

PERSONAL AND COMPANY TAXATION

The field of direct taxation is not directly regulated by European legislation. Nevertheless, several directives and the jurisprudence of the Court of Justice are helping to establish harmonised standards for corporate tax and taxation of private individuals. Moreover, communications and guidelines emphasise the concern to prevent tax evasion and double taxation within the EU.

LEGAL BASIS

There is no explicit provision in the EC Treaty for legislative competences in the area of direct taxes. Action in this field has therefore had to be based on other provisions (*4.18.1). Legislation on the taxation of companies has usually been based on **Article 115 TFEU**, which authorises directives for the approximation of such laws, regulations or administrative provisions of Member States as directly affect the establishment or **functioning of the internal market**. As in the case of Article 113 TFEU – and in contrast to Article 114 TFEU under which most internal market legislation was adopted – unanimity and the consultation procedure apply.

Article 65 TFEU qualifies the **free movement of capital** by allowing Member States to distinguish between tax-payers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested. However, on 14 February 1995 the ECJ ruled (Case C-279/93) that **Article 45 TFEU** is directly applicable in the field of tax and social security. This Article provides that **freedom of movement for workers** ‘shall entail the abolition of any discrimination based on nationality between workers of the Member States as regards employment, remuneration and other conditions of work and employment’. Article 293 TEC (repealed; now derives from Articles 110-113 TFEU) requires Member States to enter into negotiations for the **abolition of double taxation** within the Community and Article 55 TFEU forbids **discrimination between the nationals** of Member States as regards participation in the capital of companies. Most of the arrangements in the field of direct taxation, however, lie outside the framework of Community law. An extensive network of **bilateral tax treaties** – involving both Member States and third countries – covers the taxation of cross-border income flows.

OBJECTIVES

Two specific objectives are the prevention of tax evasion (e.g. the proposed withholding tax on interest) and the elimination of double taxation (e.g. agreements on dividend payments to non-residents). More generally, some harmonisation of business taxation (both corporation tax and the personal taxation of dividends) is considered necessary to prevent distortions of competition, particularly of investment decisions. Harmonisation might also be justified to prevent the undermining of revenues through ‘tax competition’ (*4.18.1.) and to reduce the scope for manipulative accounting (e.g. via transfer pricing).

ACHIEVEMENTS

A. Company taxation

Proposals for the harmonisation of **corporation tax** have been debated within the European Community for over 30 years. The Neumark Report of 1962 and the Van den Tempel Report of 1970 both advocated harmonisation, though on different systems. In 1975 the Commission published a proposal for a directive – unacceptable for the Member States – proposing the introduction in all

Member States of yet another system, with an alignment of rates between 45% and 55%. In 1980 the Commission was arguing that, though a common system might be desirable on competition grounds, ‘any attempt to resolve the problem by way of harmonisation would probably be doomed to failure’ [COM(80)139]. Instead, the Commission decided to concentrate on more limited measures essential for completing the internal market. The ‘Guidelines for Company Taxation’ of 1990 [SEC(90)601] gave priority to three already-published proposals, which were adopted later that year:

- the **Mergers Directive** (90/434/EEC), on the treatment of capital gains arising when companies merge;
- the **Parent Companies and Subsidiaries Directive** (90/435/EEC), eliminating double taxation of dividends paid by a subsidiary in one Member State to a parent company in another; and
- the **Arbitration Procedure Convention** (90/436/EEC), which introduced procedures for settling disputes concerning the profits of associated companies in different Member States.

At the beginning of the following year, the Commission also published a proposal covering a common system of taxation applicable to interest and royalty payments made between parent companies and subsidiaries in different Member States [COM(90)571]. Despite being revised two years later [COM(93)196] and receiving a favourable opinion from Parliament, it was withdrawn as a result of failure to agree in Council. A new version appeared in 1998 [COM(98)67] as part of the ‘Monti package’ (*4.18.1.), which also included the Code of Conduct and the proposal on the taxation of savings income (see below). It was adopted as Directive 2003/49/EC on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.

Meanwhile, the **Ruding Committee of independent experts** was established in 1991 and reported in March 1999 (Report of the Committee of Independent Experts on Company Taxation), recommending a programme of action to eliminate double taxation, harmonise corporation tax rates within a 30%-40% band and ensure full transparency of the various tax breaks given by Member States to promote investment. The Commission did not agree with all of Ruding – notably on rates of corporation tax – but accepted the need for priority action on double taxation [SEC(1992)1118]. In the following year it proposed **amendments to enlarge the scope of the directives on mergers and parent/subsidiaries** [COM(93)293] and drew attention to two draft directives that had already been tabled: that on **the carry-over of losses** (COM(84)404) and on **losses of subsidiaries situated in other Member States** [COM(90)595].

In 1996, the Commission launched a new approach to taxation (*4.18.1.). In the field of company tax the main result was the **Code of Conduct for Business Taxation**, adopted as a Council resolution in 1998. Council also established a Code of Conduct Group (known as the ‘**Primarolo Group**’) to examine cases of unfair business taxation. Its report was presented in 1999, identifying 66 tax practices to be abolished within five years.

At the end of 1998, the Commission was asked by Member State governments to prepare ‘an analytical study of company taxation in the European Community’. It accordingly established two panels of experts, one academic and one from the business community and trade unions. The study was published in October 2001 [Company Taxation in the Internal Market, SEC(2001)1681]. There followed a Commission Communication ‘supplementing and building’ on the study [COM(2001)582]. The main problem faced by companies, the documents observed, was that they had to adapt to different national regulations in the internal market. The Commission proposed several approaches for providing companies with a consolidated tax base for their EU-wide activities, namely home state taxation (HST), an optional common consolidated tax base (CCTB), a European company tax and a compulsory, fully harmonised tax base.

In order to discuss these proposals, the Commission organised a conference in 2002, which agreed that companies operating in more than one country should be taxed on the basis of a consolidated tax

base. Smaller companies (SMEs) should be subject to HST and for larger companies to CCTB. A CCTB Working Group was established in 2004, the results of which were adopted in Commission proposal for a directive COM(2011)121. This proposes a common system for calculating the tax base for companies operating in the EU. The proposed 'common consolidated corporate tax base' (CCCTB) would mean that companies would benefit from a system with a central contact point where they could submit their tax refund claims. They would also be able to consolidate the gains and losses arising from their activities in the EU. The Member States would maintain complete control over setting their own corporate taxes.

B. The taxation of SMEs

In 1994 the Commission published a Communication [COM(94)206] stating that, compared with larger firms, SMEs faced three main problems: attracting sufficient financial resources; coping with administrative complexity; and continuity when the business changed ownership. Although there was no intention to harmonise the purely national tax treatment of SMEs, action might be needed on cross-border aspects. Annexed to the communication was a 'first initiative on self-financing' (later 94/390/EC). Since 2001, and most recently in 2005, the Commission has presented the 'Home State Taxation' scheme [COM(2005)702] as a possible solution for SMEs. Essentially, the scheme foresees that SMEs would be allowed to compute their profits according to their (familiar) home state rules of the parent company or the head office when doing business in another Member State.

C. Personal direct taxation

1. Income tax

The taxation of those who work in or draw a pension from one Member State, but live and/or have dependent relatives in another, has been a source of problems. Bilateral agreements avoid double taxation in general, but fail to cover such questions as applying various forms of tax relief available in the country of residence to income in the country of employment. In order to ensure equal treatment between residents and non-residents, the Commission proposed under Article 115 TFEU a **directive on the harmonisation of income tax provisions with respect to freedom of movement** [COM(79)737]. This would have applied the general principle of taxation in the country of residence, but was not adopted by the Council and was withdrawn in 1993. Instead the Commission issued a recommendation under ex-Article 211 of the EC Treaty (now replaced, in substance, by Article 17(1) TEU) covering the principles that should apply to **the tax treatment of non-residents' income**.

In addition, infringement proceedings were brought against some Member States for discrimination against non-national employees. The ECJ ruled in 1993 (Case C-112/91) that a country could tax its own nationals more heavily if they resided in another Member State. It found, however, that a country cannot treat a non-resident national of another Member State working as an employed person less favourably in terms of collecting direct taxes than its own nationals in a comparable situation (see above: Case C-279/93). In general, the integration in the field of personal direct taxation can be said to evolve through ECJ rulings rather than the ordinary legislative procedure of the institutions.

2. Taxation of bank and other interest paid to non-residents

In principle, a taxpayer is required to declare such income. In practice, the free movement of capital together with the existence of bank secrecy will increase the potential for tax evasion by individuals (Ruding Report). Some Member States impose a withholding tax on interest income; but when in 1989 Germany introduced such a tax at the modest rate of 10%, there was massive movement of funds into Luxembourg, and the German tax had temporarily to be abolished.

That same year the Commission published a proposal for a directive for a **common system of withholding tax on interest income** [COM(89)60], levied at the rate of 15%; this was withdrawn and replaced by a new proposal **to ensure a minimum of effective taxation of savings income in the form of interest payments within the Community** [COM(1998)295] (with a tax rate of 20%). It also proposed an alternative system of providing information. After lengthy negotiations, a compromise was agreed at the Santa Maria de Feira European Council on 20 June 2000, and in 2003, Directive 2003/48/EC on taxation of savings income in the form of interest payments was adopted. It entered into force on 1 July 2005 and contains the following provisions:

- All Member States will ultimately exchange information on interest payments to individuals resident for tax purposes in another Member State. All Member States except Austria, Belgium and Luxembourg will immediately introduce a system of information reporting;
- Austria, Belgium and Luxembourg are entitled to receive information from other Member States and will introduce a system of information reporting at the end of a transitional period during which they will levy a withholding tax of 15% for the first three years, 20% for the following three years and 35% thereafter; 75% of this revenue is to be transferred to the Member State of residence of the saver concerned;
- The transitional period will end if and when the EC enters into agreement with Switzerland, Liechtenstein, San Marino, Monaco and Andorra to exchange information upon request and these countries continue simultaneously to apply the withholding tax, and if and when the Council agrees by unanimity that the US is committed to exchange of information.

On 2 June 2004 the Council adopted a decision on the agreement between the EC and Switzerland providing for measures equivalent to those in the directive. The agreement was signed on 26 October 2004. Its key elements also form the basis for agreements with Andorra, Liechtenstein, Monaco and San Marino.

ROLE OF THE EUROPEAN PARLIAMENT

On tax proposals, Parliament's role is generally confined to the consultation procedure. Its resolutions and amendments have broadly supported all Commission proposals in the fields of both company and personal direct taxation – including all elements of the 'Monti Package' – while advocating a widening of their scope. It gave its opinion on the Ruding Report, and the Commission's reaction to it, in a report adopted in April 1994. In giving general approval to the Commission's approach on SMEs on 24 October 1994, Parliament called for a plan of action in a form that could form part of an integrated programme for SMEs.

Parliament gave its initial views on the Commission's proposals in the field of corporate taxation in its resolution of March 2002 (*4.18.2.). Of the alternatives under consideration, Parliament was interested in the idea of Home State Taxation, perhaps as an intermediate stage in moving towards a 'common tax base', understood as 'new harmonised EU rules, existing in parallel to national rules, available to European companies'. Parliament adopted a resolution on Corporate Tax on 13 December 2005. In this resolution, Parliament welcomes and reiterates its support for the Commission proposals with regard to the Common Consolidated Tax Base and Home State Taxation for SMEs.

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