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The Impact of Freedom of Investment on The Direct Taxation of Company Incomes in The European Union

European Tax Law

KEYWORDS : freedom of investment, company incomes, direct taxation

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ABSTRACT

Taking into consideration the peculiarities that characterize the gradual process of harmonization and approximation of tax systems of Member States with the European Law, as well as the abusive application of the European provisions related to the exercise of freedoms of establishment and movement of capital, pillars of freedom of investment, this paper has as purpose to outline the impact of direct taxation measures to the company incomes for which it is necessary to individualize the process established from the EU against the tax provisions that emerge distortions to the internal market from which generate the problem of the damaged tax competition, as well as the fundamental principles established from the Court of Justice of the EU. In view of this objective, the proposed paper valuates the extent to which company income tax measures, applied by Member States and affecting patterns of investment between Member States, should be removed.

1. Introduction.

The European Law, noted as a set of rules that disciplines the organization and the development of the European Union (EU) and the relationships between the EU and Member States, is created with the aim to establish the legal boundaries of the common market which the composition is inspired from the principal purpose to establish the single European economic space declared by the six original Member States of the European Economic Community (EEC) established by the Treaty of Rome[1].

In fact, the process of the configuration of the European order it is completed in the course of time with a set of rules laid down by the European institutions that are integrated and strengthened by the pronunciations of the European Court of Justice noted for its role to watch the Treaty of the EU in order to guarantee the respect from the legal orders of the Member States of the *«four freedoms»* as pillars of the single market.

On this point should be noted that the term freedom, according to the content of the article 26 second point of the EU Treaty (*ex* article 14 of the Treaty of EEC)[2], is the key of the establishment of the common market. As result, can be deduced that the European order is a set of rules which, being established on the regulation of mechanisms essentially of economic nature, attempt to *«approximate»*, or *«harmonize»* where is possible, the legal orders of the Member States with the aim to abolish all the obstacles that prevent the correct function of the common market.

In this context, it is not difficult to understand how the economic activity of the companies or the freedom of the investment represent institutions of deep interest in the face of the purposes established in the Treaty of the EU and pursued through the issue of the acts that belong the derived European Law[3].

In function of these finalities, the European Law has influenced completely in different sectors of right in force to the Member States operating, in particularly, on those that directly influenced to the constitution of the single market. As result, the intervention of the European Union to guarantee the function of the common market is an expression of the European tax policy configured to the positive and negative forms[4].

In view of the importance that detects the matter in question it is relevant to evidence that the tax positive policy prevue the progressive realization of the harmonization and approximation process of the national legal orders of the Member States. The process of the harmonization of tax systems of Member States is legitimated from the article 113 of the Treaty of the EU (*ex*. article 92 of the Treaty of EEC) which states that *«the adaptation with Counsel's unanimity of the articles that concern the harmonization of the legal orders related to the turnover taxes, consumption taxes and others indirect taxes must be carried out to the extent in which the harmonization it is necessary to assure the establishment and the function of the single market[5]»*.

As evidenced, the disposition limits only to the indirect taxes the possibility of the European interventions in this legal field and on the basis of which is realized the European harmonization in the field of the VAT. Instead, doesn't exist an equivalent explicit disposition of the Treaty in the field of the direct taxation[6]. Conversely, the process of the approximation of tax systems of Member States results to be subject of the article 115 of the Treaty of the EU (*ex*. article 94 of the Treaty of EEC) from which detects *«the Counsel has the power to adopt directives to approximate the national legal orders»*. *Inter alia*, this article permits to the Counsel to interfere if it considers that the differences between the legal and administrative dispositions of the Member States have a direct impact to the function of the single market.

This article is on the base of the all proposals of the harmonization in the field of direct taxation. But, unlike the article 114, the Member States are not free to choose the most appropriate measure as regulation, directive, recommendation to obtain the aimed result, but are required to take only the directives given that it comes to measures that don't have automatic effects on European Union citizens, but require a measure of transposition into the legal order of the Member States.

However, it should be noted that the long and difficult path of the process of the establishment of the EU stood out, above all, for the difficulties encountered in the field of taxation and, specifically, for the obstacles encountered in the field of direct taxation.

In light of the arguments mentioned above I arrive at the conclusion that *«in the EU Treaty doesn't exist a system of rules related to the direct taxation, as result, doesn't exist any disposition that can discipline the field of the direct taxation of company incomes»*. In fact, it appears that the direct taxation, in reason of fiscal sovereignty principle, is remained well preserved in the *domestic jurisdiction* of the Member States. However, it should be noted that, in the recent years, a number of EU interventions have played a leading role given its growing importance in the process of European economic integration.

In the light of the reflections already highlighted and taking into consideration the peculiarities that characterize the gradual process of harmonization and approximation of tax systems of Member States with the European Law, as well as, the primary consideration from the fiscal point of view of EU Treaty is that of micro economy for which the European legislator prohibits the national attitudes likely to disturb the allocation of factors to discriminate between States or the goods and services produced in other Member States. This analysis also allows us to highlight that, taxation does not fall, except indirectly, in the tasks of the Community indicated in the article 2 of the Treaty of EEC now repealed by the Treaty of Lisbon of 13 December 2007.

In the light of the reflections already highlighted and taking into

consideration the peculiarities that characterize the gradual process of harmonization and approximation of tax orders of Member States with the European Law as well as the abusive application of the European provisions related to the exercise of the freedom of establishment and the freedom of movement of capital as pillars of the freedom of investment, this paper has as purpose to outline the impact of the direct taxation measures to the company incomes for which it is necessary to individualize the process established from the EU against the tax provisions of the Member States that emerge distortions to the internal market from which generate the problem of the damaged tax competition, as well as the fundamental principles established from the Court of Justice of European Union in the base of which the Member States of the EU must approximate their direct taxation systems.

In view of this objective and also taking into account the principle of the international tax neutrality, the proposed paper, being based on the analysis of the EU discipline related to the company incomes taxes in the field of direct taxation valuates the extent to which the company income tax measures, applied by Member States and affecting patterns of investment between Member States, should be removed.

2. Towards a single market without fiscal barriers.

The reform of the EU in the sector of company taxation is applied in conformity of purpose Lisbon Strategy *"...to become the most competitive and dynamic knowledge-based economy in the world..."*[7]. The European Commission, taking into consideration that the current application of the company taxation in the single market creates obstacles to cross-border economic activities, as well as inefficiencies and prevents operators from exploiting their benefits which imply a loss of European Union welfare and undermine the competitiveness of EU businesses, has made a lot of attempts to adopt a strategy in the field of taxation of companies incomes aiming an efficient single market without fiscal barriers[8].

2.1. Towards the abrogation of the company fiscal barriers to cross-border economic activities in the single market.

The European Commission[9] identified a set of sectors[10] where the taxation of companies incomes constitute an obstacle for the cross-border economic integration; a problem which derives from the fact that the companies in the EU need to comply with different rules of Member States. The multiplicity of tax laws, conventions and practices entails substantial compliance costs and represents a barrier to cross-border economic activity.

To abrogate or reduce the company tax obstacles, the European Commission, in collaboration with the Member States, projected to develop the guidance on important European Court of Justice rulings and to co-ordinate their implementation, to give priority the amendments to the existing proposals for extension of the Merger and Parent-Subsidiary Directives, to draw its old proposal for a directive concerning cross-border loss-offset, to examine the Danish joint taxation system, to develop and exchange best practices on Advance Pricing Agreements and documentation requirements, to improve the Conventions and to turn into an instrument of EU law, to approach the double taxation Treaty issues with the aim to overcome the current complexities, to realize a perspective of the EU version of the OECD Model Tax Convention against the double taxation of the incomes, to adopt certain provisions against the double taxation with the purpose to constitute the first step towards the possible elaboration of the EU Model Tax Treaty.

2.2. How the European Court of Justice guarantee the freedom of investment?

The Court of Justice of the EU has played a decisive role in the field of direct taxation and in that of the freedom of investment by the freedom of the establishment of companies and freedom of movement of capitals, making possible the establishment of the EU pillars intervention in relation of the harmonization of direct taxation, despite the qualification as an exclusive competence of the Member States.

With its case-law the Court of Justice of EU made possible the solution of a formal difficulty related to the tax issue through the definition in the Treaty of the EU of the European direct taxation groundwork. The Court of Justice of EU, taking into consideration that the Member States are obligated to exercise their competence in conformity with the European Law, enlarged the field of application of direct taxation related to the principle of non discrimination in the matter of the freedom of establishment of companies and movement of the capitals. In relation to the interdiction of the discrimination, the Court of Justice of EU readdressed also the interdiction of any discrimination dissimulated or realized to the damage of the non residents subjects. With these developments evidence the gradual but decisive activity for the construction of an European direct taxation to the opera of the Court of Justice of EU, to the response of the distortions effects derived by the presence of discriminatory national provisions.

The harmonization realized in the field of companies taxation it is, in fact, result of the application of provisions contained to the article 115 of the EU Treaty related to the approximation of the legislations (*ex*. article 94 of CEE Treaty)[11] that request the unanimity for the acts of the Counsel and for which the field of direct taxation remains an exclusive competence of the Member States. However, also in this field the Member States must observe the principles and the interdictions established to protect the general purposes of the European Union. Among the instruments that permit the realization it is identified *in primis* the establishment of the internal market characterized by the elimination, between the Member States, of the interdiction to free movement of the goods, persons, services and capitals[12]. The principles of the equality to the fiscal treatment and the interdiction of the discrimination, among the others, assume then an importance at the perspective of the valuation of the conformity of the domestic legislations with the European purposes.

The extensive interpretation adopted by the European Court of Justice for the interdiction of discriminatory restrictions sanctioned to the European Union Treaty and of the most general of the non discrimination principle in the base of the nationality has permitted the application to the question of fiscal nature of so-called *"fundamental freedoms"*. Then, to the European Court has appertained the delicate mansion to exercise the action of the intermediary in way to equilibrate the purposes of the EU Treaty and the tax subsidiary principle protected from the Member States of EU.

To general terms, the principle of the non discrimination imposes that analogue situations must not be treated at the same way except the case when that treatment isn't justified objectively[13]. In fact, the tax provisions only in specific cases produce directly a distinction in the base of the nationality. A different treatment founded to the residence or to the legal office of the company can constitute a dissimulated discrimination in the base of the nationality. Essentially, the European Court of Justice has clarified that the principle of the equity prohibits not only the overt discrimination founded to the nationality but also the covert discrimination, nevertheless founded to others criteria's of distinction, in fact arrive to the same result[14]. In addition, can be a covert discrimination if the related provision it is entirely susceptible to influence at the discriminated category more than doesn't result with that of not discriminated and if there exist the subsequent danger that the first it is subjected to a specific situation not favourable[15].

However, the Court, subsequently, has integrated and become more organic its reasonable interpretation establishing that doesn't exist discrimination in the case where the presumed discriminatory provisions are justified as result of objective considerations independently from the nationality of the interested persons when those are in proportion with the legal objective to follow from national legislation.

The jurisprudence of the European Court of Justice in the field of the interdictions and restrictions of fundamental freedoms permits to evidence certain principles related to the possible

cases of justification of the treatment disparity among the resident and not resident subjects. However, must evidence that the EU Treaty prevue a series of derogations related to the fundamental freedoms and to the principles of non discrimination founded to some important national interests as the reasons of public order, public security and public sanity.

The fundamental reason of the justification derived from the pronunciations of the European Court of Justice is related to the so-called *"principle of the coherence of tax systems"* called to a multiple sentences of the Court and effectively to the condition guarantee the direct applicability of the principle of equal treatment. In fact, the principle of subsidiary of the Member States to the direct taxation, except the application of the European law, brings to the necessity to guarantee the integrity and the coherence of the domestic tax systems, eventually also between the introduction of the provisions that prevue a different treatment for the situations that reasonable are different[16].

Except the coherence of the tax regime, exist others possible cases of justification of restrictions to the freedoms of establishment related to the necessity to guarantee the efficacy of the tax controls, to eliminate the difficulties of administrative order, to the necessity to eliminate the reduction of taxable income and also to contrast the fiscal evasion and the fiscal elusion.

Differently to other fundamental freedoms prevue to the EU Treaty, to the freedom of movement of capitals is recognised a direct effect, one of the purposes that the Member States should realized to guarantee the final purpose: the function of internal market. The liberalization of the movement of capitals it is entirely realized only with the adoption of the directive 88/361/CEE of 24 June 1988[17], entered in force in 1 July 1990 that has prevue the abrogation of the restrictions to the movement of capitals in the European field.

In the basis of the conflict was request to the Dutch Tax Administration the exemption of Mr. Verkooijen to the taxation in way to obtain the possibility to be exempted from the final tax that he must pay to the taxable income at the moment of the distribution of the dividends from a Belgium society. These dividends were subject of the taxation in source in Belgium of 25% rate tax. The tax administration doesn't accepted the application to the dividends distributed from the Belgium society haven't detrained the Dutch tax to the dividends, a necessary requirement in application of the Dutch legislation to obtain the exemption requested.

Against the decision of the first grade where it is presented the request of Mr. Verkooijen, the Dutch Tax Administration presented a request to the High Court Hoge Raad that has suspended the judgement asking to the European Court of Justice to recognize if the Dutch provision it is compatible with the provision contained to the directive 88/361/CEE of 24 June 1988.

The European Court of Justice has valuated that the domestic legislation of a Member State doesn't subordinate the concession of an exemption from the tax income, to the which are subjects the dividends distributed to individuals persons that are in possession of the incomes, to the condition that these dividends are pay from the societies that has the legal office to this Member State, discriminating in this way the dividends pay from societies residents to an other State of EU[18].

In fact, this sentence it is noted for its relevant importance because enlarged for the first time to the freedom of movement of capital the principles established in the field of others fundamental principles. In particularly, this sentence brings relevant implications for the Member States in the field of direct taxation of dividends. The interdiction of any discrimination founded to the residence imposes to the Member States the requirement to approximate their domestic legislation to the European Law due the different tax treatment, verified in a major part of Member States, based to place of establishment of the society that distribute the dividends.

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WATTEL (2005), European Tax Law, 4 edition, p. 16-19. | Firstly, this objective was established at the European Counsel in Lisbon in March 2000 and reiterated by the Stockholm European Counsel of March 2001 (Communication from the Commission to the Counsel, the European Parliament and the Economic and Social Committee, COM (2001), 582 final, Brussels, 23.10.2001). | Communication "Tax Policy in the European Union", COM (2001) 260. | Executive Summary of the Commission Services Study on "Company Taxation in the Internal Market", SEC (2001) 1681. | The allocation of the profits on arms' length basis by separate accounting on a transaction by transaction basis that gives, inter alia, to numerous problems in the fiscal treatment of infra-group transfer pricing in the form of high compliance cost and potential double taxation; cross-border flows of incomes between associated companies which often are subject to additional tax, specially, withholding taxes on bona-fide intra-group payments of dividends; interests and royalties that contain a risk of double-taxation being not in line with the single market idea; major limits on cross-border loss relief which may lead to double-taxation; cross-border restructuring operations give rise to substantial tax charges, the reason for which the Merger Directive (90/434) provides for the deferral of corporate tax on such operations but its scope is too narrow and its implementation in Member States is very difficult, consequently, as result of capital gains taxes and transfer taxes on cross-border restructuring operations are often prohibitively high, the companies are forced to leave economically sub-optimal structures untouched; the specific problems relating to double taxation conventions in the European Union. | | "The Counsel, establishing with unanimity to the proposal of the Commission and consultation of the European Parliament and of the Economic and Social Committee, establishes directives addressed to the approximation of the legislative provisions and administrative of the Member States that have a direct influence to the establishment or function of the internal market". | «The Community has the mansion to promote at the whole of the Community, between the establishment of a common market and of an economic and monetary union and among the application of common policies and actions as sanctioned to the articles 3 and 4, an harmonized development, equilibrated and sustainable of economic activities, a high level of occupation and social protection, the equality between the men's and woman's, a sustainable enlargement, a high degree of the competition and convergence of economic results, a high level of the protection of the ambient and the improvement of the quality of this last, the improvement of the level and quality of the life, the economic and social cohesion and the solidarity among the Member States». | Sentence Sermide v Cassa Conguaglio Zucchero and Others, 13 December 1984, C-106/83, Raccolta 1984, point 28. This classic phrase it is utilized at a series of decisions of the European Court of Justice. V. UCKMAR (2006), Corso di Diritto Tributario Internazionale. | Sentence Sotgiu, 12 February 1974, C-152/73, Raccolta 1974, point 11 "the rules regarding the equality of treatment between nationals and non nationals forbid not only overt discrimination by reason of nationality but also all covert forms of discrimination which by the application of other criteria of differentiation, lead to the same results". | About this question it is recommended to consult the Sentence O'Flynn v Adjudication Officer, 23 May 1996, C-237/94, Raccolta 1994, point 20. | Sentence Bachmann c/Kingdom of Belgium, 28 January 1992, C-204-90, Raccolta, 1992, page 249. | GUCE, L. 178 of 8.08.1988, page 5 ss. | M. DASSESSE. J. MALHERBE, P. MALHERBE, Fiscalitè europeénne : impôts directs, Paris 2005-2006. |