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A proposal for harmonizing the rules on the allocation of taxing rights within the EU and in the relations between Member States and third countries: ATRiD and EU tax treaties

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This contribution lays down a general plan for what the EU should do in order to attain a harmonized set of norms regulating the allocation of taxing rights among Member States and in the relation between those States and third countries, which would benefit both Member States and their taxpayers by eliminating several instances of double taxation and contributing to a more effective response to tax avoidance and aggressive tax planning schemes.

It is my opinion this plan is viable and represents a complement to the most recent EU actions in the field of corporate taxation, such as the ATAD and the CC(C)TB Proposals. It also appears substantially in line with the tax roadmap recently outlined by the Austrian government (see: the Schelling-Plan) and which should become one of the hot items of the EU political agenda during the Austrian semester of Precedency of the Council (July-December 2018). A technical development of this plan is on its way, as part of the research I am carrying on within the Research Project "*European Tax Coordination: Law, Policy and Politics*", organized by the GREIT (see: Group for Research on European and International Taxation).

The starting point of the analysis is a matter of facts. Direct tax law, within the European Union, is still characterized by two negative features, which adversely impact on the well functioning of the internal market. First, the fact that "*a taxable event might be taxed twice*" within the Union represents "*the most serious obstacle there can be to people and their capital crossing internal borders*" (AG Colomer of the CJEU, Opinion, 26 October 2004, Case C-376/03, *D.*, p. 85). Second, the "*current lack of coordination in corporate taxation between Member States creates obstacles*" for companies acting in the Internal Market, "*as they are confronted with 28 different tax bases of corporate taxation, creating heavy compliance costs and administrative burdens which are detrimental to European competitiveness*", as well as opportunities for aggressive tax planning schemes based on the exploitation of mismatches (see European Commission, *Communication from the Commission to the European Parliament and the Council, A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action*, COM(2015) 302 final, p. 2).

Both features are caused by the lack of harmonization of the rules on the allocation of taxing rights among EU Member States and between such States and third countries. It is my opinion that the time is ripe to set aside these issues by a coordinated effort at the EU level. Such harmonization/coordination would be also complementary to the CCTB project. One the one hand,

it could prove a viable alternative to the "consolidation" of the common corporate tax base. On the other hand, should the CCCTB "consolidation" directive see the light, harmonization/coordination of the rules on the allocation of the taxing rights among Member States would complete the picture by introducing (or triggering the introduction of) rules on the division of taxing rights in respect of individual income tax and cases falling outside the scope of the CCCTB project.

I submit that a Directive on the Allocation of Taxing Rights (ATRiD) would be the most effective and proportionate solution to achieve such harmonization/coordination of the rules on the allocation of the taxing rights among Member States.

Indeed, the negative effects on the internal market discussed above often derives from the exercise in parallel of the uncoordinated tax rules of different Member States, which therefore requires an effective harmonization to be solved. Moreover, the negative effects created by the tax rules of a single Member State have been perpetrated for decades, notwithstanding the various coordinating actions (soft law) put forward by the Commission, which have proven ineffective in removing them.

Similarly, with regard to the need to fight against aggressive tax planning, Member States have experienced enormous difficulties to deal with such an issue through unilateral actions, which has led the G20 and the OECD to launch the BEPS project and the EU Council to adopt Directive 2016/1164, laying down rules against tax avoidance practices that directly affect the functioning of the internal market (hereafter "ATAD") and to amend (twice) the Parent-Subsidiary Directive.

More generally, the ATRiD would fall within the current trend of adopting an increase number of directives for the purpose of harmonizing direct tax rules among EU Member States in order to ensure the well functioning of the internal market, such as the two revisions to the Parent-Subsidiary Directive, the ATAD I and II, the Proposed Directive on Double Taxation Dispute Resolution Mechanisms in the European Union, the two Proposed CCCTB Directives and the proposed revision of the Interest and Royalty Directive. In addition, it would be largely complementary to the EU-level legislation in company law and fit with projects such as the Capital Markets Union and the several other initiatives in tax matters.

Based on the above, it can be argued that the ATRiD, as a legal instrument introducing measures for the approximation of the Member States legal systems that directly affect the establishment or functioning of the internal market, falls within the scope of article 115 TFEU.

In addition, although direct taxation does not fall within the domain of the EU's exclusive competences, the ATRiD would nonetheless comply with the principle of subsidiarity under article 5(3) TEU, since, as previously discussed, it appears that the negative effects on the internal market that the ATRiD aims at healing could be tackled effectively only through a common legal solution. Individual initiatives by each Member State would just perpetuate the current situation, as it has been the case for several decades, which is characterized by the uncoordinated fragmentation of the domestic rules on the allocation of taxing rights that triggers double taxation and exacerbate phenomena of aggressive tax planning and directive/tax treaty shopping. Experience shows that coordination (via soft law tools, such as recommendations) is a slow process and past results have been extremely modest. Moreover, tax coordination typically addresses only specific, targeted issues and cannot cater for the wide variety of problems, like those targeted by the ATRiD, which require a holistic solution.

The ATRiD would also comply with the principle of proportionality under article 5(4) TEU, as the proposed measures would be both suitable and necessary for achieving the desired result. Indeed, the proposed directive would not go beyond the harmonization of the rules on the allocation of taxing rights, imposing, where necessary, a minimum level of taxation (in particular for certain categories of outbound income flows, e.g. dividends, interest and royalties) and an obligation to relieve international double taxation, while streamlining the rules aimed at avoiding cross-border double taxation within the EU. In this respect, the ATRiD would not restrict Member States' sovereignty more than strictly necessary, as it would not affect Member States' right to set their own income tax rates (with the exception of a minimum tax rate applicable to certain categories of outbound income flows).

The ATRiD should cover both individual and corporate income tax, including any substitute tax and withholding tax, applied under the EU Member States tax systems. In this respect, it would be advisable to include an article, dealing with taxes covered, resembling article 2 of the OECD Model.

The Directive would apply to income derived by individual and entities, both resident and non-resident of EU member States. It would mainly shape the taxing rights and obligations of EU Member States in respect of cross-border income. In addition, it would also deal with the issue of the taking into account, by different EU Member States, of the ability to pay of the taxpayers.

With regard to the allocation of taxing rights, tax residence should, as a general rule, be the primary connecting factor. Therefore, the ATRiD should include uniform definitions of tax residence for both individual and entities. That would not conflict with the possibility for member States to treat (resident and non-resident) entities as transparent for tax purposes. In the case of multiple tax residence in two or more Member States, specific tie-breaker rules should apply. Under such rules, the tax residence could be allocated to a Member State for a certain part of the fiscal year and to another Member State for the remainder thereof. The Directive should include a provision explicitly allowing recourse to the (currently, proposal for a) Directive on Double Taxation Dispute Resolution Mechanisms in the case of conflicts among EU Member States concerning tax residence. Finally, it would be possible to include a general exit tax rule, which would complement the provision of the ATAD, being applicable to both individuals and entities.

The Directive would also identify the source of income through *ad hoc* definitions. In respect of income sourced in EU Member States, the Directive would oblige such States to tax the income by applying a minim tax rate, unless the specific category of income were exempt or qualified as non-taxable income under the general rules of the national tax system applicable to resident persons.

In respect of income sourced abroad and derived by resident persons and domestic permanent establishments (PEs) of non-resident persons, the ATRiD would impose on Member States a duty to relieve juridical international double taxation through either exemption, or credit. Switchover rules (from exemption to credit) would apply in the case of low or no taxation in the source State.

Finally, special rules would apply in the case of intra-EU income flows, which would derogate from the above-described norms. In general terms, source taxation would be greatly limited, based on reciprocity, and would substantially apply only in the case of income connected to PEs and immovable property situated in the territory of the relevant Member State. A certain percentage of the tax levied by the State of residence, in connection with employment income, would be transferred to the EU Member State where the employment activity in actually carried out.

In the limited number of cases where individuals had their income taxable in different Member States, each of those States should be required to grant the personal and family allowances provided for under their respective legislations in proportion to the quota of the overall taxpayer's income that they effectively subject to tax. The taxpayer should provide Member States' tax authorities with the information necessary to compute such proportion, in particular information on his global income.

Finally, the ATRiD should include a general anti-abuse rule, shaped after article 6 of the ATAD, purported at counteracting artificial arrangements aimed at achieving illegitimate tax benefits.

Disputes arising among Member States and concerning the application of the ATRiD should fall within the scope of application of the future Directive on Tax Dispute Resolution Mechanisms in the European Union (Ecofin Proposal of 19 May 2017, 2016/0338 (CNS), 9420/17, *Proposal for a Council Directive on Tax Dispute Resolution Mechanisms in the European Union*). This, combined with the CJEU's competence to interpret the Directive, should ensure a coherent and effective application of ATRiD throughout the Union.

The interpretation of the ATRiD would subject to the ordinary hermeneutical principles applied by the CJEU for the purpose of construing secondary EU legislation, in particular directives. Against that background, interpretation would be facilitated by the use of numerous definitions, in particular those concerning the source of income and those relating to the scope of certain categories of income. In addition, the Directive should include a "general rule of interpretation", which would be structured along the lines of article 3(2) OECD Model and explicitly providing that, for the purpose of interpreting the Directive, the "context" would include the OECD Model and Commentaries, as well as any other OECD materials which led to the adoption of that Model and Commentaries. Under certain conditions, subsequent OECD materials, including the OECD Model and Commentaries, would be considered as part of the "context" relevant for the purpose of construing the Directive.

In order to be fully effective, however, the harmonization should cover also the relations between EU Member States and third country, which are currently dealt with also in bilateral tax treaties. Indeed, in the relation with third countries, the autonomous actions of Member States have not been, so far, effective in ensuring the well functioning of the internal market and the smooth operation of the free movement of capital. A more significant involvement of the European Union institutions in designing the rules governing the relations between EU Member States and third countries in the direct tax field would facilitate the achievement of these two objectives and, at the same time, could prove more effective in eliminating the possible conflicts between EU secondary legislation and tax treaties concluded between Member States and third countries. Finally, the involvement of EU institutions in the negotiation of tax treaties with third countries would further promote tax good governance and the fight against aggressive tax planning (See COM(2016) 24 Final, *Communication from the Commission to the European Parliament and the Council on an External Strategy for Effective Taxation*).

Once EU Member States rules on the allocation of taxing rights were harmonized by the ATRiD, it would become questionable whether bilateral tax treaties would continue to represent a proper and legitimate tool for regulating the allocation of taxing rights in the relationship between Member States and third countries. Indeed, article 216 TFEU grants to the European Union the competence to conclude, *inter alia*, any international agreement that "*is likely to affect common rules or alter their scope*". Moreover, article 3(2) TFEU states that the competence of the European Union to

conclude such agreements is exclusive. These provisions of the TFEU are aimed at codifying the principles developed by the CJEU in its case law on the external competence of the Union in respect of the conclusion of treaties with third countries. That case law has grown around the seminal judgment delivered in the ERTA case, where the Court asserted that, when the EU, "*with a view to implementing a common policy envisaged by the Treaty, adopts provisions laying down common rules, whatever form these may take, the Member States no longer have the right, acting individually or even collectively, to undertake obligations with third countries which affect those rules*" (CJEU, 31 March 1971, Case 22/70, *Commission v. Council (ERTA Case)*, p. 17). These principles, and in particular the rule *in foro interno, in foro externo*, have been further developed by the Court in its subsequent decisions and finally codified in the TFEU by the Lisbon Treaty, which has introduced the current wording of articles 3(2) and 216 TFEU.

The ATRiD, as well as the other direct tax directives (in particular the ATAD), would lay down common rules purported at ensuring the well functioning of the internal market, which, in turn, represents one of the common policies of the Union. Thus, the provisions of the ATRiD (and other direct tax directives) would represent common rules that might be theoretically affected or altered by the conclusion of international agreements between Member States and third countries. As a consequence, under articles 216 and 3(2) TFEU, the Union would acquire an exclusive competence to conclude tax treaties with third countries with regard to the vast majority of the substantive tax treaty provisions and the procedural provisions ancillary to such substantive rules. On the other hand, the competence would be shared between the European Union and the Member States with respect to (i) certain non-discrimination treaty provisions, (ii) rules on exchange of information and assistance in the collection of taxes going beyond the mere application of substantive treaty rules, and (iii) compulsory arbitration clauses. That would imply the need, for the European Union, to negotiate and conclude tax treaties with third counties, subject to the requirement to ensure the involvement of Member States in relation to matters for which the external competence is shared.

This would require the development of a EU tax treaty model, to be used by the Union as a basis for negotiating treaties with third countries. This model should take into account the idiosyncratic features of the EU legal system, first of all the need to comply with the fundamental freedoms. For such a reason, it should include (i) a EU law compliant LOB provision, with equivalent beneficiary clauses covering all EU Member States, (ii) a principal purpose test rule in line with primary EU law, and (iii) specific rules clarifying the possibility for Member States to apply their exit tax and CFC rules, as long as those rules comply with the ATAD and the ATRiD.

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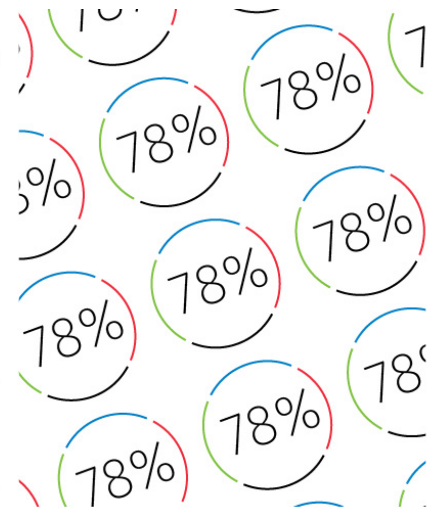

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