

European Tax Law

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# EUROPEAN TAX LAW

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BEN TERRA  
PETER WATTEL

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## Preface

The authors teach tax law, international tax law and European tax law at the University of Amsterdam, both in the regular Law Faculty curriculum and in the Amsterdam Law Program for foreign students, taught in English. Ben Terra specializes in indirect taxation, Peter Wattel in tax procedure, international tax law and European direct tax law.

This book is to serve as a textbook for advanced students of Tax law and/or of Community law, and as a reference book for Tax law or Community law practitioners. It offers a systematic survey of the tax implications of European integration and of Community tax-harmonization policy, and a discussion of the Community tax rules in force and pending.

Chapters 1-3 and 9-13 were written by Peter Wattel; chapters 5-8 by Ben Terra. Chapters 4 and 14 are joint efforts.

The text was completed on 1 January 1997.

## List of Abbreviations

ACT	Advance Corporation Tax
Art.	Article
BOI	Binding Origin Information
BTI	Binding Tariff Information
Bull.	Bulletin
C-	Court case number (as opposed to T- for Tribunal)
CEN	Capital Export Neutrality
CIN	Capital Import Neutrality
CMLRep.	Common Market Law Reports
CMLR	Common Market Law Review
CN	Combined Nomenclature
COM	Document of the Commission of the EC
CUP	Comparable Uncontrolled Price
EC	European Community
ECOFIN	Council of Ministers for Economy and Finance
ECR	Reports of cases before the Court
ECSC	European Coal and Steel Community
ECU	European Currency Unit
ECJ	Court of Justice of the European Communities
EEC	European Economic Community
EEIG	European Economic Interest Grouping
EMU	Economic and Monetary Union
ESC	Economic and Social Committee
<i>et seq.</i>	<i>et sequitur</i>
EU	European Union
EUA	European Unit of Account
FF	French Francs
GDP	Gross domestic product
i.e.	id est
IBFD	International Bureau of Fiscal Documentation
IFA	International Fiscal Association

## LIST OF ABBREVIATIONS

<i>l.c.</i>	<i>locus citandi</i>
LIt	Italian Lira
nyr	not yet reported
OECD	Organization for Economic Cooperation and Development
OECD Model	OECD Model Double Taxation Convention on Income and on Capital
OJ	Official Journal of the European Communities
PAS	Postponed accounting system
SAD	Single administrative document
SE	Societas Europaeae
TARIC	Integrated tariff of the EC
TEU	Treaty on European Union (“Maastricht”)
UK	United Kingdom of Great Britain and Northern Ireland
VAT	Value added tax
VIES	VAT information exchange system
Vol.	Volume
WFR	Weekblad voor fiscaal recht
ZfZV	Zeitschrift für Zölle und Verbrauchsteuern
£	British Pounds Sterling

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## *Chapter 1*

# Introduction

The EC Treaty, notably Article 2, lays down several Community objectives of an economic and social nature. Article 2 also specifies the means to be used to reach these objectives. The most important of these means are the establishment of a common market and the establishment of an economic and monetary union. A common market requires free movement of goods, services, persons and capital, normal conditions of competition (a "level playing field"), and harmonization of national law insofar as disparities between national law create impediments to the functioning of the common market. Important fiscal obstacles to a common market are fiscal burdens on the cross-border movement of goods, services, income or capital, differential tax treatment of domestic and imported goods and services, substantial differences among national tax laws, double taxation of foreign-source income, and differential tax treatment of residents and non-residents. These differences, which distort neutrality as to where to trade or invest, cause market fragmentation along national borders. A certain degree of tax harmonization or at least co-ordination between the Member States is, therefore, indispensable for the establishment and the proper functioning of a common market. In the following chapters, we will discuss the tax measures already taken at the Community level, their legal basis, the proposals for Community action in the area of taxation under discussion within the Council, as well as the Community policy towards indirect and direct tax harmonization. Chapters 5 through 8 deal with the current state of positive harmonization of indirect taxes (customs, VAT, excises and capital duty), chapters 9 through 11 with the current state of positive integration of direct taxes. Chapter 4 offers a survey of Community tax harmonization policy. In chapter 13, some proposed direct tax measures are discussed.

Positive integration (harmonization measures at EC level) is not, however, the sole and maybe not the most important factor in the process of doing away with tax impediments to the proper functioning of the common market.

Whereas most of the extensive harmonization of indirect taxes, especially of customs duties, turnover taxes and excises has been achieved by way of positive integration measures (EC regulations and directives), much of the -modest- integration of direct taxes is a result of what is called negative integration, i.e., integration through prohibitions. The EC Treaty contains several fundamental principles which are to be respected in tax matters as well, one of which is the prohibition of discrimination against goods, services, workers, as well undertakings and capital from other Member States, and of any other discrimination based on nationality within the scope of the EC Treaty. This, and other fundamental principles such as Community loyalty and neutrality of State aid to undertakings have significant consequences for national tax sovereignty. They limit Member States' freedom to arrange their national tax systems. We will discuss the impact of these general (non-fiscal) Community rules on national taxation in chapter 3. Negative integration is especially important in direct tax matters because national tax systems invariably distinguish to a certain extent between domestic source income and foreign source income, and between resident taxpayers and non-resident taxpayers, whereas the EC Treaty forbids all overt or covert discrimination of undertakings and nationals of other Member States.

Another harmonizing factor that may -at least in direct tax matters- be more important than positive integration efforts is tax competition between Member States. Tax competition leads to more or less spontaneous harmonization, since neighbouring States with a comparable level of economic opportunity, infrastructure, social security and public services, cannot afford to diverge significantly in tax burdens, especially as the other obstacles to individual or corporate emigration and to cross-border economic activities are gradually removed, and as the economic and monetary union approaches. If Member States do diverge significantly in tax burdens without offering corresponding public service or economic opportunity, economic activity will move to the more tax-efficient Member States. The ensuing economic and social necessity for less tax-efficient Member States to keep up with the rest of the EC is usually a more convincing argument to national tax policy makers than are political abstractions. Tax competition, however, also has a dark side to it. Excessive tax competition may lead to tax erosion, i.e., Member States outbidding each other with tax incentives designed to attract investors, but resulting in an EC-wide loss of tax revenue.

On the other hand, even if national tax legislation is harmonized at the Community level, or spontaneously aligned by tax competition, the average taxpayer in one Member State may still consider actual compliance with tax obligations a matter to be taken rather more lightly than the average taxpayer in another Member State does. By the same token, national administrative



practice and tax recovery lenience are not automatically aligned by harmonization of statutory tax rates and tax bases. Harmonization of written legislation is not the same as harmonization of national habits and *couleur locale*. It is hard to imagine, for instance, that in any northern Member State, employees would take to the streets for a protest march, demanding equal tax evasion opportunities as tax-dodging, self-employed persons and companies. In certain southern Member States, however, such an event is not only possible, it actually happened. In Italy. Member State compliance in *enforcing* tax legislation ensuing from EC measures is one of the major headaches of the Community institutions.

Harmonization of taxes, especially of direct taxes, is a politically highly-sensitive area. Tax sovereignty is a fundamental part of national sovereignty. One of the most basic rights of national parliaments is the right to vote on taxes. The European Parliament cannot, as yet, be considered a sufficient substitute for national democratic parliamentary control. Moreover, taxation is the most important instrument for national economic and social policy. It may be used to redistribute income, to encourage investments or savings, or to discourage the consumption or the use of certain goods, etc. The further the harmonization process and, therefore, the loss of national freedom of policy in the field of *indirect* taxation progresses, the more the Member States will feel the need to defend their remaining tax sovereignty, that is sovereignty in the field of *direct* taxation.

Finally, we observe that a genuine *European* tax hardly exists as such. There is no tax levied at Community level by a Community tax authority (except the payroll tax on the salaries of the EC civil servants, the "Eurocrats"). The Community has its "own resources", for the most part consisting of a percentage of the national bases of the Value Added Tax, a percentage of gross domestic product (GDP) of the Member States, the revenue from customs duties at the external borders of the EC, and certain agricultural levies, but these are levied and collected at the national administrative level, and the revenue transmitted to the EC is relatively small as compared to the percentage of GDP of the Member States taken by *national* taxation. At Community level, taxes play a very limited role as a Community policy instrument. Consequently, the Community barely has a tax policy of its own. Its policy is one of aligning, insofar as is necessary for a common market, national taxes and tax policies, and to eliminate real or potential discriminatory and protective national taxation. To date, the largest policy impacts on national tax systems of EC law were, for indirect taxation, the introduction of the VAT system and the harmonized base for all national turnover taxes, and for direct taxation the case law of the EC Court prohibiting tax discrimination of non-residents and of foreign-source income.