Double Non-Taxation: Not only a Policy but also a Legal Problem

Kluwer International Tax Blog
January 5, 2018

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Please refer tot his post as: Christoph Marchgraber, 'Double Non-Taxation: Not only a Policy but also a Legal Problem', Kluwer International Tax Blog, January 5 2018, http://kluwertaxblog.com/2018/01/05/double-non-taxation-not-policy-also-legal-problem/

Among the main issues the BEPS project intends to address is the phenomenon of "double non-taxation". It is a term that is used quite frequently nowadays; primarily in order to describe situations that are considered as problematic from a policy perspective. However, not all situations where something remains untaxed provoke public outrage. As, for example, neither Austria nor Germany levy an income tax on lottery winnings, a German citizen who wins in the Austrian lottery does not have to pay taxes in either state. Although the lottery winnings could thus be regarded as double non-taxed, it is doubtful that such an outcome would trouble the tax administrations involved. From a legal perspective, referring to the phenomenon of double non-taxation is also not in itself sufficient to prove that something is against the law. Still, the European Commission considers double non-taxation to be as incompatible with the internal market as double taxation.[1] From an EU law perspective, this raises the question whether there are legal arguments supporting such a view.

Double Taxation From an Internal Market Perspective

Double taxation is considered to be a severe obstacle for free movement. In the past, the ECJ even considered the abolition of double taxation to be included among the objectives of EU law.[2] However, from an EU law perspective, it is still unclear what the meaning of the term double taxation actually is. This may seem surprising, because there is a vast consensus that by using this term reference is either to "*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*" (juridical double taxation) or to "*taxation of the same income in the hands of different persons*" (economic double taxation). However, from an internal market perspective, the main shortcoming of today's commonly used definition of double taxation is that the overall tax burden is disregarded.

With regard to juridical double taxation in the area of direct taxes, for example, the same taxpayer could still be subject to "*comparable taxes in two […] states in respect of the same subject matter and for identical periods*", even if the residence state "*allow[s] […] as a deduction from the tax on the income of that resident, an amount equal to the income tax paid in [the other contracting state]*" (Article 23 B para. 1 OECD MC). This is particularly the case if the amount of tax levied by the residence state was higher than the amount of tax levied by the other contracting state. However, since the overall tax burden in such a cross-border situation is the same as the tax burden that would arise in the residence state if there was no cross-border situation, it is at least not obvious why such a situation should be problematic from a free movement perspective.

Whether a cross-border situation is unduly burdened so that the internal market's objective of free movement is restricted can thus only be determined if the taxation of the cross-border situation is contrasted with the taxation of a comparable domestic situation, unless taxation *per se* is considered to impede the establishment of the internal market. From an EU law perspective, double taxation should hence be perceived as a situational and relative phenomenon. Whether a cross-border situation is subject to double taxation depends on the tax burden the respective comparable domestic situation would have to face in the individual Member States which are involved.

Double Non-Taxation From an Internal Market Perspective

This understanding is insofar plausible as free movement is (and hence potentially the fundamental freedoms as well are) impaired if a cross-border transaction sustains a higher tax burden than a comparable domestic transaction. However, if the result is the other way around, i.e. a cross-border transaction sustains a lesser tax burden than a comparable domestic transaction, the internal market's free movement requirement is obviously not infringed. On the contrary, as every form of taxation hinders economic activity in one way or another, there is nothing better for free movement than a taxpayer, a certain item of income, a transaction or an activity remaining untaxed. If this is true, why does the European Commission consider double non-taxation to be as incompatible with the internal market as double taxation?

The explanation is unintentionally given by the OECD, according to which double non-taxation may lead to "*a reduction of the overall tax paid by all parties involved as a whole, which harms competition, economic efficiency, transparency and fairness*".[3] From an internal market perspective, the first two aspects in particular are legally remarkable, because the EU is based on the economic policy perception of "*an open market economy with free competition, favouring an efficient allocation of resources*" (Article 120 TFEU). Therefore, the TFEU, *inter alia*, contains provisions aimed at avoiding distortions of competition induced by the Member States (Articles 106-107 TFEU). If it is hence correct that competition and economic efficiency may be harmed by a cross-border transaction sustaining a lesser tax burden than a comparable domestic transaction, the question arises whether the Treaties' provisions dealing with undistorted competition prohibit such a preferential treatment of cross-border situations.

From a tax perspective, the State aid rules of Articles 107-109 TFEU are the most relevant means to implement the competition aspect of the internal market concept. The most important criterion of the State aid rules for tax matters is whether a domestic measure causes a selective advantage. According to the ECJ's jurisprudence, this is the case if a tax measure leads to a preferential treatment of certain economic operators which are in a comparable situation with non-privileged economic operators.[4] The Court's State aid analysis is thus based on a comparison. In order to determine whether a cross-border situation is unduly privileged so that the internal market's objective of undistorted competition is harmed, the taxation of the cross-border situation should hence be contrasted with the taxation of a comparable domestic situation. Against this background, when referring to double non-taxation, the European Commission seemingly refers to a situation in which a cross-border transaction sustains a lesser tax burden than a comparable domestic transaction.

According to such an understanding, double non-taxation does not necessarily mean that a taxpayer, a certain item of income, a transaction or an activity remains untaxed. Although neither Austria nor Germany levy an income tax on a German citizen who wins in the Austrian lottery, the resultant non-taxation of the lottery winnings would be in line with the internal market concept, even if the tax laws of other Member States subjected lottery winnings to income tax. From an internal market perspective, such an outcome is not a cause for concern insofar as the Member States are free to deliberately decide that a property gain should not be taxed. Rather, it is only problematic if the tax systems of two or more states overlap in such a manner that the cross-border situation bears a lesser tax burden than a comparable domestic situation would have to face. Just as double taxation, double non-taxation should hence be perceived as a situational and relative phenomenon for purposes of EU law. Whether a cross-border situation leads to double non-taxation depends on the tax burden the respective comparable domestic situation would trigger in the individual Member States which are involved.

Double Non-Taxation as Unlawful State Aid?

Against this background, it is understandable that the European Commission considers double non-taxation not to be in line with the internal market concept. In fact, since the resultant distortions of competition are primarily induced by the Member States' unharmonized tax systems, it may even be questioned whether the State aid rules of the TFEU prohibit such a preferential treatment of cross-border businesses and obliges Member State to avoid situations of double non-taxation.

Before the BEPS-project has started, the impact of EU law on the phenomenon of double non-taxation has not attracted a lot of attention. In fact, the discussion still seems to be its infancy. However, considering the similarity between double taxation and double non-taxation (both of which should be perceived as a situational and relative phenomena for purposes of EU law) it suggests itself to analyze the intensive discussions on double taxation and EU law, which were held in the past, and, based thereon, to consider whether the arguments that have been brought forward in this respect may also help to verify whether double non-taxation is in fact incompatible with EU law, in general, and with the State aid rules, in particular.

Since it is widely recognized that Article 107 TFEU has the potential of putting traditional pillars of the Member State's tax systems into question,[5] the phenomenon of double non-taxation should no longer be understood as a mere political but rather (and for legal scholars primarily) as a legal issue. From an EU law perspective, it is thus inevitable to analyze whether the measures which were suggested by the OECD (and partly already implemented by EU Member States) are in line with EU law (in particular with the fundamental freedoms). However, it should not only be considered whether such measures are justified and proportional but also whether (at least some of) these measures might even be legally required.

* The author has published a book on "Double (Non-)Taxation and EU Law", which is available at Wolters Kluwer (see: here) and which intends to foster the discussion on the implications of EU law on the BEPS initiative.

[1] See, for example, Taxation in the European Union, SEC(96) 487 final (20 March 1996), at p. 13 ("*[t]he Single Market is clearly not compatible with either double taxation of the same taxable base or no taxation at all*").

2 Judgment in *Gilly*, C-336/96, EU:C:1998:221, at para. 16; also see Judgment in *Bouanich*, C-265/04, EU:C:2006:51, at para. 49; Judgment in *Damseaux*, C-128/08, EU:C:2009:471, at para. 28; Order in *Levy and Sebbag*, C-540/11, EU:C:2012:581, at para. 27.

3 OECD, *Action Plan on Base Erosion and Profit Shifting* (OECD, 2013), at p. 15.

4 See, for example, Judgment in *Adria-Wien Pipeline and Wietersdorfer & Peggauer Zementwerke*, C-143/99, EU:C:2001:598, at para. 38.

5 Cf. C. HJI Panayi, 32 *Intertax* 6/7 (2004), at p. 306 ("*Art. 87 […] has the potential to develop into a powerful weapon at the disposal of the Commission; well capable of re-opening the debate for tax harmonization.*").