate on domestic income (continued)
  - *Haribo*: exemption in domestic situations and indirect tax credit at *nomina*l tax rate of *subsidiary* State in transnational situations allowed
  - *FII GLO 2*: Less favorable treatment of foreign dividend possible due to differences in *nominal* tax rates: disparity
    - As result of different rules of determination of tax base
    - Not inconsistent with TFEU
  - Observations
    - Different rules of determination of tax base leads to different *effective* tax rates
    - Solution: indirect tax credit at nominal tax rate of *subsidiary* State based on tax base of *parent* State?

Cross-border loss compensation

- CLIN is starting-point, but for final losses CLEN is applied
  - Taxation is MS where economic activity is carried out
  - Ensuring a balanced allocation of tax jurisdiction
- Foreign Subsidiaries
  - No cross-border loss compensation, unless final losses
    - *Marks & Spencer*: no cross-border group relief (CLIN)
      - Exception for final losses (CLEN)
        - Very restrictive approach by MS is allowed: Case C-172/13 (*EC v. UK*): economic activity stops
          - Comes close to CLIN
    - *X Holding*: no cross-border fiscal unity (CLIN)
      - Final losses not addressed
    - *A Oy*: final losses of subsidiary in cross-border merger to be taken into account (CLEN)
  - No cross-border group contribution*: Oy AA* (CLIN)

Cross-border loss compensation

- Foreign permanent establishments
  - No cross-border loss compensation, unless final losses
    - *Lidl Belgium*: no inclusion of MS PE losses: no final losses (CLIN)
      - Exception for final losses (CLEN)
        - Very restrictive approach by MS is allowed: *Timac Agro*: economic activity stops
          - Comes close to CLIN
  - Claw-back allowed of non-final losses in head office state
    - *Krankenheim Ruhesitz am Wannsee* (CLIN): yes
      - Claw-back when PE profits are made
      - Even if PE state does not take losses into account
    - *Nordeabank* (CLEN): no
      - Claw-back exceeded realized PE profits
  - Non-inclusion of Third State PE losses
    - *Stahl Ergstige Westig*: US PE lossess (CLIN)
      - Art. 49 TFEU does not apply to US
      - Art. 63 TFEU does not need to be tested

Cross-border loss compensation

- Foreign immovable property
  - No cross-border capital loss compensation
    - *K.*: Capital gains/losses under DTC FIN-FRA allocated to FRA (CLIN)
      - No capital loss for tax purposes at all in FRA: no final loss
        - Disparity cannot be fixed based on fundamental freedoms

Conclusions

- CLIN v. CLEN in the Eyes of the CJEU
  - CLIN best satisfies the internal market
  - Choice between CLIN or CLEN is economic political choice
  - CJEU is protector of development of the internal market
  - CJEU is bound by political choices: limited room for own policy
  - CJEU allows both exemption (CLIN) and (in)direct tax credits (CLEN) as methods for relief of double taxation
    - Ordinary tax credit is sufficient to neutralize source state restriction if source state taxation is actually (and fully) compensated
    - Exemption in domestic situations next to indirect tax credit in transnational situations is allowed if tax rate on foreign income not > on domestic income
      - In respect of dividends: indirect tax credit at nominal tax rate of *subsidiary* State based on tax base of *parent* State?
  - CJEU tends to emphasize more CLIN than CLEN in respect of cross-border loss compensation which is in line with benchmark